

Communicating transparency: a genre network approach

How do corporate governance codes – the SOX and
the Tabaksblat Code – affect Dutch cross-listed
companies' corporate communication?

Transparantie communiceren: een genre netwerk benadering

Hoe beïnvloeden corporate governance codes – de SOX en
de Code Tabaksblat – de bedrijfscommunicatie van
Nederlandse bedrijven met twee beursnoteringen?

(met een samenvatting in het Nederlands)

Proefschrift

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List of abbreviations

AC	Audit Committee
AS2	Accounting Standard 2
AS3	Accounting Standard 3
BoM	Board of Management (used by case-study company)
BU	Business Unit
CCU	Corporate Communication Unit
EA	External Auditor
GMS	General Meeting of Shareholders
MB	Management Board
PCAOB	Public Company Accounting Oversight Board
RC	Remuneration Committee
RPAF	Registered Public Accounting Firm
SAC	Selection and Appointment Committee
SB	Supervisory Board
SEC	Securities Exchange Committee
SOX	Sarbanes-Oxley Act

Introduction

1.1 The research subject

The Tabaksblat Code is referred to in the Dutch media on a regular basis and many Dutch citizens are likely to have heard of it, in particular those involved in business. But what is this Code? Why has it been established? And what is its goal? On the one hand, the aftermath of Enron still echoes in the United States, raising questions like: How could a company like Enron fail? Who was responsible for the scandal? On the other hand, the Sarbanes-Oxley Act nowadays has a rather bad reputation, at least in the accounting industry and in Dutch cross-listed corporations. This gives rise to questions about the strictness of the rules and whether this corporate governance code actually leads to more investor confidence.

This dissertation shows that Searle's (2005) theory of institutions entails that the collective acceptance of an institution actually brings that institution into existence. Chapter 2 shows that corporate governance – which includes 'good governance' – is an institution, and that the rules included in the corporate governance codes in fact constitute 'good governance'. The goal of 'good governance' is company transparency. This means that if companies comply with the Code's rules, transparency will have been achieved; which consequently implies that 'good governance' has been collectively accepted. The collective acceptance of the institution 'good governance' means that this institution has come into existence.

Corporate governance

Corporate governance can be described as the system by which business corporations are directed and controlled. The core elements of these systems concern power distribution within the corporation and the roles and authorities of the main participants in the corporation, namely the board, the managers, and the shareholders, whereby the country-specific corporate governance systems each determine how powers are to be distributed and which corporate bodies are the most important ones in their particular country. The possible tension between the management and the shareholders when the management board decides to operate in its own interest instead of in the shareholders' is the most significant example of a corporate governance problem. People (in business) acting in their own interest is an age-old issue; as early as the 18th century Adam Smith stated that:

The directors of such (joint-stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own.
(Smith 1776, p. 700)

Smith holds the view that it is "a certain propensity in human nature [...] to truck, barter, and exchange one thing for another", and this propensity is "common to all men, and to be found in no other race of animals, which seem to know neither this or any other species of contracts". That people have been defined here as a "species of contracts" could in fact be considered the precursor for the ideas of Coase 1937 (1991) in his efforts to clarify the nature of the firm, which in turn are seen as the preliminary ideas for the underlying theories of corporate governance. Coase stated that a firm consists of relationships (or contracts and authorities, including the notion that the owner can comment because he has the authority to do so) which come into existence when the direction of resources is dependent on an entrepreneur, where the entrepreneur is to be seen as the agent. The agency relationship can

be defined as a contract under which one or more persons – the principal(s) – engage another person (the agent) to perform some service on his/her/their behalf that involves delegating some decision-making authority to the agent. Thus, the central position that Adam Smith gives to the contract between two or more people appears to be the core of the firm according to Coase.

The selfish, opportunistic behavior of both agents and principals can be seen as a contracting problem leading to different kinds of conflicts. In controlling these conflicts, corporate governance plays a very important role. The corporate governance systems have been developed over time, with each system being confronted with specific corporate governance problems in specific periods of time, and having found specific solutions to these problems. Corporate governance and its systems, however, tend to fail.

The financial scandals and the corporate governance codes

The accounting scandals around 2000 occurred in the United States as well as in Europe. The US Enron scandal and the Dutch Ahold accounting scandal, for example, caused the abrupt need for changes in the corporate governance systems concerned. A major consequence was the establishment of corporate governance codes. In the US, the Sarbanes-Oxley Act was enacted in 2002, while in the Netherlands, the Tabaksblat Code was introduced in 2003 for Dutch listed companies. Compliance with the Dutch code has been legalized differently than compliance with the American code. In the Netherlands, the ‘comply or explain’ rule¹ has been legally embedded; in the US, the entire Act is a law itself.

This section has shown that corporate governance codes – the Tabaksblat Code and the Sarbanes-Oxley Act – have been established as a consequence of the accounting scandals, which forms the first step in clarifying the structure of this study:

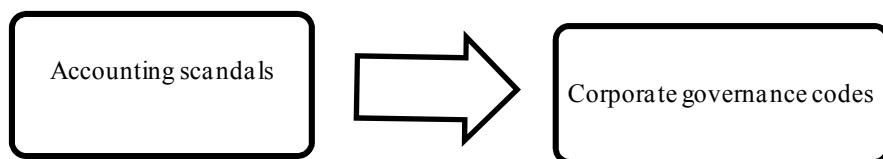


Figure 1.1: Step 1

It is a hypothesis of the corporate governance codes and of this dissertation that accounting scandals can be solved by changing the corporate governance structure (according to the corporate governance codes) leading to ‘good governance’. An important part of ‘good governance’ is corporate communication. This study focuses on corporate communication as part of ‘good governance’.

Research

a. with respect to corporate governance

Corporate governance and its codes is a well-researched subject, having been investigated from different perspectives. To name a few: from an economic perspective, with a focus on institutional economics (e.g. Jensen 2003; North 1990; Porter 1990 (1995); Williamson 1985) or with a focus on the causes of accounting scandals, including that of Enron (e.g. Coffee 2006; Deakin and Konzelmann 2006; Roe 2002); from a juridical point of view (e.g. Bartman 2004; Winter 2003); and from the (typically American) combination of an economic-juridical

¹ According to the ‘comply or explain’ rule, listed corporations may deviate from the rules, but are required to declare any deviations and explain the reason for non-compliance in their annual report.

perspective (Raaijmakers and McCahery 2000); and from a comparative perspective in order to compare the different corporate governance systems (e.g. Groenewegen 2004).

b. with respect to corporate communication

Numerous analyses of companies and their corporate communication have been carried out, for example analyses of certain parts of the annual report (e.g. Nickerson and De Groot 2005; de Groot 2006 and 2008; Garzone 2004; Yuthas et al. 2002), texts and contexts in business communication (e.g. Gunnarsson 2005; Orlikowski and Yates 1994), integrated business communication (e.g. Nielsen 2006; Vonwil and Lackus 2006), and corporate communication and culture (e.g. Knoblauch 2001; Shaw et al. 2005). However, research into the connection between corporate governance codes and corporate communication is still fairly novel.

c. with respect to the relationship between corporate governance codes and corporate communication

To the author's best knowledge, only one study concerning corporate governance codes and corporate communication has been conducted: Will et al.'s (2006) study among DAX-30 and M-DAX-50-companies. The 'corporate communicators' in that study were asked how they deal with the communication requirements of the German corporate governance code (Kodex), in particular the transparency recommendations included in the Kodex. The results showed that institutional investors and analysts were considered to be the most important stakeholders and that the Internet/Intranet, press conferences, and annual reports are the most important communication media for providing corporate governance information. Will et al. stressed the need for further investigation; in their understanding, corporate governance is essentially good management or good management processes, which in turn are considered to be the information and communication processes between individuals. Will et al. thus conclude that corporate governance should be one of the core tasks of corporate communication. They state that the need to link corporate governance with corporate communication has not been an issue to date, although the transparency goal of the corporate governance codes is regarded to be the 'condition *sine qua*'.

As stated above, the corporate governance codes are focused on transparency in order to prevent financial and accounting scandals. Will et al. (2006) in fact assert that transparency could be accomplished through communication. The role of corporate communication and corporate governance is thus explained in the next section.

The institution 'corporate governance' and the corporate governance codes

Searle (2005) criticizes institutional economic theorists for presupposing language when analyzing institutions, whereas in his view it is the role of language in constituting institutions that should be analyzed. Searle holds the view that language is the "fundamental social institution" (2005, p. 11) because it enables people to see the logical structure of the other social institutions, since "Language does not just describe a pre-existing institutional reality but is partly constitutive of that reality" (2005, p. 12). The relationship between institutions and communication is very strong because institutions would not exist without language, but also because institutions need specific texts in order to be constituted at all. Institutions and specific text types both stem from the context in which they are constructed, and depend on that very same context to be maintained. Corporate governance can be defined as an institution and an institution is, according to Searle, a system of constitutive rules. Searle states that these rules have the form '*X counts as Y in C*', whereby the *X* term concerns the characteristics of an object, person, or state of affairs, the *Y* term is *X* with an added status function, and finally the *C* term is the context or the collective acceptance of the fact that *X* has a certain status function and therefore counts as *Y*. The collective assignment of the status

function to X has created a situation in which it has been generally accepted that a person S has an adequate relation to X such that '*We accept (S has power (S does A))*'. This means that a power relationship has come into existence with a new form of power, whereby S has 'deontic power', namely the power to impose rights and obligations.

The institution 'good governance' is a system of constitutive rules that have the form ' X counts as 'good governance' in C '. The corporate governance codes attempt to solve the problems with respect to corporate governance by imposing the 'collective assignment of status function to X ' to all participants by constitutive rules that make explicit what 'good governance' is. The case study presented in this dissertation should provide an answer to whether this succeeds, and thus whether this intention can be realized.

In his theory of institutions, Searle emphasizes that the status function as symbolized in ' X counts as Y in C ' should be represented by the use of language (or other symbols). He formulates this as follows:

A status function must be represented as existing in order to exist at all, and language or symbolism of some kind provides the means of representation. (Searle 2005, p. 12)

This is the theoretical reason for using the communication perspective within this dissertation. The corporate governance codes include constitutive rules that have the form ' X counts as 'good governance' (Y) in C '. This means that the corporate governance codes include rules that bring to existence or that constitute 'good governance', which makes clear which principles a corporation should comply with and which communication practices it should hold. The Tabaksblat Code and the Sarbanes-Oxley Act determine that 'good governance' can be achieved if corporations comply with the rules in the codes. These rules consist mainly of communication rules, and this dissertation focuses on these communication rules.

Companies that are complying with the codes should adjust their corporate communication to the rules of the codes. Nielsen emphasizes the significance of corporate communication by defining it as "all-embracing framework co-ordinating marketing, management and organizational communication" (2006, p. 1), the latter including, for example, investor relations, corporate affairs, and internal communication. This shows that corporate communication in fact represents the organization, and that internal as well as external communication are equally important.

The second step with respect to explaining the structure of this study can thus be visualized as follows:

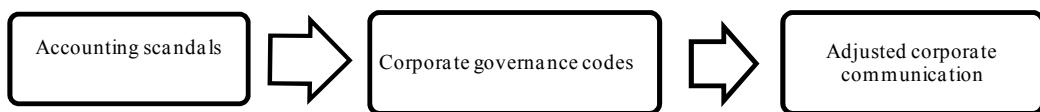


Figure 1.2: Step 2

Since corporate communication is an extremely broad category within a corporation, this dissertation focuses on a specific text, namely the annual report.

The specific text type – the annual report genre

Genre theory considers a certain text to be a genre if that text shows certain features that characterize a certain genre. An annual report, for example, becomes an annual report genre if it shows the specific features of the annual report genre. Bhatia (2005) holds the view that these features that make a certain text a specific genre together construct the integrity of this specific genre. The genre on which this dissertation focuses is the annual report genre. The annual report genre reflects the corporate communication of an enterprise, and the annual

report can thus be considered to be representative for the entire corporate communication of a company. The constitutive communication rules included in the Tabaksblat Code and the Sarbanes-Oxley Act determine what the annual report genre should look like. The concept of genre (e.g. Bhatia 2005) provides an adequate framework both for mapping the rules of corporate communication (included in the codes) – which constitute good governance – and for adhering to these rules in a company’s practice (the annual report). If a Dutch company’s Dutch annual report shows the features of the annual report genre according to the Tabaksblat Code, that annual report demonstrates the integrity of the annual report genre as determined by the constitutive communication rules of the Code. The same counts for the company’s American annual report (Form 20-F). If that annual report displays the generic integrity of the annual report genre as set out in the Sarbanes-Oxley Act, it demonstrates the integrity of the specific American annual report genre. This integrity, in Searle’s view, is the primary feature of the institution ‘good governance’. (Searle’s view on institutions is elaborated further in Chapter 2.)

The last step underlying the structure of this investigation posits the annual report genre as the focus of the analysis:

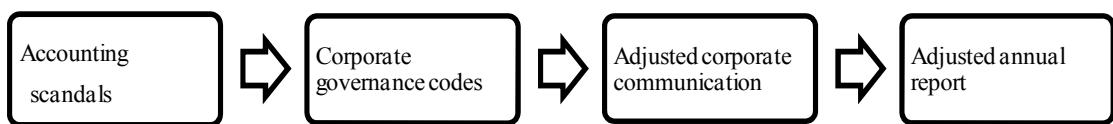


Figure 1.3: Step 3

The steps above show the rationale for this study’s focus on the analysis of the annual report as representative of one Dutch cross-listed company’s corporate communication in order to determine how that communication has been modified in accordance with the codes’ constitutive communication rules.

The last remaining issue with respect to the structure of this investigation concerns how the influence of the corporate governance codes on a Dutch cross-listed company can be analyzed. This is explained in the next section.

Analysis steps

As stated above, the annual report is regarded as representative of the entire corporate communication. This means that if the structure and content of a company’s annual report have been investigated, then so too has the corporate communication as a whole. It would therefore be necessary to investigate an actual annual report and an actual Form 20-F of a Dutch cross-listed company. If the annual report shows the features of the Dutch annual report genre according to the Tabaksblat Code, it can be stated that the corporate communication has been appropriately adjusted and that the company complies with the rules of the Code. If the company’s Form 20-F corresponds with the features of the US Form 20-F genre according to the Sarbanes-Oxley Act, it can again be stated that the corporate communication has been appropriately adjusted and that the company complies with the rules of the Act. This means that the analysis of the case-study company’s annual report will show whether and how it actually displays the features of the Dutch annual report genre. These results will reflect the ‘is’ situation of the company’s annual report. Likewise, the analysis of the case-study company’s Form 20-F will show whether and how it displays the features of the US Form 20-F genre. The results of that analysis, too, show the ‘is’ situation of the company’s Form 20-F. This can be visualized as follows:

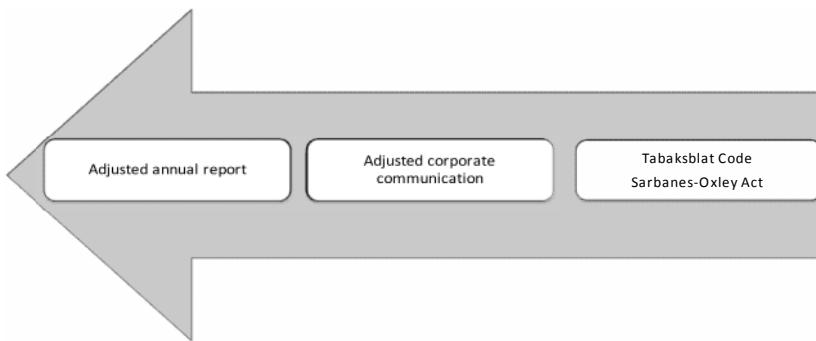


Figure 1.4: Focus of analysis step 2

However, in order to be able to analyze an actual (adjusted) annual report and Form 20-F, we need to know what the annual report and Form 20-F should look like according to the Tabaksblat Code and the Sarbanes-Oxley Act. Once the annual report requirements of these codes have been determined, an actual annual report and Form 20-F can be investigated by comparing them (the ‘is’ situation) with the generic requirements of the annual report determined as ‘correct’ (‘ought’ situation) by the corporate governance codes. This means that the Dutch and American codes first have to be analyzed separately, based on which of the codes’ rules specifically influence the corporate communication. The rules including communication requirements are expected to determine the communication structure (including the communication lines) and communication processes. The communication structure shows which corporate body should communicate with which other corporate body or bodies, and thus reveals the communication lines between these bodies. The communication processes include what (the content) and how (i.e. in the form of a report, meeting, etc.) the corporate bodies should communicate. The following example of a Tabaksblat Code rule includes a complex communication requirement, showing the complex communication process involved in the appointment procedure for the external auditor and the relevant communication lines between the general meeting of shareholders, the supervisory board, the management board, and the audit committee:

V.2 Role, appointment, remuneration and assessment of the functioning of the external Auditor. Principle. The external auditor is appointed by the general meeting of shareholders. The supervisory board shall nominate a candidate for this appointment, for which purpose both the audit committee and the management board advise the supervisory board. The remuneration of the external auditor, and instructions to the external auditor to provide non-audit services, shall be approved by the supervisory board on the recommendation of the audit committee and after consultation with the management board. (Tabaksblat Code 2003, p. 31)

Thus, the rules in the Tabaksblat Code and in the Sarbanes-Oxley Act, which are regarded as determining the corporate communication – the constitutive communication rules – first have to be identified. The separate analyses of the corporate governance codes will subsequently reveal what the communication requirements specifically entail with respect to the corporate communication. Based on these results, whether they show the features of the annual report genre and Form 20-F, and how they determine the integrity of the annual report genre and Form 20-F, will be revealed. The final results will show how the annual report should be adjusted according to the Tabaksblat Code, and how Form 20-F should be adjusted according to the Sarbanes-Oxley Act. The analyses of the Dutch and US corporate governance codes are to be seen as covering the ‘ought’ situation, which describes the respective requirements with which the annual report and Form 20-F should comply. Defining and describing the ‘ought’ situation is an elementary step that precedes description of the ‘is’ situation, covered by analysis step 2 (Figure 1.4). This first step of the analysis can therefore be visualized as follows:

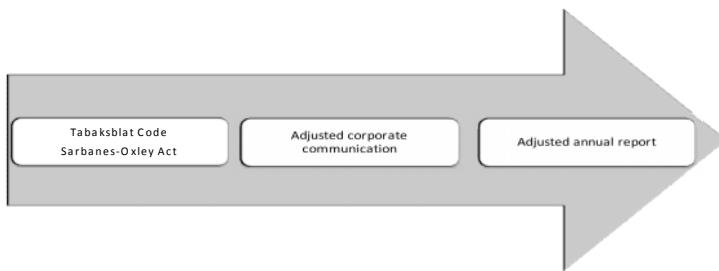


Figure 1.5: Focus of analysis step 1

The next step relates to the transparency goal² of the corporate governance codes. The Dutch and American codes have been established in order to achieve a transparent organization that prevents corporate governance problems, or that might at least detect corporate governance issues at an early stage, thereby allowing for timely correction. This means that the requirements of the codes have to result in company transparency, and that the annual report genre (representing the corporate communication as a whole) according to both codes should include transparency as a communicative purpose.

This dissertation investigates whether the ‘is’ situation corresponds with the ‘ought’ situation. The better both ‘situations’ of the annual report correspond with each other, the more likely it will be that the annual report represents transparent corporate communication and thus that the company under investigation might be considered to be transparent too.

The corporate governance codes impose the ‘collective assignment of status function to X’ on all participants by way of constitutive rules that make explicit what ‘good governance’ is. If companies comply with these constitutive rules, which will be revealed by means of comparing the ‘ought’ situation with the ‘is’ situation (whereby completely corresponding ‘ought’ and ‘is’ situations show the company’s compliance with the rules), transparency will have been achieved. The collective acceptance of the Dutch and US institution ‘good governance’ is only a fact if transparency has been achieved. This leads to the last step of the study:



Figure 1.6: Step 4

Scope of the study

Although it can be an interesting exercise to map the entire development of the corporate governance codes, starting with the reasons for their introduction, the introduction itself, the communication adjustments within companies in order to comply with the rules, the reviews of the codes leading to new or adjusted rules, and consequently the newly adapted corporate communication, the scope of this investigation captures only the central part, between the (reason for the) introduction of the codes and how the desired effect of transparency has been achieved. This is because this part of the process covers what happens within a listed company. The core of this study, therefore – as it has been explained in the previous sections – can be presented as follows:

² ‘Transparency’ in this dissertation refers only to formal transparency, as this is the goal of formal corporate governance codes.

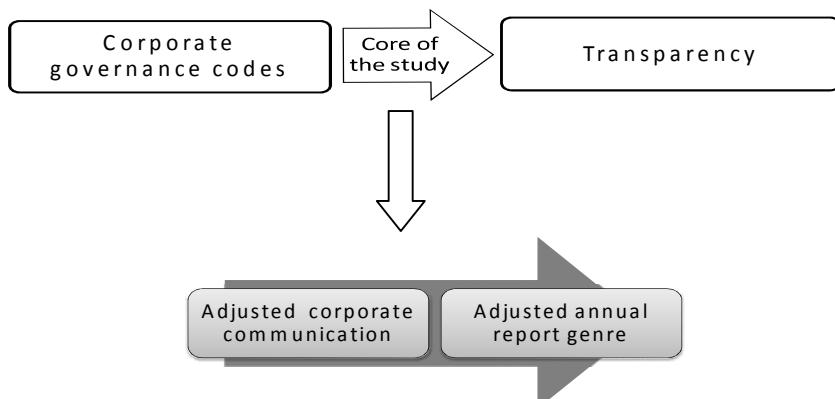


Figure 1.7: Core of the study

The core of this study concerns the process of adjusted corporate communication leading to the adjusted annual report genre as shown in Figure 1.7. It can thus be summarized as follows: The communication perspective of this study focuses on how the constitutive communication rules included in the codes determine how the corporate communication should be organized. The constitutive communication rules determine the integrity of the annual report genre in particular. Since the annual report is representative of corporate communication as an essential part of ‘good governance’, adjustments within the corporate communication will also be visible in the annual report. The concept of genre is useful here to clarify with which communication actions ‘good governance’ can be constituted. The communication rules included in the codes are constitutive for ‘good governance’, which means that language – namely, communication in texts like specific genres and communication actions – is used to represent the status function ‘good governance’, and thus language – as communication in texts and communication actions – represents how X becomes Y (‘good governance’).

If a cross-listed company complies with the constitutive rules, this would lead to the establishment of a Dutch annual report in accordance with the Tabaksblat Code and a US annual report (Form 20-F) in accordance with the Sarbanes-Oxley Act, with both annual reports having the characteristics of the Tabaksblat Code’s annual report genre and the Sarbanes-Oxley Act’s annual report (Form 20-F) genre, respectively. If the case-study company’s Dutch annual report and its US Form 20-F can be considered to be the Dutch annual report genre according to the Code and the US Form 20-F genre according to the Act, the company has achieved ‘good governance’. If all listed companies’ annual reports and Forms 20-F meet all constitutive rules of the Tabaksblat Code and the SOX, the companies are considered to be transparent, and thus the Dutch and the US institutions ‘good governance’ have been collectively accepted and both institutions have been constituted.

The core of this study is captured in the main research question:

How do listed companies adapt their corporate communication to the rules of the Tabaksblat Code and the Sarbanes-Oxley Act?

As this main research question is quite complex, various sub questions have been formulated. These questions are described and explained in the next sub chapter.

1.2 Sub questions

The sub questions are addressed in the different parts of this study. The first group of sub questions forms the basis for understanding corporate governance in general and the nature of the Dutch and American corporate governance codes (the Tabaksblat Code and the Sarbanes-Oxley Act) in particular.

The second group relates to the first step of the analysis in this study. It contains sub questions that cover the relationship between the two corporate governance codes and corporate communication, specifically with respect to how the Dutch and American corporate governance codes can be analyzed in order to map their influence on corporate communication and thus on the annual report. Further, the second group includes sub questions with respect to the actual analyses of the Tabaksblat Code and the Sarbanes-Oxley Act.

The third group of sub questions corresponds with the second step of the study's analysis, comparing the results of the first sub part with the actual 2006 annual report of a case-study company.

The fourth and last group consists of sub questions on whether the transparency goal of the Dutch and American corporate governance codes has been achieved in the 2006 annual report and in the opinion of the interviewee, the company's representative.

I Corporate Governance

The first sub question entails insight into the concept of corporate governance. This is needed in order to understand how the contents of the corporate governance codes under investigation, the Tabaksblat Code and the Sarbanes-Oxley Act, relate to corporate governance in general and to the country-specific corporate governance systems from which they derive. A clearer view of the relations between corporate governance issues and corporate governance codes enables a better understanding of the impact of these codes on an organization.

The second sub question concerns the characteristics of the US and the Dutch corporate governance system. Sub chapter 1.1 explained that corporate governance systems change in order to adapt to new situations in specific periods of time. Each country has indeed followed its own path in solving the corporate governance problems with which it has been confronted. Since the US system is a shareholder system and the Dutch a stakeholder system, the two systems are compared in this sub question.

Sub questions 3 and 4 concern the reasons for the introduction of the Tabaksblat Code and the enactment of the Sarbanes-Oxley Act. This is because it is important to understand the contexts in which these corporate governance codes were established, and why they are regarded as a means to prevent future accounting scandals while focusing on transparency. Further, the legal embedding of the codes is important, because countries and their corporate governance systems depend on the path that their political, economic and juridical systems set for them. Differences in legal embedding might lead to different compliance levels. If a listed company must comply with the rules because it is a legal obligation, the company is expected to make all necessary communication adjustments in order to comply fully. However, if the company may deviate from the rules under certain circumstances, for example, its communication adjustments will probably not cover the requirements entirely. Furthermore, the content of the codes is of utmost importance, as the rules represent what 'good governance' is according to the relevant corporate governance system. Listed companies should comply with these rules. The goal of both the Tabaksblat Code and the Sarbanes-Oxley Act is transparency. Compliance with the rules included in the codes should lead to

(formal) transparency, which should imply that the institution ‘good governance’ has been accepted collectively and that the institution ‘good governance’ has come into existence.

The sub questions included in the first group are the following:

I Corporate Governance

- I.1 What is the concept of corporate governance?
- I.2 What are the characteristics of the Dutch corporate governance system and the US corporate governance system?
- I.3 Why has the Tabaksblat Code been established, how is it legally embedded, and what is its core content and goal?
- I.4 Why has the Sarbanes-Oxley Act been established, how is it legally embedded, and what is its core content and goal?

The analysis of the Sarbanes-Oxley Act (the SOX) also includes Auditing Standards 2 and 3, as these standards are elaborations of the most important sections of the SOX (SOX404 and 103(a)(2)(A)(iii)) – as is explained later – and are therefore considered to be a fixed part of the SOX.

II. Analysis Step 1: Relationship between Corporate Governance Codes and Corporate Communication/Annual Report

The first group of sub questions forms the basis for understanding what corporate governance is and what the corporate governance codes are about. The second group corresponds with the first step of the analysis in this study, focusing on how the Tabaksblat Code and the Sarbanes-Oxley Act (and Auditing Standards 2 and 3) influence corporate communication. First, it has to be made clear how each corporate governance code can be analyzed with respect to corporate communication, and thus what the constitutive communication rules within the Tabaksblat Code and the Sarbanes-Oxley Act are. Although this study focuses on the adjustments in the annual report, the annual report itself is not the starting point of the first analysis step of this investigation. The reason for this is that not every rule included in the Tabaksblat Code and in the Sarbanes-Oxley Act and related Standards is expected to significantly influence the corporate communication; thus, those rules that can be seen as having major influence on the corporate communication (namely, the constitutive communication rules) are first identified and analyzed. The following sub question has therefore been formulated:

II. Relationship between Corporate Governance Codes and Corporate Communication/Annual Report

- II.1 How can the rules included in the Tabaksblat Code and the Sarbanes-Oxley Act be identified and analyzed as communication requirements?

The constitutive communication rules that have been identified will then be analyzed separately. The results of each analysis will show how the communication requirements determine the corporate communication in general, which in turn will provide the relevant information with respect to the annual report requirements ('ought' situation). This leads to the following sub questions:

- II.2 How do the communication requirements included in the Tabaksblat Code determine corporate communication (communication structure including communication lines, and communication processes), and how do the communication rules determine the annual report genre?

- II.3 How do the communication requirements included in the Sarbanes-Oxley Act determine corporate communication (communication structure including communication lines, and communication processes), and how do the communication rules determine the Form 20-F genre?

The sub questions of group II relate to Figure 1.5, which was presented above:

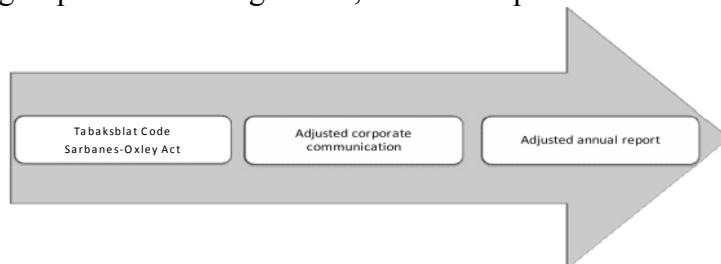


Figure 1.5: Focus of analysis step 1

III. Analysis Step 2: Relationship between Annual Report/Corporate Communication and Corporate Governance Codes

The analyses of the Tabaksblat Code and the Sarbanes-Oxley Act thus reveal how the Dutch and the US annual report genre have been determined according to the codes. Based on this information, the practices that take place in reality will be investigated. The 2006 annual report and the 2006 Form 20-F ('is' situation) of a Dutch cross-listed company will be analyzed by comparing the structure and content of the annual report with the structure and content required by the Tabaksblat Code and the Sarbanes-Oxley Act. Further, use will be made of the information obtained from interviews with the interview partner of the company concerned, and with the representative of an accounting firm. Both the analysis of the 2006 annual report's structure and content and the answers of the company representatives will show whether the corporate communication in general and the annual report's structure and content in particular reflect the adjustments required by the corporate governance codes.

This gives rise to the following sub questions:

- III. Relationship between Annual Report/Corporate Communication and Corporate Governance Codes
- III.1 How do the 2006 annual report's structure and content reflect the adjustments as required by the Tabaksblat Code?
- III.2 How do the 2006 annual report's (Form 20-F's) structure and content reflect the adjustments as required by the Sarbanes-Oxley Act?

The comparison of the 'ought' and 'is' situations will reveal how the Tabaksblat Code and Sarbanes-Oxley Act influence the company's corporate communication, which is represented by the annual report.

The sub questions of group III relate to Figure 1.4, which was presented above:

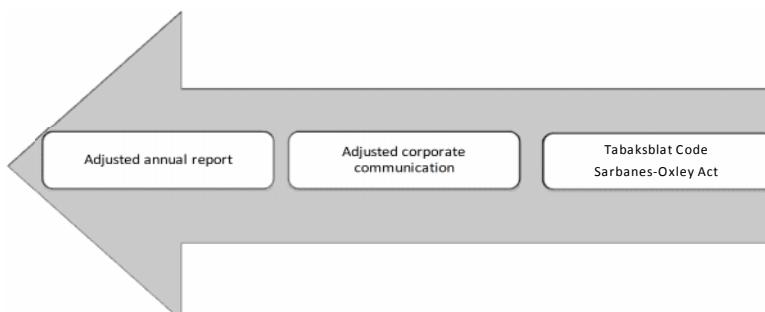


Figure 1.4: Focus of analysis step 2

IV. Transparency

Searle's theory of institutions – as is elaborated in Chapter 2 and used in the case study – is considered to provide an adequate line of approach for this dissertation, and it enables the Tabaksblat Code and the Sarbanes-Oxley Act to be seen as a handle for institutions to define transparency. Transparency will be constructed through compliance with the rules; however, non-compliance with certain rules (of the Tabaksblat Code) does not necessarily lead to non-transparency, because company-specific rules may also bring about transparency. This is elaborated further in chapters 9 and 10.

Based on the results of analysis step 2 and the related answers of the interviewee of the case-study company, certain conclusions with respect to transparency can be drawn. Namely, the results will reveal (Chapter 11) whether the corporate communication, adjusted in order to comply with the rules of the Tabaksblat Code and the Sarbanes-Oxley Act and represented by the (adjusted) annual report, has led to transparency. Hence the final sub question:

IV. Transparency

- IV.1 Does the corporate communication, adjusted in order to comply with the Tabaksblat Code and represented by the adjusted 2006 annual report, and adjusted in order to comply with the Sarbanes-Oxley Act and represented by the adjusted 2006 Form 20-F, lead to transparency? Why or why not, and according to which aspects?

With the sub questions having been presented, the next sub chapter describe the specific scope of the study.

1.3 Scope of this study

This study focuses on the constitutive communication rules that represent 'good governance' according to the Dutch and US codes. It analyzes the corporate communication, consisting of the communication structure (which includes the communication lines between the corporate bodies) and the communication processes as required in the codes. The required communication structure and processes form the basis for the annual report genre as determined by the corporate governance codes. This study focuses explicitly on four corporate bodies, which can be seen as the most significant 'corporate participants'. The four selected corporate bodies are the representatives for the remaining corporate bodies. Given that the significance of the corporate bodies concerned is determined by the features of the underlying corporate governance system, the main corporate bodies in the Tabaksblat Code differ from those in the Sarbanes-Oxley Act. The following sections explain which corporate bodies are the most significant with respect to these two codes, and why they are so important. Since the four most significant corporate bodies per corporate governance system are also to be seen as the major communicators within the corporation, they have been called 'Corporate Communication Units' (CCUs).

The Dutch corporate governance system – the four most significant Corporate Communication Units

The Dutch corporate governance system is characterized by a two-tier board system, in which the supervisory board controls and monitors the management board. The key points of the Dutch system are reflected in the Tabaksblat Code, including efficient supervision (the 'checks') of the management board by the supervisory board, and a balanced distribution of influence and power between the management board, the supervisory board, and the general meeting of shareholders (the 'balances'). The management board is primarily accountable to the shareholders, who hold the top position in the listed company's organizational hierarchy.

The Tabaksblat Committee wants to avoid an “excessive concentration of power” in the management board, and therefore the positions of the supervisory board and the general meeting of shareholders have been strengthened. Further, the independence of the auditor has been strengthened by the requirement that the auditor reports directly to the supervisory board. The four main ‘actors’ in the Dutch system and Dutch code, thus, are the supervisory board, the management board, the shareholders, and the external auditor. The focus of this study is on these corporate bodies, in particular on their role and function in corporate communication as individual CCUs and in relation to the other three CCUs. According to the Tabaksblat Code, the supervisory board of a listed corporation (depending on the size of the supervisory board) should have three committees, namely the audit committee, the remuneration committee, and the selection and appointment committee. These committees and the chairman of the supervisory board are all considered to be part of the CCU ‘supervisory board’.

The US corporate governance system – the four most significant Corporate Communication Units

The US corporate governance system is characterized by the central position of the shareholder and by the one-tier board system, whereby the board consists of executive and non-executive directors. Although the non-executives have a monitoring role, the main control role since the enactment of the SOX is that played by the external auditor or ‘registered public accounting firm’, whose independence is a central feature in the US code. The audit committee also plays a key role within the SOX, being directly responsible for the appointment, compensation, and especially the oversight of the external auditor’s work. The chief executive officer (CEO) and chief financial officer (CFO) are members of the board of directors of a company (the issuer), but bear huge responsibility as they are personally accountable for the company’s performance by way of certifying each annual and quarterly report.

The main corporate bodies in the US corporate governance system and code are thus the issuer (including the executives, non-executives, CEO, and CFO), the external auditor, the audit committee, and the investors, which are therefore considered to be the main US CCUs. The CEO and CFO are to be seen as part of the CCU ‘issuer’.

Although the CCUs with respect to the Tabaksblat Code are different in terms of names – and sometimes in terms of tasks and roles too – from the CCUs in the Sarbanes-Oxley Act, they are nevertheless comparable. As this study concerns a Dutch cross-listed company, the CCUs can be compared as follows: the ‘US’ issuer is the corporation, including the board of directors, and will be compared with the ‘Dutch’ management board; the ‘US’ audit committee will be compared with the ‘Dutch’ supervisory board, given that the two-tier board system is a feature of the Dutch corporate governance system (cf. 3.5.1) and the supervisory board in large corporations usually includes three committees, one of them being the audit committee; and finally, although the ‘US’ investors cover a larger and more differentiated group they will be compared with the ‘Dutch’ general meeting of shareholders.

1.4 Outline of the dissertation

This dissertation is structured as follows. Chapter 2 presents the theoretical framework, namely Searle’s theory of institutions, and the methodological framework, including detailed the description and explanation of the selected methods (genre theory and case-study theory) as well as their relevance for this study.

Chapter 3 explains the concept of corporate governance (sub question I.1). It also describes the US and the Dutch corporate governance system, and elaborates on relevant historical developments in corporate governance (sub question I.2).

Chapter 4 describes the establishment of the Code as well as the reasons for establishing it, and its legal embedding, goal, main content, and main actors. This chapter also identifies the most significant corporate bodies, namely the supervisory board, the management board, the shareholders, and the external auditor. It thus provides the answer to sub question I.3.

Chapter 5 describes the Sarbanes-Oxley Act and Auditing Standards 1 and 2, focusing on the motives for its establishment, as well as its goal, legal embedding, main content, and main ‘actors’. Like Chapter 4, it also identifies the most significant corporate bodies, in this case the board of directors (executives and non-executives), the audit committee, the shareholders, and the registered public accounting firm (RPAF). In doing so, Chapter 5 covers the sub question I.4. It then concludes with a sub chapter about the effects of the Tabaksblat Code and the Sarbanes-Oxley Act as measured between 2002/3 and 2007.

Chapters 6 and 7 cover all sub questions included in group II, concerning *Analysis Step 1: Relationship between Corporate Governance Codes and Corporate Communication/Annual Report*.

Chapter 6 starts by explaining how the communication requirements included in the Tabaksblat Code and in the Sarbanes-Oxley Act can be identified, and defines specific research questions for analyzing the communication requirements included in the codes (sub question II.1). Subsequently, it reports on the analysis of the communication requirements included in the Tabaksblat Code, thus also covering sub question II.2.

Chapter 7 then reports on the analysis of the communication requirements included in the Sarbanes-Oxley Act and Auditing Standards 2 and 3, thus covering sub question II.3.

Both chapters 6 and 7 describe the ‘ought’ situation for the annual report genre according to the Tabaksblat Code (Chapter 6) and the Sarbanes-Oxley Act (Chapter 7).

Chapters 8–10 cover the sub questions belonging to group III, *Analysis Step 2: Relationship between Annual Report/Corporate Communication and Corporate Governance Codes*.

Chapter 8 introduces the case-study investigation, describing the setup of the investigation; that is to say, the company’s general annual report process. In this regard, the general process for establishing the Dutch 2006 annual report can be seen as the preparation for the annual report process for the 2006 Form 20-F.

Chapter 9 analyzes the case-study company’s Dutch 2006 annual report based on comparison of the obligatory features of an annual report genre and the communication structure (including the communication lines between the most significant corporate bodies or CCUs) and communication processes according to the Tabaksblat Code. This analysis is grounded in the 2006 annual report of the case-study company and the interviews conducted. In this way, Chapter 9 covers sub question III.1. The analysis provided here also allows for an answer to sub question IV.1, on transparency with respect to the case-study company’s 2006 annual report and the Tabaksblat Code from the perspective of Searle’s theory of institutions.

Similarly, Chapter 10 analyzes the case-study company’s 2006 Form 20-F based on comparison of the obligatory features of the US Form 20-F genre and the communication structure (including the communication lines between the most significant corporate bodies or CCUs) and the communication processes, this time according to the Sarbanes-Oxley Act. This analysis is rooted in the 2006 annual report of the case-study company and the interviews conducted. This chapter therefore includes the answer to sub question III.2, as well as to sub question IV.1 on transparency with respect to the case-study company’s 2006 Form 20-F and the Sarbanes-Oxley Act from the perspective of Searle’s theory of institutions.

Chapter 11 provides the general conclusions of the study.

Theoretical and Methodological Framework

2.1 Introduction

The main research question, as introduced in the previous chapter, is the following: How do listed companies adapt their corporate communication to the rules of the Tabaksblat Code and the Sarbanes-Oxley Act? We have seen in Chapter 1 that the constitutive rules included in the corporate governance codes make explicit what ‘good governance’ entails. Communication is a major part of ‘good governance’, and language, according to Searle (2005), is the means to represent the status function ‘Y’, namely ‘good governance’. Language – and specifically the communication in texts and the communication actions included in the constitutive rules of the codes – shows how the X becomes Y in accordance with Searle’s formula with respect to constitutive rules, namely ‘X counts as ‘good governance’ (‘Y’) in C’. If companies comply with the rules, formal transparency will be achieved, which in turn means that the codes’ attempt to institutionalize ‘good governance’ will have succeeded.

Chapter 1 explained that this study focuses on the annual report genre as a specific text type (communication in texts). The rules included in the corporate governance codes determine what the characteristics of the annual report genre – which represents the entire corporate communication – need to be in order to achieve formal transparency, and thus to constitute ‘good governance’.

This study therefore investigates the actual annual report of a specific corporation in order to analyze the ‘is’ situation. The investigation will center around whether the actual 2006 Dutch annual report and the actual 2006 Form 20-F of a Dutch listed company show the characteristics required to demonstrate the integrity of the Dutch annual report genre and the US Form 20-F genre according to the constitutive communication rules included in the Tabaksblat Code and the Sarbanes-Oxley Act, respectively.

However, before starting with this step of the analysis, another step must first be taken. As explained in the previous chapter, the analysis should start by investigating what kind of adjustments should have been made according to the Tabaksblat Code and the Sarbanes-Oxley Act (the ‘ought’ situation) in order to comply with these corporate governance codes. The ‘ought’ situation will be established by the constitutive communication rules of the two codes that determine the text-internal and text-external factors of the Code’s and the Act’s respective annual report genres. The ‘ought’ situations show what the integrity of the Dutch annual report genre ought to be according to the Tabaksblat Code, and what the integrity of the American annual report genre ought to be according to the Sarbanes-Oxley Act.

The following figure (2.1) shows how the two steps of analysis are interrelated:

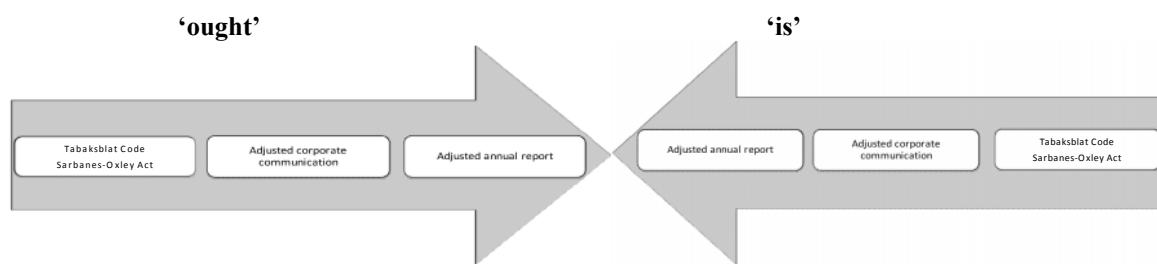


Figure 2.1: Focus of analysis step 1 and 2

The first part of the analysis ends with the annual report genre, whereas the annual report forms the start for the second part of the analysis. Both parts together form the basis for the third analysis step, namely, whether the ‘ought’ and ‘is’ situations fully correspond with each other and thus whether the case-study company’s annual report(s) – representing the adjusted corporate communication – demonstrate the integrity as determined by the codes’ constitutive communication rules. This integrity is regarded as characteristic of ‘good governance’. If the case-study company’s 2006 Dutch annual report and the 2006 Form 20-F show such integrity, then transparency has been achieved. If all Dutch cross-listed companies’ annual reports should show the required integrity, Dutch and US ‘good governance’ has been collectively accepted, which is the condition for the institutionalization of ‘good governance’.

Bhatia’s (2005) concept of genre provides an adequate framework for mapping the rules for communicative actions (which constitute ‘good governance’) included in the codes, and for adhering to those rules in the company’s practice (the annual report). This concept of genre and its relevance for this dissertation are explained in the following sub chapters.

The second analysis step starts with the annual report in order to investigate whether the company involved has adjusted its corporate communication in a suitable manner. Since only the analysis of the actual annual report of the ‘case-study company’ – a Dutch cross-listed company – would be relevant here, supported by the comments on the generic integrity of the annual report by the company’s representative, a case study appears to be the most suitable and relevant method for the second part of the analysis.

The first sub chapter starts by describing Searle’s theory of institutions (2.2). Sub chapter 2.3 describes the general features of the concept of genre, followed by a characterization of business genres (2.3.1), then a clarification of the annual report genre (2.3.2). Section 2.3.3 describes why the concept of genre is relevant for this dissertation, while 2.4 includes a historical overview of the development of case studies as research method, followed by a definition of case study. Subsequently, 2.4.1 demonstrates the relevance of the case study as research strategy and describes the different types of case studies. Finally, 2.4.2 gives an indication of the relevance of the case study for this dissertation.

2.2 Searle’s theory of institutions

Searle wanted to capture the very first step, namely how come institutions into existence at all, before defining what an institution actually is. He considers language to be the condition *sine qua non* for institutions to come into existence at all. His view of language is important for this dissertation as the case study discussed later takes a communication perspective, using genre theory as an instrument, to show how the constitutive rules of ‘good governance’ included in the corporate governance codes have been put into practice. The case study shows how the ‘game’³ of corporate governance is played in business practice.

Searle holds the view that although the structure of actual human societies is highly complex, the underlying principles are simple. He uses three ‘primitive notions’ (Searle 2005, pp. 5-6) to explain social and institutional reality, namely collective acceptance, the assignment of function, and status functions. First, according to Searle, humans have the capacity for collective acceptance and thus the capacity to form societies. Second comes

³ The term ‘game’ has been used in this dissertation to describe how the ‘game’ of ‘good governance’ is played in business practice.

‘primitive notion’, the capacity to “impose functions on objects where the object does not have the function” (2005, p. 7) intrinsically but only in virtue of the assignment of that function. The third underlying principle is connected with the second in that it concerns a special kind of assignment of function, since the object or person has a certain status and with that status a function (hence the term *status functions*). Searle explains this third ‘primitive notion’ as follows:

[...] where the object or person to whom the function is assigned cannot perform the function just in virtue of its physical structure, but rather can perform the function only in virtue of the fact that there is a collective assignment of a certain *status*, and the object or person performs its function only in virtue of collective acceptance by the community that the object or person has the requisite status. (Searle 2005, p. 7)

Searle states that these kinds of assignments take the form *X counts as Y*, or more specifically, *X counts as Y in context C*, whereby *X* identifies certain characteristics of an object, person, or state of affairs, and *Y* is the person, object, or state of affairs to which a certain function has been assigned. Very important in this regard is the fact that in every case, the object or person acquires a function which can only be performed in virtue of the collective acceptance of the corresponding status, which refers to the term *C* as context. Searle further states that when the procedure or practice of counting *X* as *Y* becomes regularized it becomes a rule, and rules of the form *X counts as Y in C* are then constitutive of institutional structures. Searle distinguishes between constitutive rules and regulative rules. He had already used the term ‘constitutive rules’ in his book about speech acts, which hypothesized:

Speaking a language is a matter of performing speech acts according to systems of constitutive rules.
(Searle 1969 (1978), p. 38)

Searle describes constitutive rules, in contrast, as rules that constitute (and also regulate) an activity, whereby the activity’s existence is logically dependent on these rules. Searle exemplifies this by pointing out that the rules of football or chess do not merely regulate playing football or chess, but rather create the very possibility of playing such games. This means that the activities of playing football or chess are constituted by acting in accordance with the appropriate rules. It also means that constitutive rules create or define new forms of behavior. Searle points out that where the rule is purely regulative, behavior which is in accordance with the rule could be given the same description or specification⁴ whether or not the rule existed. If, however, the rule (or system of rules) is constitutive, behavior in accordance with the rule can receive specifications or descriptions which it could not receive if the rules did not exist. For example, the phrase “He hit a homerun” is a specification which could not be given without constitutive rules. Some rules within systems of constitutive rules might have the same form as the regulative rules, namely “Do *X*” or “If *Y* do *X*”; others will have the form “*X* counts as *Y*”, or “*X* counts as *Y* in context *C*” (1969 (1978), p. 35).

Searle 1969 (1978) defines the regulative rules as rules that regulate an already existing activity whose existence is logically independent of the rules. This means that the regulative rules regulate antecedently or independently existing forms of behavior. Examples of such rules are many rules of etiquette that regulate inter-personal relationships which exist independently of the rules. Searle points out that regulative rules have the form or can be paraphrased in the form “Do *X*” or “If *Y* do *X*” (1969 (1978), p. 34).

Searle explains that the form “*X* counts as *Y*”, or “*X* counts as *Y* in context *C* is not a formal criterion for distinguishing constitutive and regulative rules. Moreover, he states that “any regulative rule could be twisted into this form” (1969 (1978), p. 36). However, the constitutive rules underlie two specific qualifications that distinguish them from regulative

⁴ Searle explains the meaning of ‘the same description or specification’ here as the same answer as that given to the question “What did he do?” (1969 (1978), p. 35)

rules or regulative rules that could be pressed into the form “*X* counts as *Y* in context *C*”. First, constitutive rules come in systems. Therefore, it can be stated that “it may be the whole system which exemplifies this form and not individual rules within the system” (1969 (1978), p. 36). Searle uses the following example to clarify this statement. The first rule of basketball, namely that the game is played with five players to a side, is to not to be seen as a constitutive rule having the form “*X* counts as *Y* in context *C*”. However, acting in accordance with all or a sufficiently large subset of the rules does count as playing basketball. Second, the *Y* term is not simply a label, but rather will “mark something that has consequences” (1969 (1978), p. 36). For example, “offside” or “checkmate” introduce further consequences by way of penalties as well as winning and losing.

Searle also used the concept of constitutive and regulative rules also for explaining what institutions are. He states that an institution is any system of constitutive rules of the form *X counts as Y in C*. Since corporate governance is an institution and since institutions, according to Searle, are systems of constitutive rules (whereby *X counts as Y in C*), the corporate governance codes can be seen as products of the institution ‘corporate governance’. This means that the Tabaksblat Code is the product of the Dutch institution ‘corporate governance’ and the Sarbanes-Oxley Act is the product of the US institution ‘corporate governance’. Dutch cross-listed companies have to comply with both codes and thus with both systems of constitutive rules. The Tabaksblat Code’s principles are specifically constitutive rules and the ‘comply or explain’ rule does not apply to the principles. It has been mentioned already that constitutive rules come in systems, according to Searle (1969 (1978)). Therefore, the game of ‘good governance’ should be played on the basis of all rules. The existence of the new institution will be undermined if companies only comply with some of the rules.

The relationship between the institution ‘listed company’ and the codes’ rules for the Dutch and American institutions of ‘corporate governance’ calls for clarification of the quality and capacity of the codes’ rules.

The institution ‘listed company’ has been constituted by certain constitutive rules. It is thus logically dependent on certain constitutive rules and will cease to exist if these specific constitutive rules are lost. With respect to these constitutive rules, the rules included in the Tabaksblat Code and the SOX are regulative. The codes’ rules regulate the actions within the institution ‘listed company’. If these rules no longer exist, the institution will still remain, since regulative rules regulate an already existing activities whose existence is logically independent of the regulative rules.

However, according to the codes, the very rules included in the codes not only regulate the actions within the company, but also constitute what counts as ‘good governance’. This means that these rules are constitutive with respect to the quality of corporate governance. Thus ‘good governance’ is logically dependent on the codes’ rules that have the form ‘*X* counts as *Y* in *C*’.

If the codes’ rules no longer exist and if ‘good governance’ has been institutionalized, the new institution ‘good governance’ will still remain. There have been previous attempts to institutionalize the quality of corporate governance, but they all failed. The financial scandals called for a need to subject behavior and activities within companies to new rules by creating new institutions.

It has thus been the task of the Tabaksblat Committee and the PCAOB to come up with rules that develop a new institution, namely ‘good governance’, on top of the ‘old’ institution ‘listed company’. This means that a second institution should be created that will be collectively accepted. The new institution’s existence depends on its general acceptance.

Both codes’ attempt to institutionalize the quality of corporate governance and they thus attempt to make the existence of ‘good governance’ logically dependent on the rules

included in the codes. The codes' rules can therefore be seen as layered. The top layer concerns the regulative function and the second layer stresses the constitutive function. The main aim of this dissertation is to show on the basis of the case study to what extent the Dutch and American systems of constitutive rules have actually been brought into practice and thus whether the codes' attempts have succeeded.

Searle states further that the essential role of human institutions (and the purpose of having institutions in any event) is not to constrain people as such, but, rather, to create new sorts of power relationships, which he calls *deontic powers*. Deontic power is the power to bring something into existence by means of applying constitutive rules. Institutions, like corporate governance, come into existence by means of constitutive rules. The corporate governance codes include such constitutive rules that determine who should do what. An example of a constitutive rule⁵ with respect to Dutch listed companies is that, except for one member at the most, the supervisory board members should be independent. This rule thus establishes the notion that the supervisory board members should be independent, and what this independence means. If the company does not comply with this rule the consequence is that 'good governance' has not been achieved and the quality of corporate governance has not been institutionalized.

Not only is the deontic power itself institutional; as Searle put it, "just about all institutional structures are matters of deontic power" (Searle 2005, p. 10). Searle elaborated on the idea of status functions as matters of deontic power by stating: "We accept (S has power (S does A))" (2005, p. 16), which relates to the previous statement *X counts as Y in C* in that we only accept people as having power if they hold that power in virtue of their institutional status.

The status function as symbolized in *X counts as Y in C* must be represented "as existing in order to exist at all" (Searle 2005, p. 12), and according to Searle, language provides the means of representation. This statement has been elaborated further as the notion that the cognitive capacity to see things requires a linguistic (or symbolic) capacity, and the form of collective acceptance has to be linguistic too, given that "there is nothing else there to mark the level of status function" (2005, p. 13). This view of the use of language that represents the status function 'Y' explains why this study is essentially a communication investigation. This dissertation, therefore, shows from the communication perspective – whereby genre theory is used as an instrument, because language is here 'communication in texts' and communication actions – how the constitutive rules of 'good governance' included in the corporate governance codes have been put into practice.

Language has four functions in the constitution of institutional facts. First, the fact can only exist insofar as it is represented as existing, and the form of that representation is in the broadest sense linguistic. The second function is a consequence of the first, namely that the forms of status function are almost always matters of deontic power, which have to be represented in some linguistic form. Third, deontology or the deontic power can continue to exist after its initial creation, which can only be the case if the obligation involved is represented by some linguistic means. And finally, a crucial function of language lies in the recognition of the institution as such; in other words, institutions can only exist as far as they are recognized, and that recognition has to be linguistic.

Since the status functions should be collectively recognized (because there is nothing in the person or the object itself that will indicate its status), certain kinds of *status indicators*, such as passports, marriage certificates, drivers' licenses, and so on, are needed. This again

⁵ Tabaksblat Code 2003, III.2.1: All supervisory board members, with the exception of not more than one person, shall be independent within the meaning of best practice provision III.2.2.

demonstrates the importance of language and communication through the documents that serve as status indicators, and genres can be seen specifically as status indicators. These status indicators, however, should be issued by official agencies that are themselves supported by collective recognition.

Searle defines the institution as follows:

An institution is any collectively accepted system of rules (procedures, practices) that enable us to create institutional facts. These rules typically have the form of *X counts as Y in C*, where an object, person, or state of affairs X is assigned a special status, the Y status, such that the new status enables the person or object to perform functions that it could not perform solely in virtue of its physical structure, but requires as a necessary condition the assignment of function. They typical point of the creation of institutional facts by assigning status functions is to create deontic powers. So typically when we assign a status function Y to some object or person X we have created a situation in which we accept that a person S who stands in the appropriate relation to X is such that (S has power (S does A)). (Searle 2005, pp. 21-22)

Corporate governance is an institution and since institutions, according to Searle, are systems of constitutive rules (whereby X counts as Y in C), the corporate governance codes can be seen as products which include systems of constitutive rules that determine the quality of corporate governance, namely ‘good governance’. This means that the Tabaksblat Code includes constitutive rules of the Dutch institution ‘good governance’ and the Sarbanes-Oxley Act contains constitutive rules of the US institution ‘good governance’. The rules included in the codes can thus be identified as constitutive corporate governance rules, and the majority of these are constitutive communication rules. These rules determine the text-internal and text-external factors of the annual report genre according to the Tabaksblat Code and the Sarbanes-Oxley Act. These factors, in turn, thus determine the integrity of the annual report genre. If an annual report displays the factors required by the relevant code, it demonstrates the specific integrity that characterizes the institution ‘good governance’. The corporate governance codes thus make explicit what constitutes the underlying institution ‘corporate governance’, which had been merely implicit until the codes were established as a consequence of the accounting scandals. The corporate governance codes include the constitutive rules which make explicit for listed companies *X counts as Y (good governance) in C*, whereby C is the context of the relevant corporate governance system of the specific country. The result is that the companies should take seriously the core of corporate governance as it has been made explicit in the codes’ clarification of *X counts as Y in C* by complying with the codes’ rules.

To sum up, Searle holds the view that institutions exist because of language, which represents the status function, because the collective recognition of institutions or institutional facts as such has to be linguistic. An institution is a system of constitutive rules of the form *X* (certain characteristics of an object, person, or state of affairs) counts as *Y* (assigns a special status to *X*) in *C*, whereby *C* represents the context, which is the collective acceptance of the corresponding status. The role of institutions is to create new sorts of power relations (deontic powers) and thus the complete formula is *X counts as Y in C, whereby we accept (S has power (S does A))*. Since ‘good governance’ is an institution too, it comes into existence by means of constitutive rules, which are included in the relevant corporate governance codes.

The process of influencing a genre has been explained by Orlikowski and Yates as follows:

A genre established within a particular community serves as an institutionalized template for social action – an organizing structure – that shapes the ongoing communicative actions of community members through their use of it. Such genre usage, in turn, reinforces that genre as a distinctive and useful organizing structure for the community. The notion of community here broadly includes identifiable social units such as groups, organizations, and occupations. (Orlikowski and Yates 1994, p. 542)

The quote by Orlikowski and Yates enhances the parallel between institutions and genres because the genres are influenced by their context (broader and immediate), but at the same time they also influence the context in which they are constructed. Institutions are also characterized by this same vice versa influence.

The sections above have shown that language is considered to be the condition *sine qua* for the existence of institutions. Language is the means by which *Y* is represented in *C*. This means, in essence, that institutions depend on language. According to Bhatia, genre refers essentially to language use, namely:

In a conventionalized communicative setting in order to give expression to a specific set of communicative goals of a disciplinary or social institution, which give rise to stable structural forms by imposing constraints on the use of lexicogrammatical as well as discursal resources (Bhatia 2004, p. 24)

Genres can thus be seen as the concrete use of language on which institutions depend. Bhatia enhances this view by defining genres as “socially constructed, interpreted and used in specific academic, social, institutional and professional contexts” (2004, p. 87). In other words, institutions depend not only on language, but specifically on genres. The genres are influenced by their wider context (which includes institutions and culture), but also by their immediate context (for example the company).

We saw in Chapter 1 that the investigation of the 2006 annual report and the 2006 Form 20-F presented in this dissertation enables description of the ‘is’ situation in comparison to the ‘ought’ situation that follows from analysis of the Tabaksblat Code and Sarbanes-Oxley Act requirements for annual reports. If the analyses of the ‘is’ situation show that all requirements have been met, it can be supposed – based on the collective acceptance of the status function⁶ of the Code and the Act – that transparency has been accomplished. This collective acceptance could be seen as a kind of reliability stamp, which makes a norm explicit. This dissertation therefore investigates, on the basis of the assumptions of the Tabaksblat Code and the Sarbanes-Oxley Act, the notion that certain constitutive communication rules (the Dutch and the US annual report genre requirements) are obligatory, and if Dutch listed companies comply with these rules (which are considered to be having the form ‘*X* counts as *Y* in *C*’) transparency will have been achieved. The Dutch Code’s ‘comply or explain’ rule, however, is a potential limitation because it allows listed companies to deviate from best practice provisions if they explain their reasons for doing so in their annual report. Another potential limitation is the focus of this study on the communication by and between the four selected corporate bodies⁷ (cf. Chapter 1), whereas more than four corporate bodies are involved in listed companies. Further, other rules, in particular laws and regulations, can influence the corporate communication rules in the sense that compliance with these laws and/or regulations could be of higher importance than the Tabaksblat Code (or the Sarbanes-Oxley Act).

2.3 The concept of genre – general

Good governance consists mainly of corporate communication. We have seen in Chapter 1 that because corporate communication is a very wide-ranging category, this dissertation focuses on the annual report genre, which is representative of corporate communication. The

⁶ Collective acceptance refers to *C* as context in Searle’s formula: *X* counts as *Y* in *C*.

⁷ The Corporate Communication Units (CCUs) in the Tabaksblat Code are the management board, the supervisory board, the general meeting of shareholders, and the external auditor. The CCUs with respect to the Sarbanes-Oxley Act are the issuer, the registered public accounting firm, the investors, and the audit committee.

constitutive communication rules as included in the corporate governance codes determine the features of the annual report genre. The concept of genre provides an adequate framework to map these communication rules (which constitute good governance) as well as the company's compliance with these rules in practice (the annual report).

The concept of genre and genre research has long focused on literary texts. The interest in professional texts and business genres did not appear until the late 1990s and early 2000.

ESP school and Bhatia

The British ESP school⁸, which Bhatia and Swales represent, focuses on the investigation of:

conventionalized or institutionalized genres in the context of specific institutional and disciplinary practices, procedures and cultures in order to understand how members of specific discourse communities construct, interpret and use these genres to achieve their community goals and why they write them the way they do. (Bhatia 2004, p. 10)

The British school emphasizes both the formal features of genre and its immediate and wider context, and is therefore significant for this study given that context is also important for institutions – and thus for corporate governance as an institution. The formal corporate governance rules are captured in the corporate governance codes, which influence the annual report's generic integrity, which in turn is constructed through and by its immediate and wider context.

Bhatia (2004) explains that genre theory is characterized by two elementary aspects. On the one hand, there is a clear emphasis on the conventions and norms expressed in the generic integrity, which is determined by regulations and legislation but also by company conventions. On the other hand, genre theory includes the propensity for innovation and change since members of a professional community, for example the writers of the annual report, may create new genre forms in order to “respond to novel rhetorical contexts (which could be new legislation) or to convey private intentions within the socially recognized communicative purposes” (Bhatia 2004, p. 24).

The nature of genre

According to Bhatia, genres are:

Conventionalized discursive actions, in which participating individuals or institutions have shared perceptions of communicative purposes as well as those of constraints operating on their construction, interpretation and conditions of use. (Bhatia 2004, p. 87)

In that sense, “genres are socially constructed, interpreted and used in specific academic, social, institutional and professional contexts, and have their own individual identity”. This “individual identity” is referred to as generic integrity, and it is through this that the genre is recognizable, although this integrity might undergo slow and subtle changes over a long period of time. Bhatia defines generic integrity as follows:

Generic integrity may be understood in terms of a socially constructed typical constellation of form-function correlations representing a specific professional, academic or institutional communicative construct realizing a specific communicative purpose of the genre in question. It is essentially constructed in the context of the goals of the professional or disciplinary culture that it is often associated with. It is possible to characterize it in terms of text-internal and/or text-external or a combination of such features. It is not static, fixed or prescribed, but is often flexible, negotiable or sometimes contested. (Bhatia 2004, p. 123)

The generic integrity could be seen as the core of genre; therefore, it can be assumed that analyzing the generic integrity means analyzing the genre. Although genres are highly

⁸ The ESP school represents a reaction against the Australian school.

conventionalized, genre analysis is not easy, as it is “essentially an attempt to explain and account for most of the realities of the world, which are often complex, dynamic and unpredictable” (2004, p. 113). Bhatia compares genre analysis with the analysis of the stock market:

[Genre analysis is] like analysing the stock market in a highly complex and volatile economic environment, where it is almost impossible to take into account all the variables contributing to the movements of the stock market. (Bhatia 2004, p. 113)

Communicative purpose

Swales (2004) refers to Askehave, who stressed that communicative purposes are complex, multiple, and evasive. Based on this view, Swales differentiates the importance of communicative purpose as the guiding criterion, stating that the communicative purpose should be abandoned as an “immediate or quick method for sorting discourses into generic categories, while retaining it as a valuable long-term outcome of analysis” (Swales 2004, p. 69). Swales emphasizes that after having analyzed the genre, the communicative purpose initially identified may turn out not to be the real purpose – or in other words, the texts may not be doing what they seem, or not doing what they have traditionally been assumed to have been doing. According to Swales, communicative purposes evolve over time. He therefore proposes the genre repurposing method, which includes two possible procedures: the ‘text-first’ approach and the ‘situation-first’ approach. The ‘situation-first’ approach takes the situation or context as the starting point, whereas the ‘text-first’ situation considers the text to be the starting point. The ‘text-first’ approach starts with an investigation of the structure, style, content and purpose of the text. Based on the outcomes, the genre can be defined, the context can then be investigated and, based on that analysis, the genre can be repurposed. Finally, the last step is to determine how the repurposed genre fits into a genre hierarchy. The ‘situation-first’ approach, in contrast, starts with the identification of a communicative situation. Then the goals, values and material conditions of the groups in the situation are examined, followed by analysis of the ‘horizons of expectation’ and the genre repertoires and etiquettes. The selected genres can subsequently be repurposed and the textual and other features of genre clarified.

Text-internal and text-external factors of genre

As Bhatia’s quote above has shown, generic integrity is determined not only through the communicative purpose, but also by means of text-internal and/or text-external factors.

The *text-internal factors* concern contextual, textual, and intertextual aspects, and are very important for genre-based analysis with respect to the way texts/genres are constructed and interpreted. From a general perspective, the contextual indicators incorporate the communicative purpose and the communicative context. More specifically, the contextual factors can be distinguished in the most immediate context, concerning aspects of the text that “are part of the immediate surroundings of the text” (Bhatia 2004, p. 125); for example writer, audience, and the linguistic traditions that form the background of the specific genre. They can also be distinguished in the wider context, providing information about, for example, the goals of the relevant professional community, but also the “extra-textual reality which the text is trying to represent, change or use and its relationship with the text” (Bhatia 2004, p. 125), as long as this ‘extra-textual reality’ has direct implications for the genre construction. If it has only indirect influence on the genre construction or interpretation, it is considered to be a text-external factor. Bhatia was aware of the fact that context in a broader sense might seem to be problematic as it can be seen in different ways; he therefore distinguishes between the following two possibilities:

In one sense, it may have direct implications for the construction of a particular genre, in which sense it will be considered text-internal.

However, interpretation of broader context may also validly contribute to the nature and function of the disciplinary community or culture in question and hence only indirectly to the construction or interpretation of a particular text, in which case it can be considered text-external. (Bhatia 2004, p. 126)

Since the annual report is greatly influenced by regulative and legislative rules, context will be considered a text-internal aspect, in line with Bhatia.

The second group of text-internal aspects includes those textual aspects containing lexical, rhetorical-grammatical, and discursal elements. The latter elements are particularly important as they are considered to be organizational elements, which are also known as *move structures*. Whereas the content of the genre is the specific information for a specific genre, the move structure is the representation of the rhetorical organization of the text. Moves are in fact text fragments, each contributing to the realization of the general purpose of the full text. These moves are considered to be conventionalized and thus are part of the knowledge of the professional community. Conventions and norms, and thus moves, can be determined by the professional community as well as through legislation and regulation. Another discursal element is the information structure or theme.

Finally, the third group of text-internal aspects includes intertextual aspects. Bhatia describes intertextuality as referring to a number of relationships that the text in question may have with those which in some way have been used, referred to or exploited either directly or indirectly in the construction of the text in question, and may include some of the following:

- 1) Texts providing a context (i.e. a letter to which the one in question is a reply);
- 2) Texts within and around the text (i.e. a chapter in the context of a book);
- 3) Texts explicitly referred to in the text (i.e. references in academic journals);
- 4) Texts referred to implicitly in the text;
- 5) Texts embedded within the text (i.e. conversation within a story);
- 6) Texts mixed with the text (i.e. quotations) (Bhatia 2004, pp. 126-127).

The *text-external factors* are much more complicated, and include discursive practices, discursive procedures, and disciplinary culture. Discursive practices consist of information about which genre is expected to be the most appropriate in order to achieve the professional objectives in specific professional contexts. Further, discursive practices include knowledge about the appropriate mode of communication.

The second group, discursive procedures, relates to the procedural elements of genre construction; for example, the annual report process. These procedures include, for instance, the genre contributors, the extent of the contribution and the phases in which each contribution has to take place, and the interpretation of ‘generic actions’. Most professional community genres are constructed by several professionals working together, and each of these professionals or contributors plays a specific role in genre construction. When analyzing the discursive procedures, it is important to seek answers to the following questions:

- (1) How do professionals construct, interpret, use, and exploit professional genres?;
- (2) Who are the participants and who has the authority with regard to which part of the genre?; and
- (3) Who controls each phase of the process?

Discursive procedures are further characterized by different phases with “identifiable inputs and outputs” (Bhatia 2004, p. 129). Another important element of discursive procedures are ‘contributing genres’, which can be very helpful in making the existence of the genre concerned possible at all. These can lead to genre mixing or genre embedding, or might include systems of genre (e.g. legislation or cases). Bhatia calls this latter development “interdiscursivity in genre construction” (2004, p. 128), whereas Swales refers to permutations of genres or genre chains as “recontextualization” (Swales 2004, p. 22).

The third group of text-external factors includes disciplinary culture, which concerns professional goals and objectives, generic norms and conventions, and professional and organizational identity. Generic norms and conventions restrict the discursive practices and

indicate the “ways in which they often preserve and express their professional and/or corporate identity” (Bhatia 2004, p. 130). This feature of genre is comparable to the characteristic of institutions of including formal and informal constraints that “shape human interaction”, as they are “the framework within which human interaction takes place” (North 1990, p. 4).

Genre hierarchies – genre chain, genre set, genre system and genre network

Domain-specific genres can be subcategorized. To this end, several genre hierarchies can be distinguished (Bhatia 2004, Swales 2004). The first is the *genre chain*, which is characterized by a chronological ordering, in particular when one genre is a necessary antecedent for another. Another genre hierarchy is the *genre set*. This term was introduced by Devitt in the early 1990s and involves that part of the total genre network that a particular individual engages in receptively or productively as part of his or her normal professional practice. The third genre hierarchy is the *genre system*, which was introduced and defined by Berkenkotter as:

a complex web of interrelated genres where each participant makes a recognizable act or move in some recognizable genre, which then may be followed by a certain range of appropriate generic responses by others. (Orlikowski and Yates 1994, p. 545)

The last kind of genre hierarchy is the *genre network*, which can be related to generic intertextuality and to Bhatia’s abovementioned ‘interdiscursivity’. The focus of this study, the annual report genre, is considered to be a genre network. A genre network consists of the use of “earlier generic forms, or the use of the linguistic and rhetorical features associated with those genres, to strengthen or modify” (Swales 2004, p. 21) the genre. It includes all genres available for a particular sector “as seen from any chosen synchronic moment” (Swales 2004, p. 22).

Not all researchers, however, define the annual report as a genre network. Some consider it to represent a genre system or genre set as it combines several separate non-financial texts, which are defined by some scholars as “well-defined and standardized sub-genre[s]” (i.e. Garzone 2004, p. 314), and by others as “narrative portions” (i.e. Yuthas et al. 2002, p. 143). These annual report components are interrelated and, together, establish the annual report as it will be published at the end of the annual report process. De Groot (2008) also considers the annual report to be a “genre set” and, moreover, the Dutch-English and British annual reports to be “global genre sets” because in his study they “consisted of comparable instances of different genres that had been unified within the annual report as a genre set. In other words, the Dutch-English and British-English annual reports comprised genre sets that were comparable across cultures, i.e. global genre sets” (2008, p. 239). Hundt supports the idea of a genre set, describing the annual report as a collective name for completely different text types which are nevertheless strongly standardized given that the separate subtexts’ structure and order within the annual report remain stable in most German companies. The structure of the German annual report genre set is as follows:

1. Inhaltsverzeichnis
2. Tagesordnung für die Hauptversammlung
3. Vorwort des Vorstandsvorsitzenden/Brief an die Aktionäre
4. Liste der Vorstandsmitglieder
5. Vortrag des Vorstandsvorsitzenden
6. Bericht des Aufsichtsrates/bzw. des Verwaltungsrates
7. Lagebericht über Konzern-/Unternehmensaktivitäten
8. Prognose für das laufende Geschäftsjahr
9. Bericht über einzelne Gesellschaften
10. Informationstexte über die Produktpalette, Unternehmensbereiche, Investitionsvorhaben (Werbung)
11. “Über die eigenen Mitarbeiter”

12. Bericht über die Finanzlage
13. Tabellen/Bericht über die Aktienentwicklung (Analyse und Prognose)
14. Kennzahlentablelle
15. Gewinn-/Verlustrechnung
16. Konzernbilanz
17. Kommentar zur Konzernbilanz
18. Einzelbilanzen z.B. zu Konzernteilen, Tochtergesellschaften etc.
19. Kommentar zu den Einzelbilanzen
20. Tabellen: statistisches Material zur Bilanz (z.B. Mittelflussrechnung, Wertschöpfungsrechnung)
21. Längerfristige Bilanzübersichten (z.B. eine Zehnjahresübersicht)
22. Placet des Wirtschaftsprüfers: Bestätigungsvermerk
23. Zur Konzern-/Unternehmensstruktur (Beteiligungen, Anteilsstrukturen etc.)
24. Hinweise auf verbundene Unternehmen/Forschunseinrichtungen, Filialen, Adressen
25. Tabelle zur Entwicklung des Anlagevermögens
26. Glossar der wichtigsten Fachbegriffe. (Hundt 2000, p. 656)

The genre-based analyses of the annual report by, for example, Garzone, Yuthas, Hundt, and De Groot show that the annual report consists of several texts, but it is Swales (2004, pp. 21-22) who considers the generic intertextuality to be the basis underlying a *genre network*. A genre may include parts of text from an earlier text, but the intertextuality might also manifest in the “replication of rhetorical structure” (2004, p. 21), which refers to the use of earlier generic forms or linguistic or rhetorical features related to those genres. Sub chapter 2.1 showed that Bhatia distinguishes between the text-internal and text-external factors of generic integrity, whereby intertextual aspects are regarded as a component of the text-internal factors. The annual report could be seen as such a genre network, because different texts are included in and together make up the annual report genre. The annual report is thus not a single homogeneous text or genre, as it is composed of different parts with different internal and external features. This means that each separate part has its own specific generic integrity (cf. chapters 6 and 7).

Further, the annual report genre is expected to include intertextual aspects, for example references to laws or other legislative documents in order to comply with those legislative obligations that concern the annual report.

This dissertation focuses on the professional genres, more specifically the business genres (and in particular the annual report genre). These are described further in the next section.

2.3.1 Business genres

Although Hundt (2000) refers mainly to institutional economic language, he stresses the importance of conventions in business texts, asserting that their stability is their main feature, and that it would be unwise to allow large variation in the communicative routines given that certainty about processes and procedures is of the utmost importance. Another element of stability that enhances certainty is standardization. With respect to the classification of business texts, Hundt states that most business texts are commissive (mainly contracts) and declarative (mainly documentation and performance of transactions). These commissive and declarative texts are important, in Hundt’s view, because they correspond with the need for certainty in the field of business.

Hundt’s emphasis on stability and standardization represents only the first elementary aspect of genre – the emphasis on conventions expressed in generic integrity – as referred to by Bhatia in the previous sub chapter. The second aspect of genre, however, stresses the complexity of genre. It is this aspect that is essential for business genres, as Bhatia points out: “Business genres in professional contexts are complex and dynamic in their construction,

interpretation and use" (2005, p. 3). According to Bhatia (2004), genre integrity can be viewed from different perspectives: the contextual perspective, the ethnographic perspective, and the socio-cognitive perspective. The contextual perspective can be very important because contextual factors operate on or constrain genres. Changes in contextual factors consequently lead to changes in generic integrity – a major aspect of this study. The ethnographic perspective deals with characteristics constraining genre construction. Analyzing genre from the ethnographic perspective means observing genres in action, making use of the "narrative accounts of first-hand experiences of active professionals" (Bhatia 2004, p. 166). Finally, the socio-cognitive perspective provides information on the one hand about the patterns of language, ideology, and power associated with a particular use of genre, and on the other hand about the interaction between genre and social practices (including intercultural constraints). The perspectives described here are part of the multidimensional and multi-perspective approach to genre-based analysis, which is needed to be able to analyze the dynamic and complex professional genres.

The generic perspective: genre and context

According to Bhatia, the generic perspective corresponds with a genre-based view of discourse. The genre-based view extends the analysis:

beyond the textual product to incorporate context in a broader sense to account for not only the way the text is constructed, but also for the way it is often interpreted, used and exploited in specific institutional or more narrowly professional contexts to achieve specific disciplinary goals. (Bhatia 2004, p. 20)

This kind of analysis has been defined as "the study of situated linguistic behaviour in institutionalized or professional settings" (Bhatia 2004, p. 22). Thus, the generic perspective is useful for corporate genres in particular.

The immediate and wider context is very important for business genres. As Knoblauch (2001) explains:

Contextualization means that in communicating, speakers and listeners use verbal and non-verbal signs to indicate what they are doing: arguing, debating, [...] These "contextualization cues" are not universal but depend on local contexts. [...] Context is a feature which characterizes the communicative actions; typical contextualization cues are conventions within certain communities of practice by which typical contexts are constructed. In order to be a competent member of a culture one has to know and be able to perform (and negotiate) this contextualization. (Knoblauch 2001, p. 12)

Related to Knoblauch's explanation of the importance of context, contextual factors influence genres, and changes in context lead to changes in generic integrity. Bhatia points this out very clearly:

Most successful constructions of professional genres have recognizable generic integrity [...]. It may be complex, in that it may reflect a specific form of mixing and/or embedding of two or more generic forms, or even dynamic, in the sense that it may reflect a gradual development over a period of time in response to subtle changes in the rhetorical contexts that it responds to; but it will certainly continue to have a recognizable generic character, which might undergo slow and subtle changes over a long period of time. (Bhatia 2004, p. 115)

The significance of context in investigating genres is comparable to the importance of context for institutions, since the genres and context have the same mutual influencing power over one another as that of institutions and context. North refers to the interaction between institutions and organizations, stating that "both what organizations come into existence and how they evolve are fundamentally influenced by the institutional framework. In turn they influence how the institutional framework evolves" (1990, p. 5). Moreover, institutions, together with the standard constraints of economic theory, determine the opportunities in a society, and organizations are "created to take advantage of those opportunities, and, as the organizations evolve, they alter the institutions" (North 1990, p. 7). Institutions thus change, and as a consequence, organizations change too (and vice versa). The tempo of these changes

depends on whether informal or formal constraints cause the change. Informal constraints come from “socially transmitted information and are a part of the heritage that we call culture” (North 1990, p. 37); this “cultural processing of information that underlies informal constraints” (1990, p. 44) plays an important role in the incremental way in which institutions evolve. In other words, the cultural context influences institutional changes, just as the context of genres influences changes in generic integrity.

The conventionalized characteristics of genres are “far from static”; in fact, “most of them are dynamic, in the sense that they can be exploited to respond to novel rhetorical contexts, and that they have the propensity for innovation and further development” (Bhatia 2004, p. 29). These changes, however, can only be realized by people who have the expertise and the power to effect change. The way in which changes occur seems to be bilateral: regulations and legislation may determine genre conventions, but companies may also determine requirements with respect to corporate genres. Although Nielsen (2006) doubts whether a company is able to adapt to the “dynamic world” because it is “disciplined” by communication regulations, the interaction between genre and context has often been food for research. Gunnarsson, for example, states that “producing texts is a part of the organization’s activities and an important one”, and that “the texts are a reflection of the organization” (2005, p. 4). Moreover, Gunnarson holds the view that texts determine the various social dimensions of the organization: the “shaping of an organization (its social structure, its values, its knowledge, its culture)” is based on goodwill, confidence and a good reputation in order to “satisfy the long-term needs of owners and customers” (2005, p. 4). This foundation of a specific organizational culture is then translated into performance and finally into actions, which also include communicative actions. Gunnarson concludes, based on her investigation of banks and engineering firms in three different European countries, that texts are not only a product of the social situation, but in turn also shape it. Her case-study companies showed, for example, that the group structure was reflected in the communication structure: the hierarchical social structure was reflected in communication patterns relating to influence and supervision. Orlowski and Yates also confirm the bilateral interaction between genre and context, stating that “genres shape and are shaped by individuals’ communicative actions”, this being “a central aspect of a community’s organizing process”. Further,

A genre established within a particular community serves as an institutionalized template for social action – an organizing structure – that shapes the ongoing communicative actions of community members through their use of it. Such genre usage, in turn, reinforces that genre as a distinctive and useful organizing structure for the community. (Orlikowski and Yates 1994, p. 542)

This means that, according to Orlowski and Yates, the analysis of a community’s repertoire of genres provides information about its communicative practices and, therefore, about its organization. Furthermore, “changes in a community’s genre repertoire over time reveal changes in the community’s communicative practices and thus aspects of its organizing process” (Orlikowski and Yates 1994, p. 542). In the present study, change is seen as adapting the corporate communication – and therefore the annual report as representative of the corporate communication – to the communication requirements of the Tabaksblat Code and the Sarbanes-Oxley Act in order to comply with the rules.

The intertwining of corporate communication and corporate organization was also a core element of a 2006 investigation by Vonwil and Lackus, who recognized the increased external pressure in the first decade of the 21st century on companies to legitimate themselves and account for their activities. As corporate communication is also an instrument for reputation building and a significant confidence factor between the company and its stakeholders, it is regarded as the most important distinctive and competitive factor between companies. It is of utmost importance that companies act in accordance with what they communicate, since any discrepancy would lead to a lack of stakeholder confidence. Vonwil

and Lackus investigated some 76 Swiss companies with respect to the relationship between corporate communication and corporate behavior. They concluded that corporations attracting a lot of public attention recognized the need for well-organized corporate communication, although formal adjustments alone seemed to be sufficient. The companies that found themselves caught up in scandals turned out to be those unwilling to align or improve their communication.

Other genre-based analyses show that generic integrity is influenced not only by the organization's or corporation's culture, but also by culture at a national or international level. This could be seen as the wider context as opposed to the immediate context (which includes, for example, the company). Although Knoblauch refers to oral genres, his definition of genres – which emphasizes the strong cultural influences upon them, turning genres into culture-specific communicative 'expressions' – could also apply to written discourse:

Communicative genres are historically and culturally specific fixed solutions to recurring communicative problems. On the one hand, they guide the interactants' expectations about what is to be said (and done) in pre-defined types of situation. On the other hand, they are the sediments of socially relevant communicative processes. Communicative genres are socially constructed and thus vary from culture to culture. In intercultural situations, interactants often encounter different repertoires of communicative genres. Lack of knowledge of such differences may lead to problems in some situations. (Knoblauch 2001, pp. 1-2)

Shaw et al. (2005) investigated the relationship between text type and culture, concluding that an individual may react to a text type in three possible ways: the individual accepts the text type, or experiences it as being familiar, or prefers a certain text type. Shaw et al. confronted individuals in several European countries with a few slightly different text types in English in order to measure their reactions. The conclusions show that people from different countries have different patterns of reference, but more congruent patterns of acceptability. According to the researchers, this is probably the result of 'glocalization', which involves local preferences surviving against a background of international homogenization.

Trosborg and Jørgensen (2005) are in line with Shaw et al. in pointing out that although globalization leads to more common generic frames for producing and understanding the communication of the market place, complete homogeneity in international business communication is unlikely since each professional genre is characterized by its own set of patterned communicative utterances whose order and content are immediately sensitive to changes in the situational context. The presumed lack of homogeneity in international business communication and the importance of cultural influences on communication is also relevant for the present study, given that the characteristics of the annual report required by the Tabaksblat Code are expected to differ from those required by the Sarbanes-Oxley Act since these codes are 'products' of different corporate governance systems.

Context and culture are interrelated phenomena that are both highly important for genres and for institutions. The interaction between context, culture, and language/communication with respect to institutions, such as corporate governance, has been stressed by Searle, and is explained in the following section.

2.3.2 The annual report genre

The annual report can be defined as a genre of organizational communication (Orlikowski and Yates 1994). This is a distinctive type of communicative action, characterized by a socially recognized communicative purpose and common aspects of form. Garzone (2004) emphasizes the importance of the annual report genre as the key instrument between a firm's management and its shareholders. Gunnarsson enhances Garzone's view, stating that:

It is through discourse that the organization attracts its customers and investors. It is efficient communication that builds up good and stable external relationships. Most companies therefore attach great importance to their annual reports. (2005, p. 103)

Several scholars have offered a conception of the annual report's communicative objective. For example, Yuthas et al. consider the annual report's communicative purpose to be "to provide a fair representation of the firm's economic reality" (2002, p. 142). Garzone (2004) suggests that the purpose lies in the fact that the company describes and accounts for its activities and performance during the relevant year. According to Hundt (2000), the communicative purpose is not information provision (assertive text type), but rather its main function is to praise the company by embellishing its performance and activities; therefore, the annual report is considered to be a directive text type. De Groot (2006) studied the English-language annual reports of various Dutch companies and the annual reports of British companies, and found that the overall communicative purpose was to inform readers about a variety of company-specific issues. The secondary objective was to influence readers' attitudes by establishing a positive and trustworthy corporate image, mainly through the non-financial texts⁹ within the annual report. The interviewees (directors of the Communication Departments and/or Investor Relations Departments), however, put forward additional specific purposes. The Dutch interviewees regarded the annual report to be primarily a financial communication tool, which had to be published due to legal requirements. The British interviewees also considered the annual report to be a financial communication tool, but further emphasized its use as a 'corporate brochure' for stakeholders with a general interest in the company.

Readers/Addressees

Whereas Hundt considers investors to be the sole addressees of annual reports, Garzone (who investigated the annual reports of companies in different EU countries) sees the readers as the company's shareholders, potential investors, financial analysts and specialized journalists, as well as its executives and other officers. In contrast with Garzone, who did not distinguish between the country-specific annual reports, De Groot (2006) states that the addressees of the Dutch and British annual reports are the same, and specifically consist of investors, analysts, media, clients/suppliers, employees/staff, policy-holders, and special interest groups. The priority given to each of these groups, however, differs. The Dutch put the financial readers in the first position, followed by the company's internal readers, and finally the 'broader audience'. The British, on the other hand, view the institutional investors as the main addressees, followed by financial groups, and in third position the employees (whom the British interviewees regard as part of the 'broader audience'). This priority ranking clearly reflects the influence of the different corporate governance systems. It is also, unintentionally, reflected in De Groot's conclusion:

[...] in spite of its contribution to the financial and corporate communication mix, the British annual report is a shareholder document most of all. Within the Dutch business community the report seems to predominantly aim at anybody with a direct interest in the company. (De Groot 2006, p. 74)

The pivotal position of the shareholder corresponds with the role of the investors in the British shareholder system, while the term "anybody with a direct interest in the company" clearly refers to the Dutch stakeholder system.

⁹ The non-financial texts contributing to the general promotional potential of the annual report were selected by the British and Dutch interviewees, and in the British and Dutch-English annual reports concern the CEO's statement, the corporate profile, and the operational review. The British annual report additionally includes the chairman's statement.

Structure of the annual report

According to Garzone (2004), the obligatory components of annual reports are the CEO's letter, the company report, the management's discussion and analysis, the financial statements and footnotes, and the independent auditor's report. The optional components may include a company overview or a mission statement, a letter to shareholders, a profile of developments during the year, a corporate governance section, a corporate responsibility section, and the notice of the general accounting meeting. In De Groot et al.'s (2006) study, both the Dutch-English and British annual reports contained the following components: (cf. 2.3 Hundt, structure of the German annual report genre):

- CEO's statement;
- Managerial foreword;
- Corporate profile;
- Operational review;
- Financial review;
- Compulsory note on executive and supervisory procedures in the board;
- Corporate governance report;
- CSR report; and
- Financial statements.

There are, however, also specific Dutch components (Executive Board report, Supervisory Board report) and specific British components (chairman's statement, operating review, financial review, director's report). De Groot states that the Dutch and British companies "appear to refer to a similar set of overall communicative norms", but that there are also "subtle normative differences" (2006, p. 81). These differences revolve around four issues (De Groot et al. 2006, p. 227):

- (1) the financial and operational performance is included in the Executive Board report in the Dutch annual reports, and in the operating and financial reviews in the British annual reports;
- (2) the corporate governance issues (De Groot considers these issues to be "details"), are integrated in the Dutch supervisory board report, signed by all non-executive directors, whereas they are included in the British director's report, signed by the company secretary;
- (3) some of the "Best Practice Texts" apparently differ, although it is not explained what texts are meant here; and
- (4) the Dutch annual reports include only a CEO's statement, whereas the British reports include a CEO's statement as well as a chairman's statement. De Groot explains that this difference could be attributable to the different management systems in place, i.e. the Dutch two-tier board and the British one-tier board.

Moves

Most scholars investigating the annual report genre have focused on the CEO's statement/letter, which might be a consequence of the fact that it is often the most read part of the report (Garzone 2004, p. 320). Garzone establishes the CEO's letter as a sub genre, and distinguishes three characteristic moves:

- (1) Reporting on the company's performance, trends and results in the relevant year;
- (2) Providing a narrative of the salient facts; and
- (3) Illustrating the outlook and priorities for the future.

Nickerson and De Groot (2005), meanwhile, investigated the moves in Dutch-English and British CEO's statements and British chairman's statements, which make up the cognitive structure of the genre. De Groot's (2008) study resulted in the identification of five common moves: context (background information contextualizing the financial performance over the past year); financial performance over the past year; financial performance in the future (maintain or create investor confidence); operations (specific details on operational performance over the past year, investor confidence); strategy (details on corporate strategy in general and in the future to show that the company is able to react quickly to changes).

The previous sections have shed light on genre theory in general, the business genres, and finally the annual report genre. The next section explains the function of genre theory in the present investigation.

2.3.3 How can the concept of genre be useful for this dissertation?

Before explaining the actual role of genre in this research, two important consequences of the concept for this dissertation require explanation. First, as we have seen, section 2.3.3 emphasizes the importance of the annual report for a company (Garzone 2004), indicating that efficient communication is needed in order to create and maintain good external relationships. This statement is reinforced by the fact that the main addressees of the annual report (2.3.3) are external readers; however, these addressees also include employees and staff, and therefore this genre is created not only as a part of external corporate communication, but also for internal communication. Garzone (2004) emphasizes the role of culture by stating that in written texts, “beyond apparent surface uniformity”, subtle divergences may arise because of “the interference of generic conventions of the ethnolinguistic culture the drafters belong to” (2004, p. 312). She holds the opinion that there will always be cultural differences of this kind because text genres are “clusters of typified responses to recurrent communicative needs and situations, which are firmly embedded in the cultural context where they are used” (2004, p. 312). Further, the influence of context has also been referred to above, whereby the wider context includes culture and institutions. This would imply that the Dutch and the US annual report are expected to be structured differently. Because genres are established in a specific cultural context, they are vulnerable to changes. According to Bhatia (2004, p. 25), however, these changes or adjustments in genre, reflecting the adjustments in corporate communication, can only be effected by people who have the knowledge and power to do so (as discussed in 2.3).

Bhatia’s concept of genre as a useful methodology for this dissertation

The introduction to this chapter posited the annual report as the unit of analysis for this study. Bhatia’s concept of genre theory is therefore of utmost importance in conducting the investigations of the first and second steps of the analysis. It provides an adequate framework for mapping the rules for communicative action – which constitute ‘good governance’ – within the codes, and for adhering to these rules in the company’s practice (annual report).

Genre theory as a useful methodology (1)

Searle’s theory of institutions considers language as the condition *sine qua non* for institutions to come into existence at all. An institution – like the institution ‘good governance’ – is a system of constitutive rules of the form ‘*X counts as Y in C*’, and the constitutive rules included in the Tabaksblat Code and the Sarbanes-Oxley Act have the form ‘*X counts as ‘good governance’ (‘Y’) in C*’. Searle states that the status function ‘good governance’ can only be represented by the use of language (or other symbols), which means that the focus in this dissertation is on the use of language, namely communication in texts, within the constitutive rules of the codes (i.e. on specific text types) in order to analyze how the *X* becomes *Y*. This effectively means that the concept of genre is used as an instrument to identify the communication actions by which ‘good governance’ is put into practice. In other words, the case study presented in this dissertation shows, from the communication perspective and using genre theory as an instrument, how the constitutive rules are put into practice.

The previous sections have shown that each genre has its own specific features, which together constitute its generic integrity. Text-external as well as text-internal factors determine this generic integrity, and thus the annual report's generic integrity will also be determined by these factors. This leads to the first step in using Bhatia's concept of genre in order to answer the main research question: namely, how do listed companies adapt their corporate communication to the rules of the Tabaksblat Code and the Sarbanes-Oxley Act?

Chapter 1 and the introduction to the present chapter showed that the first step of the analysis starts with identifying the rules that include communication requirements in the two codes. The communication requirements that are identified are expected to provide information on how they determine the corporate communication. Therefore, the Tabaksblat Code and the Sarbanes-Oxley Act (and Auditing Standards 2 and 3) will be analyzed separately, and the results of each analysis will show how the communication requirements determine the corporate communication in general. The results will also provide relevant information on the requirements concerning the annual report's integrity; that is, what the text-internal and text-external factors of the annual report genre are according to the Tabaksblat Code and the Sarbanes-Oxley Act, respectively. The 'ought' situations thus refer to what the integrity of the Dutch annual report genre (as determined by the constitutive communication rules in the Tabaksblat Code) ought to be, and what the integrity of the American annual report genre (as determined by the constitutive communication rules in the Sarbanes-Oxley Act) ought to be.

Genre theory as a useful methodology (2)

The second step consists of a genre-based analysis of the annual report of a Dutch cross-listed company (case study), based on detection of the constitutive communication rules within the corporate governance codes and how these rules have been applied by the company. This analysis is of importance for this dissertation because possible adjustments in corporate communication will be represented by the annual report. Thus, any such adjustments can be shown through and in the annual report. With respect to the importance of the corporate governance codes, in particular the importance of triggering adjustments in order to achieve their goal, the bilateral interaction between context and genre is expected to reveal the corporate communication adjustments as a consequence of complying with the Dutch and American sets of constitutive rules. The results of the analysis will demonstrate whether the 'is' situations – namely the text-internal and text-external factors of the actual annual reports – cover the 'ought' situations according to the codes.

Whereas most genre-based research takes the text or text genre as the starting point, this study takes the broader context (the corporate governance codes) as its starting point and then moves via the corporate communication to the text (or text type) itself – i.e. the annual report – in order to examine how the genre features required by the codes manifest in reality. Thus – as stated previously – this dissertation investigates, on the basis of the assumptions of the Tabaksblat Code and the Sarbanes-Oxley Act, the notion that certain constitutive communication rules (the Dutch and the US annual report genre requirements) are obligatory, and if Dutch listed companies comply with these rules (which are considered to have the form ' X counts as Y in C ') transparency will have been achieved. In consequence, this dissertation uses genre theory through contextual differences, since the obligatory communication actions of the Tabaksblat Code lead to a different ' X counts as Y in C ' than those actions of the Sarbanes-Oxley Act. The 'ought' situation will therefore be compared to the 'is' situation, whereby the Tabaksblat Code's 'ought' situation differs from the Sarbanes-Oxley Act's 'ought' situation, and thus both 'is' situations are expected to differ as well. The final question is whether both 'is' situations might potentially lead to transparency.

Concretely, this leads to the first step with respect to the use of genre theory: analysis of the Tabaksblat Code and the Sarbanes-Oxley Act in order to detect whether and to what extent the following text-internal elements of genre are included in the codes:

- situational context;
- communicative purpose;
- move structures;
- themes; and
- intertextual elements concerning the interrelation of genres.

Further analysis will examine whether and to what extent the following text-external factors can be found:

- (1) Discursive procedures consisting of:
 - (a) annual report contributors; and
 - (b) structure of the annual report process
- (2) Disciplinary culture, consisting of generic norms/conventions
- (3) Discursive practices, consisting of:
 - (a) the choice of genres; and
 - (b) communication modes.

Chapter 9 discusses the preparation for analysis step 1, which covers the description of the ‘ought’ situation of the annual report’s generic integrity according to the Tabaksblat Code (also included in Chapter 9) and the corresponding ‘ought’ situation according to the Sarbanes-Oxley Act (Chapter 10). This preparation consists first of detecting which of the rules included in the codes can be considered as containing communication actions or communication requirements, as not all rules do. Second, this dissertation focuses in particular on the communication requirements with respect to the four selected Corporate Communication Units per code. Specific ‘communication research questions’ will be formulated in order to identify and structure the communication actions per CCU. The answers to these questions will show how and to what extent the communication per CCU should be established. These answers, therefore, construct the general communication structure from which the generic integrity of the annual report can be deduced, and thus enable construction of the ‘ought’ situation of the annual report genre according to the Tabaksblat Code and to the Sarbanes-Oxley Act. Both ‘ought’ situations include the description of the text-external factors and the text-internal factors of the annual report. Genre theory will thus be operationalized in Chapter 9 in preparation for the analyses in chapters 9 and 10.

The previous sections have shown that the annual report genre is in fact a genre network, implying a complex genre in which different text parts are included and interrelated. The focus of this dissertation is on the annual report genre as such, and does not include scope for investigation of the separate annual report texts.

2.4 Case-study research

Historical development of the case study – a short overview

Many case studies in anthropology have been set up in line with Bronislaw Malinowski’s use of case studies (Hamel et al. 1993). He considered villages to be ideal observation sites for culture because of their size and homogeneity, and the cultures studied appeared to be ideal representatives for social life or culture as a whole. As society became more complex and less homogeneous, the need for a different method for studying society and culture arose. Le Play, considered the founder of sociological fieldwork and of the case study in 19th century France, used a social unit – the working-class family – to provide a better understanding of the characteristics of society as a whole. He investigated 100 families using a standardized

approach that combined observing facts, questioning workers “on subjects that could not be directly observed”, and collecting information. The reliability of the data was ensured through verification of the family statements by community members who knew the family well. Another source of evidence consisted of talks with selected informants from the local authorities. Society, however, changed over time, and eventually no longer consisted mainly of working-class families; thus, the working-family was no longer the representative unit of analysis.

The first case studies in the United States were conducted by members of the Chicago School and by social workers (around 1900). At that time, Chicago had social problems provoked by urbanization and immigration. The Department of Sociology at the University of Chicago set up a program of field studies in 1916, which triggered series of case studies on specific problems like poverty and delinquency. The case studies took an inductive approach characterized by theory building from field materials. The University of Chicago became the leader of this case-study approach in the United States until 1935.

The University of Chicago’s position was considered to be the cause of a rivalry between itself and Columbia University in New York. In Chicago the case-study method was the leading research strategy, whereas in New York the statistical survey was the main investigation method. The doubt about the relevance of the case study, however, seems to have originated from an advocate of statistical methods within the University of Chicago itself. He considered his methods to be capable of validating a theoretical idea, and if sociology would not use these statistical methods, it would not be considered a science. According to Hamel et al. (1993), the issues concerning the definition of sociological investigation from the perspective of existing methods formed the basis for the conflict between the two universities.

The conflict resulted in strict guidelines for case studies (on a statistical basis). It also resulted in the first general sociological theories, which meant the case-study method was consequently not often used until the 1960s, when a second Chicago School arose and case studies became popular research strategies once more.

2.4.1 The case-study method

Hamel et al. (1993) do not regard case studies to be a true method in themselves, as they employ various individual methods like interviews, participation observation, and field studies. This view is purely sociological, enhanced by their definition of the case-study’s goal as being to reconstruct and analyze a case from a sociological perspective. Yin (2003:1) defines the case study as a research strategy, “a way of investigating an empirical topic by following a set of prespecified procedures” (p. 15). The case study is the preferred research strategy when ‘how’ or ‘why’ questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context.

But what is a case study? Yin provides a quite extended definition, which consists of two parts. First, the technical definition begins with the scope of a case study:

1. A case study is an empirical inquiry that
 - Investigates a contemporary phenomenon within its real-life context, especially when
 - The boundaries between phenomenon and context are not clearly evident.

Second, because phenomenon and context are not always distinguishable in real-life situations,

2. The case-study inquiry:

- Copes with the technically distinctive situation in which there will be many more variables of interest than data points, [...]
- Relies on multiple sources of evidence, with data needing to converge in a triangulating fashion, [...]
- Benefits from the prior development of theoretical propositions to guide data collection and analysis. (Yin 2003:1, pp. 12-13)

For this dissertation, the third bullet of the second element above is very important, as it indicates that the case-study inquiry benefits from the prior development of theoretical propositions to guide data collection and analysis. The theoretical propositions in this study consist of two basic elements, namely (1) Searle's descriptive theory of institutions, and (2) the prescriptive constitutive rules included in the Tabaksblat Code and the Sarbanes-Oxley Act that will both be illuminated within the case study, and will show how the 'game' of corporate governance is played in practice. Therefore, one case will be sufficient to show, from the communication perspective and using genre theory as an instrument, how the constitutive rules of 'good governance' included in the codes are put into practice.

This section starts with the first part of the above definition. As stated, a primary characteristic of the case study is that it concerns "a contemporary phenomenon within its real-life context", with emphasis on the complexity of that real-life context. Stake refers to qualitative inquiry, which is characterized by "its emphasis on holistic treatment of phenomenon" (1995, p. 43). This holistic view originated from the idea put forth by qualitative researchers that:

phenomena are intricately related through many coincidental actions and that understanding them requires looking at a wide sweep of contexts: temporal, spatial, historical, political, economic, cultural, social, and personal" (Stake 1995, p. 43)

This view gives rise to Stake's definition of case study as the study of the particularity and complexity of a single case, coming to understand its activity within important circumstances. The case study is regarded as the most effective strategy of grasping the whole picture of a given case or phenomenon. Flyvbjerg (2004) stresses the importance of a 'holistic' view in this regard, stating that "the closeness of the case study to real-life situations and its multiple wealth of details" is important "for the development of a nuanced view of reality". We saw a similar kind of 'holistic view', involving the significance of context for institutions as well as for genres, in the previous section (cf. 2.3) on genre theory. Since genres are influenced by both their immediate and wider context, genre theory takes these contexts into account in order to "see 'the whole of the elephant'", as Bhatia (2004, p. xvi) put it. Institutions – and in particular those institutional rules taking the form *X counts as Y in C* – depend strongly on their context, referred to in the formula as *C*. Both institutions and genres interact between themselves and their contexts. Context can thus be seen as the linking pin that holds together the notions of institution (i.e. corporate governance), genre and case study.

With respect to the second part of Yin's definition of a case study, the last two bullets refer to the quality requirements for case-study research, particularly concerning the quality of the analysis of case-study results. In general, the quality and value of case-study research seems to have been a perpetual point of discussion since the mid-1930s, as has been described previously. Qualitative research, including case studies, is characterized as "being 'soft' social science, dealing with inadequate evidence", whereas quantitative research is considered to be "hard-nosed, data-driven, outcome-oriented, and truly scientific" (Yin 2003:1, p. 2).

The quality of case-study research

The quality of research can be indicated by its validity, its reliability, and the role of theory within the investigation. In this dissertation, the single-case study will be used to operationalize Searle's theory of institutions and genre theory, which should ensure the quality of the investigation.

The role of theory in the case study is very important, according to Yin, as a well-developed theory is the level at which analytical generalization – as opposed to statistical generalization – of the results of the case study will take place. Thereby, analytical generalization can be seen as previously developed theory used as a template with which to compare empirical results and therefore as being about generalizing to (previously formulated) theoretical propositions. Analytical generalization seems to be the most important determinant of the quality of case-study research, and forms the core content of the last element of Yin's definition of a case study.

Validity and reliability in case-study research can be achieved through different 'tactics'. According to Yin, the most important condition for constructing validity is the use of multiple sources of evidence, for example, documentation, interviews, and direct observations. According to Stake, interviews provide descriptions and interpretations by others – the interviewees – which the investigator could not have observed for him- or herself. Case-study interviews are of an open-ended nature and the interviewee is more an informant than merely an individual responding. The role of the interviewee as informant is a consequence of the interviewer asking not just about the facts of the matter but also about the interviewee's opinions of events and even his or her own insights, which could form the basis for further inquiry. Another type of interview is the focused interview. These are usually short and can also be open-ended, but the questions are often part of a case-study protocol. The third interview type is the survey, which is much more directed through structured questions. The value of documentation is considered to be an 'overall value' and of significant importance for case studies, because documents support and enhance evidence from other sources.

The use of many different sources of evidence can lead to triangulation "of only the important data and claims" (Stake 1995, p. 111), which seems to be the condition for enabling analytical generalization. There are several triangulation variations: Investor triangulation means that other researchers are asked to look at the same case; theory triangulation involves "co-observers, panellists, or reviewers from alternative theoretical viewpoints" (Stake 1995, pp. 113-114) in analyzing a particular case; and, finally, methodological triangulation includes, according to Stake, only the three case-study methods observation, interview, and document review. The latter view of methods corresponds with Yin's view of "multiple sources of evidence" for constructing validity.

The objective of reliability has been defined as:

to be sure that if a later investigator followed the same procedures as described by an earlier investigator and conducted the same case study all over again, the later investigator should arrive at the same findings and conclusions. (Yin 2003, p. 37)

A possible indicator for reliability is establishing a case-study protocol (cf. Appendix E), which includes the instrument and the procedures as well as general rules to be followed during the case-study research. This case-study protocol has two functions. First, it keeps the investigator targeted on the subject of the case, and second, it allows the researcher to detect and anticipate problems while establishing the protocol. This first function does away with the risk of a case study taking too long, which has been a conventional prejudice against case-study research. Another reliability indicator is having a case-study database which consists of, for example, case-study notes, documents, and narratives, which – if related to interviews – could be composed in the form of open-ended answers to the questions in the case-study protocol. Finally, the last possible indicator for reliability lies in taking as many steps as possible in order to demonstrate and explain each decision or step taken in the investigation.

Case-study types

The choice for a certain case study depends on certain criteria. According to Stake (1995), maximizing what can be learned from the particular case study is the only important criterion. Flyvbjerg (2004) states that the generalizability of case studies can be increased if the cases are selected strategically. Yin (2003:1) distinguishes between two major kinds of case study: single-case studies and multiple-case studies. The single-case studies are “eminently justifiable” when the case:

- (a) Represents a critical test of existing theory;
- (b) Represents a rare or unique circumstance; or
- (c) Represents a representative or typical case or when the case serves a:
- (d) revelatory or
- (e) longitudinal purpose.

In multiple-case studies, each case should be carefully selected for the purposes of either literal replication (predicting similar results) or theoretical replication (predicting contrasting results for predictable reasons). The use of multiple-case studies seems to be preferred by many scholars as a way of ameliorating the risk: the more cases, the greater the chance of doing a good case study.

Each case study can be applied in different ways, given that case studies can explain, describe or explore. Explanatory case studies present data, including information on cause-effect relationships, in order to explain how events happen (Yin 2003:1, p. 2). Descriptive case studies, meanwhile, describe a phenomenon within its context, covering the scope and breadth of the specific case under investigation. Finally, exploratory case studies are used to create a framework of study or to define the questions and hypotheses of a subsequent study. In other words, such case studies can be considered to be a ‘prelude’ to more research.

The single-case study presented in this dissertation does not fit into Yin’s case-study categories, as it is applied in a different way: it serves to ‘illuminate’ how a corporation plays the game of ‘good governance’. Its goal is to shed light on how the constitutive rules of ‘good governance’ are used within the case-study company in order to achieve formal transparency, and thus to bring ‘good governance’ into existence. It can therefore be described as an ‘illuminative’ case¹⁰ (Parlett and Hamilton 1972). Chapter 1 showed how the accounting scandals should lead to transparency, which was presented in Figure 1.6:

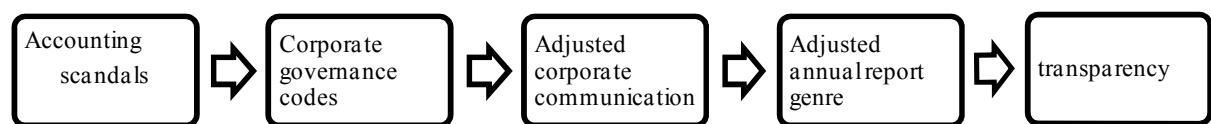


Figure 1.6: Step 4

This dissertation shows the interrelationship between the different steps to be taken in order to reach the final step, ‘transparency’, with the core of the investigation consisting of the steps 3–5.

A single-case study can represent the critical case in testing a theory or the propositions deducted from a theory. Critical cases (Flyvbjerg) can represent either the ‘most likely’ position when it comes to confirming the theory or propositions, or ‘least likely’ if they do not confirm the theory/propositions. Another case type is the representative or typical

¹⁰ The term ‘illuminative’ research was first used by Trow (1969). Parlett and Hamilton (1972) later used the term to indicate evaluation, whereby the researcher’s “chief task is to unravel [the complex scene he encounters]; to isolate its significant features; delineate cycles of cause and effect; [...].” (p. 18).

case, which could be regarded as the original version of case study; these studies consider, for example, a family to be the representative social unit for an entire society (Hamel et al.). Other types are the extreme or unique case, which is only used in clinical psychology; the revelatory case, which is the investigation of a phenomenon previously inaccessible to scientific research; and the longitudinal case, whereby the same case is investigated at two or more different points in time.

In this dissertation, the single-case study will show the applicability of the Dutch code and the US code in a specific case, namely the case-study company. The aim is to illuminate the ‘underlying theory’ of the Tabaksblat Code and the ‘underlying theory’ of the Sarbanes-Oxley Act. Each ‘theory’ consists of the constitutive rules included within the respective corporate governance code, which are considered to lead to transparency. This means that the theory (as described by Yin) will be not just analyzed, but also developed into a prescriptive basis for analyzing.

2.4.2 The relevance of case-study theory for this dissertation

Since the main research question is a ‘how’ question (How do listed companies adapt their corporate communication to the rules of the Tabaksblat Code and the Sarbanes-Oxley Act?) the case study is considered to be the preferred research strategy here (2.5). As noted above, Yin defined the case study as an investigation of a “contemporary phenomenon within its real-life context”, which makes this research strategy very useful for investigating whether the elements of genre integrity identified in the rules of the Tabaksblat Code and the Sarbanes-Oxley Act (two ‘ought’ situations) can actually be found in the 2006 annual report and 2006 Form 20-F (two ‘is’ situations) of a ‘real’ Dutch cross-listed company, which would indicate that the company’s corporate communication has been adapted to the rules. As the 2006 Dutch annual report and the 2006 Form 20-F represent the corporate communication of the case-study company, they should show the text-internal and text-external factors as determined by the Tabaksblat Code and the Sarbanes-Oxley Act, respectively. If they indeed do so and if the ‘ought’ situations thus cover the ‘is’ situations, the 2006 Dutch annual report could be said to demonstrate the integrity of the Dutch annual report genre according to the Code, and the 2006 Form 20-F could be said to demonstrate the integrity of the American annual report genre according to the Act.

The annual report genre network consists of the genre itself, the immediate context (i.e. interaction between people and the text), and the wider context (consisting of, among other elements, the corporate governance codes concerned). The importance of context is the reason why genre theory needs to be ‘assisted’ by case-study theory in this study to be able to determine whether links to the ‘transparency’ effect can or cannot be made.

The case study in this dissertation is of the ‘illuminative’ type, in that it sheds light on how the game ‘good governance’ is played in a corporation. The case in this study has two goals. The first is to show how codified rules of ‘good governance’ are used to clarify ‘good governance’ within a company, as the case study allows for comparison of the ‘ideal’ annual report genre the ‘practical’ annual report (i.e. comparison of the ‘ought’ situation with the ‘is’ situation). To this end, the case study actually includes two comparisons: (1) the ‘ought’ situation of the communication actions required by the Dutch and US corporate governance codes will be compared with the ‘is’ situation of the 2006 Dutch annual report and the 2006 US Form 20-F; but also (2) both ‘ought’ and both ‘is’ situations will be compared. The results of the two comparisons will show whether and how formal transparency has been achieved, and thus also whether and how ‘good governance’ has been institutionalized.

The second goal is to demonstrate whether the codes' attempts to institutionalize 'good governance' has succeeded. In other words, this study sheds light on the implications of Searle's theory for a specific corporation, in that it investigates how the game of 'good governance' has been played in this particular case. The Tabaksblat Code and the SOX are prescriptive systems of constitutive rules. The general validity of the rules depends on their general acceptance. This means that if the practices revealed by the case study turn out not to correspond with the codes, this would show that there is no general acceptance and 'good governance' will not have been institutionalized.

The case study presented here is a critical case in order to be able to analyze whether the generic integrity – including the internal and external generic factors – of the company's annual reports matches the constitutive communication rules that determine the annual report's generic integrity in the Dutch and American corporate governance codes. The case study focuses on one Dutch cross-listed corporation and is thus a single-case study. We have seen that Yin defines the case study's scope as investigating a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not always clearly distinguishable. This is exactly the case with respect to the case-study company. The boundaries between the case-study company's corporate communication, the contexts of the institutions 'listed company' and 'good governance', and the context of the annual report genre call for a case-study investigation. As we have seen, Flyvbjerg (2004) defines a case study as a study of the 'particularity and complexity' of a single case, and stresses the importance of a single case study as the (only) study to capture the whole picture. The holistic view of such a study, too, justifies the use of a single case study in this dissertation. According to Yin, the role of theory is very important in any case study (2003:1) (cf. 2.4.1). He considers analytical generalization to be previously developed theory used as a template with which to compare empirical results, and thus as being about generalization to previously formulated theoretical prepositions. This is what the single case study in this dissertation is about. Analytical generalization also determines the quality of the case-study investigation to a significant degree. Since the case-study company has been selected strategically (cf. chapter 8), Flyvbjerg (2004) would see this analytical generalization as guaranteed (cf. 2.4.1). The company under review can be considered a good example of a Dutch cross-listed company with clear corporate communication. The fact that the case study is a representative case as well as a critical analysis of existing theory (generic integrity of the annual report) make this dissertation's single case study an 'eminently justifiable' study (cf. 2.4.1, *case-study types*).

The use of single-case research excludes pattern matching as an analysis tool, as this is only possible in multiple-case studies. The unit of analysis is the corporate communication, specified in the communication structure, the communication lines, and the communication processes, and reflected in the company's annual report (as explained in 2.3.2). The annual report is complex in the sense that:

- (1) It is a genre network consisting not only of one text, but of multiple texts;
- (2) It is prepared and constructed by several contributors; and
- (3) It is embedded in a complex (wider) context.

The choice for a single-case study is, naturally, also strongly related to the main research question.

This research will investigate and demonstrate via the corporate governance developments in Dutch and American history – whereby history is seen as an important dimension of the context that has given rise to the existence of country-specific corporate governance systems and thus also the two significantly different codes, each with their own specific requirements for the generic characteristics of the annual report – whether the actual annual report of a Dutch cross-listed company demonstrates the specific generic

characteristics as required by the Tabaksblat Code and Sarbanes-Oxley Act, and whether this kind of corporate communication is a suitable way to achieve the aims of the corporate governance codes. The complexity of the context in this case can only be adequately captured by investigating one case thoroughly, which justifies the use of a single case here.

The overview of case-study theory above highlighted the notion that a case study should make use of several sources of evidence. The main types of data collection in this dissertation are thus in-depth interviews and analysis of the 2006 annual report and 2006 Form 20-F of the case-study company. A case-study protocol (Appendix E) will also be established.

Corporate Governance

3.1 Introduction

This chapter starts by highlighting the basic assumptions underlying the concept of corporate governance, identifying problems that can be classed as corporate governance issues, and showing how these could be solved. Chapter 1 indicated that each country reacts to corporate governance issues in its own way, which gives rise to country-specific corporate governance systems. This means that the general solutions to corporate governance issues as described in the next sub chapter (3.2) offer insight into the characteristics of the Dutch and US systems. These systems have developed over time, following their own paths, meaning that they naturally differ from each other. This chapter describes the most important characteristics of these systems as well as the historical developments that have shaped them. These characteristics represent what ‘good governance’ is within the US and the Dutch context. Relating this to Searle’s view (2005) of institutions (cf. 2.3.2), this chapter sheds light on the term *C* in Searle’s formula ‘*X* counts as ‘good governance’ in *C*’, which denotes the Dutch and the US corporate governance systems. This chapter also indicates whether the Dutch system, which is a ‘stakeholder system’, and the US system, a ‘shareholder system’, might be expected to maintain their own path, or whether these paths will likely converge in the future. In other words, to refer once more to Searle, the chapter indicates whether the *C* terms might remain different or converge.

Just as the concept of corporate governance as well as certain historical corporate governance developments are important for understanding the characteristics of the corporate governance systems, these characteristics themselves are important in that they form the basis for the content of the corporate governance codes. The rules included in the codes constitute ‘good governance’, as they make explicit what the ‘corporate governance’ institutions are all about. This means that the Tabaksblat Code includes the core elements of the Dutch institution ‘corporate governance’, and the Sarbanes-Oxley Act contains the significant elements of the US institution ‘corporate governance’.

This chapter thus answers sub questions I.1: ‘What is the concept of corporate governance?’ and I.2: ‘What are the characteristics of the Dutch corporate governance system and the US corporate governance system?’ It starts by introducing the concept of corporate governance (3.2), then explains the classification of corporate governance systems (3.3). Sub chapter 3.4 examines the characteristics of the US corporate governance system, while 3.5 does the same for the Dutch system. Subsequently, sub chapter 3.6 describes the developments with respect to the Anglo-Saxon and Rhineland models. Finally, sub chapter (3.7) provides a summary of the chapter.

3.2 Introduction to the concept of corporate governance

We saw in sub chapter 1.1 that corporate governance can be described as the system by which business corporations are directed and controlled (OECD 1999). The core elements of the system concern power distribution and the roles and authorities of the main participants in the corporation. Certain scholars, among them Jensen (2003), hold the view that the decision-making authority, for example, has been delegated by the shareholders to management.

Jensen considers the relationship between shareholders and management to be a contract by which the ‘principals’ – namely the investors – engage another person, the ‘agent’ – namely management – to perform some service on their behalf that involves delegating some decision-making authority to the agent (management). Jensen considers this relationship between principals (investors) and agents (managers) an ‘agency relationship’, and describes a corporation as a:

Legal entity that serves as a nexus for a complex set of explicit and implicit contracts among [...] individuals. (Jensen 2003, p. 136)

This idea of ‘principals’ and ‘agents’ forms the core of Agency Theory (AT). Management, however, tends to act in its own interest, which leads to opportunistic behavior. The agents’ interests tend to conflict with those of the principals. This is the point at which corporate governance comes into view, as it serves to control the conflicts between the agents and the principals. One of the possibilities to do so is through adequate remuneration for the management, since the incentives should be aligned. This could involve, for example, management compensation consisting of a fixed salary at the beginning of the management position as well as market-based compensation such as stock options, which would control the management’s incentives to minimize risk because it would ‘own’ a part of the company, and therefore have an interest in managing the corporation well and maximizing shareholder value.

Another control mechanism is the board of directors, which monitors management. The investors have delegated decision-making authority to management, but by doing so, they remove themselves from direct involvement in the decision-making process. A board of directors is therefore responsible for monitoring management on their behalf. Jensen (2003) regards the board of directors as an essential part of the internal control systems, as it has final responsibility within the functioning of the corporation. However, in order to fulfill its responsibility well,

- (1) The board should be independent;
- (2) The CEO should not chair the board of directors; firstly, because this situation might lead to conflicts of interest since the CEO is naturally a member of the management board and, therefore, might act in favor of management only; and secondly, because the CEO determines which financial information will be available for the directors, and might restrict as much information as possible; and
- (3) The board should not include too many directors because this would hinder its performance; as Jensen points out, the board as a “democratic” political model with many different representatives would not function effectively.

Power distribution between the management, directors, and investors is another key element of corporate governance. Power distribution is affected by:

- (1) The corporate owner structure;
- (2) The effects of capital and takeover markets on management behavior, namely:
 - (a) Voting rights of common shares;
 - (b) Antitakeover provisions;
 - (c) Top management changes; and
 - (d) Internal control systems.

The elements (1) and (2) revolve around discipline, and consist of internal and external disciplinary mechanisms. Frentrop (2002) has shown that the takeover market has been much more effective in the US than in Europe. Changes in top management have highlighted the effects of the takeover market, in particular of investors making use of an ‘exit strategy’: rather than accepting a diminished firm value, investors will simply sell their shares. Voting rights determine who controls the resources within the firm, and in the Netherlands, for example, this was used as a protection measure against the takeover market. Preference shares, for example, were very effective as a protection measure against takeovers, since the owners of preference shares were the ones who controlled the firm. Thus, capital markets and

takeover markets can function as external control mechanisms as well as legal-political-regulatory systems, but the internal control systems headed by the board of directors may also have a control function. Jensen (2003) states that the board of directors is considered an essential part of the internal control systems, as it has final responsibility for the board's functioning. We have seen above that the board of directors can function well if the directors are independent, if the CEO does not chair the board, and if there are not too many directors.

Since this dissertation focuses on the influence of the Dutch and US corporate governance codes on Dutch cross-listed corporations, the view of corporate governance as an institution is also highly significant. We saw in sub chapter 1.1 that Searle (2005) defines an institution as a system of constitutive rules, and in section 2.3.2 that the Tabaksblat Code can be seen as a product of the Dutch institution 'corporate governance' and the Sarbanes-Oxley Act likewise for the US institution 'corporate governance'. The codes include constitutive rules, and thus make explicit what constitutes the underlying institution 'corporate governance', which was merely implicit until the codes were established as a consequence of the accounting scandals. These constitutive rules make *X counts as Y (good governance) in C* – whereby C is the collective acceptance or context of the corporate governance system of the specific country – explicit for listed companies. The emphasis on the collective acceptance of a specific country shows that the 'corporate governance' institutions are country-specific, and that culture is an important determinant. As stated above, the C therefore implies that corporate governance will differ between countries: the Dutch institution 'corporate governance' differs from that in the US, and consequently the Dutch code differs from the US code.

Although North's (1990) view of institutions seems to be in line with Searle's (2005) emphasis on the social aspect, he regards institutions as "the rules of the game in a society". Moreover, North stresses the restrictive power and function of these rules, defining them as:

the humanly devised constraints that shape human interaction [...] Institutions can be formal and informal, the institutional constraints include what individuals are prohibited from doing and (sometimes) under what conditions some individuals are permitted to undertake certain activities. (1990, p. 3)

Further, North states that throughout history, people in different climates, with different capabilities and resources, have been confronted with different problems. This logically leads to different solutions to the problems of survival, and the development of different languages, customs, and traditions. Institutions are embedded in societies and thus they, too, change over time in order to adapt to a changed environment. North states that major changes in the formal rules are only possible when this is in the interest of those parties that have the power to initiate such changes. But at the same time, the complex of informal and formal constraints makes incremental changes possible, so that the institutional framework will offer a different set of rules over time. History plays an important role with respect to institutions, and the present Dutch and US 'corporate governance' institutions have emerged in their present forms because of historical developments. Such institutions determine the path that a country's economy takes, and consequently the Netherlands has taken a different path to the US. North calls this phenomenon "path dependency". A consequence of path dependency is that one corporate governance system can be relevant and effective in a certain period of time, whereas another might turn out to be more effective at a different time. History shows the wave-like motion of corporate governance systems both on a macro level – global or continental movements that change very incrementally – and on a micro level – country-level movements that seem to change slightly faster, with the legislator being able to bring about the fastest changes.

3.3 Classification of the corporate governance systems

Corporate governance can be described as the system by which business corporations are directed and controlled (cf. 3.2), whereby Groenewegen (2004) sees corporate governance as revolving around the control of resources in firms. Corporate governance is therefore concerned with the institutions that influence how corporations allocate resources and returns. Groenewegen states that control should be organized such that investors, managers, employees, and the other stakeholders involved are willing to commit resources to the firm on the expectation of a return. The consequence is that the corporate governance system should discipline management such that the stakeholders' objectives are realized. We saw in the previous sub chapter that there are external and internal disciplinary or control mechanisms.

Raaijmakers and McCahery state that an “ideal corporate governance system” does not exist, because such a system “depends on individuals and on circumstances in which [it] operate[s]” (2000, p. 14). However, they do propose what an ideal corporate governance system ought to be; namely, it should:

Resolve the asymmetric information problem and management entrenchment which arise from the inability of investors and management to write a complete contract that specifies *ex ante* the objectives of managers. The absence of complete contracting means that governance structures must operate as a mechanism for making decisions about the firm that are not covered in the firm's initial contract. (Raaijmakers and McCahery 2000, p. 75)

The corporate governance systems, in which the different external and internal control or disciplinary mechanisms are included, are also known as “business systems” or “varieties of capitalism” (Whitley 1998). The first term is interesting with regard to the view of researchers during the 1980s who, according to Wijmeersch (2002), observed several patterns of corporate governance in Europe. Various studies have indicated that due to differences in tradition and legislation, almost every European Union Member State had its own pattern. Further, several subsystems could be identified within each state, since every company seemed to have developed its own corporate governance culture. In line with this view, Coffee (2006) asserts that “it must be underscored that companies with dispersed ownership and companies with concentrated ownership co-exist in all major jurisdictions”, and:

The corporate universe divides into two basically alternative systems of corporate governance: a dispersed ownership system and a concentrated ownership system. (Coffee 2006, p. 217)

Wijmeersch (2002) claims that in 1993 Michel Albert began classifying the corporate governance systems into two models, namely the Rhineland model (Germany, the Netherlands, and other European countries) versus the Anglo-Saxon model (US and UK). However, many other terms were also used to define the two general groups. These terms differ according to the lens through which the characteristic determinants of a particular system were viewed. For example, there is the debtor-oriented vs. the creditor-oriented system, referring to the way in which firms attract capital (via debt or equity); or the stakeholder model – where the stakeholders hold a central position – and the shareholder model, which emphasizes the central position of the shareholder; the market-based vs. control-based system, emphasizing the power of the stock market and the larger shareholders respectively; and finally the insider vs. outsider system, whereby in the former the (inside) shareholders are ‘friendly’, and in the latter the (outside) shareholders are ‘unfriendly’. These last systems are explained further below.

As stated, the perspective of ‘inside’ or ‘outside’ depends on whether shareholders are ‘friendly’ or ‘unfriendly’. The outsider system is considered to be the ‘standard’ system, as it is often used as a benchmark for the other systems. This can be illustrated through words like a “*traditional* creditor-oriented system” and explained by the fact that comparative corporate governance research “assumed that the Berle and Means corporation, characterized by a

separation of ownership and control, was the model assumed to be used for all large enterprises” (Raaijmakers and McCahery 2000, p. 47). La Porta et al. (1999), however, have shown that this model is largely limited to the US and UK, whereas concentrated ownership is the dominant pattern especially in mainland Europe and Asia. They further point out that Berle and Means explained in their 1932 work *The Modern Corporate and Private Property* that the corporations in the US were widely held, meaning that the ownership of capital is dispersed among small shareholders, but control is concentrated in the hands of managers. Scholars, however, began to question this idea, and La Porta et al. therefore started collecting evidence about the ownership patterns of large, publicly traded firms in different countries in order to understand the relationship between ownership and control. They distinguish between “widely held” and “ultimate owners” (La Porta et al. 1999, p. 476). The controlling shareholders – the “ultimate owner” – are defined as such if these shareholders’ direct and indirect¹¹ voting rights in the firm exceed 20%. La Porta et al. used 20% as their cut-off point because 20% of the votes is “usually enough to have effective control of a firm” (1999, p. 477). They distinguish five types of “ultimate owners”, indicating that the group of controlling shareholders is fairly diverse. These are:

1. A family or an individual;
2. The State;
3. A widely held financial institution, for example, a bank or an insurance company;
4. A widely held corporation; and
5. Miscellaneous, for example, a cooperative, a voting trust, or a group with no single controlling investors.

Their results show that of large firms worldwide, only 36% were widely held, while 30% were family controlled and 18% State-controlled. Two results, concerning the controlling shareholders, were unexpected, namely:

- (1) The result that many of the largest traded firms in Austria, Singapore, Israel, and Italy are State-controlled; and
- (2) The result that “By far the dominant form of controlling ownership in the world is not that by banks and other corporations, but rather by families”. (La Porta et al. 1999, p. 496)

Groenewegen (2009) identifies two important criteria for analyzing the outsider system: first, the distinction between internal and external control, which provides information about the independence of the management board from the owners; and second, the degree of concentration of the shares. The following figure shows the possible combinations of the two criteria:

¹¹ “A shareholder has x percent indirect control over a firm A if (1) it directly controls firm B, which in turn directly controls x percent of the votes in Firm A; or (2), it directly controls firm C, which in turn controls firm B (or a sequence of firms leading to firm B, each of which has control over the next one, i.e. they form a control chain), which directly controls x percent of the votes in firm A.” (La Porta et al. 1999, pp. 476-477).



Figure 3.1: Typologies of shareholders, Morin, unpublished article, University of Toulouse, France

Groenewegen (2009) emphasizes that ideal types are models of reality, and in that sense concrete economic systems do not precisely fit the model, but will always be a mix. The characteristics of the insider and outsider systems as described below paint a picture of the ‘ideal’ insider and the ‘ideal’ outsider system.

The combination of external control and widely dispersed ownership can be found in the market for corporate control (takeover market), which can function as a controlling mechanism. The outside and ‘unfriendly’ shareholders hold dispersed shares, and can also be large shareholders or blockholders who are not involved in management. Based on the value of the shares, these shareholders can determine the value of the firm; if the value is disappointing, they can discipline management by selling their shares in the case of a hostile takeover. In such a situation, the market enforces discipline by way of an ‘exit strategy’. Once the firm has been taken over, management will be replaced. The theory of the market for corporate control includes those theories that combine external control with widely dispersed ownership. This theory indicates that the anonymous market signals the value of the firm through share prices, and information disclosure to large shareholders or the representative(s) of many small investors is therefore crucial. It also entails that the large shareholders or representative(s) of the small shareholders can monitor and discipline management by holding positions on the board of directors or the supervisory board (TCE¹²) and might use voting as a way of disciplining management. Internal control is linked to the managerial theory of the firm, in which management will optimize the interests of all stakeholders. Management is more or less autonomous, and therefore opportunistic behavior will appear in cases where control is lacking.

The shareholders in the outsider system hold a central position within society’s values and norms, but also within its legal rules and specific institutional organizations. The shareholders are regarded to be market forces (hence the term *market-oriented* system) from

¹² TCE: Transaction Cost Economics, of which Williamson (1985) is one of the proponents.

outside the corporation, as they may choose to use the ‘exit strategy’. The main characteristics of the outsider system are the following:

- (1) Firms are widely held with dispersed equity ownership;
- (2) Transparency and information disclosure are very important for the shareholders, as they are ‘outside’ the company and should be kept informed;
- (3) The shareholders are considered to be market forces that may use the ‘exit strategy’ to discipline management in the case of mismanagement;
- (4) The value of the firm at the stock exchange will be determined by opportunistic behavior and is of utmost importance to the shareholders, who regard the company as a ‘product’ which can be sold or bought;
- (5) Regulatory bodies have a supervising role with respect to the market’s disciplinary role; and
- (6) Public courts debate how to solve problems.

The insider system, of which several kinds exist, is not a ‘standard’ system. The main feature is that the insider system is related to the control-based system, which means that large investors have a central position with regard to control. The controlling blockholders, which might be banks, non-financial firms, or large families, are very closely linked to management, and monitoring is therefore much easier. The minority shareholders in an insider system are not well protected; Raaijmakers and McCahery (2000) state that the boards of directors are often passive, and the company’s accountancy is not transparent.

The key elements of the insider and outsider systems offer the opportunity to make different combinations of elements. For example, outsider systems can be characterized by external control and widely dispersed ownership, or by external control and concentrated ownership. Insider systems can be characterized by internal control and widely dispersed ownership, or by internal control and concentrated ownership.

Although scholars seem to agree on the key roles of control and ownership by comparing corporate governance systems, the terms have not yet been formulated clearly. The term ‘control’ refers to control of the resources in the firm according to Groenewegen (2004), and to the concentration of voting power according to Raaijmakers and McCahery (2000). Further, the terms ‘dispersed’ or ‘concentrated ownership’ seem to be based on relative figures when comparing different corporate governance systems, while absolute figures appear to be either non-existent or irrelevant.

The next sub chapters show how control and monitoring have been integrated into the US and Dutch corporate governance systems.

3.4 The US corporate governance system

An understanding of historical developments is important in order to understand the path taken by the US economy and how the key elements of the current US system came into existence. This chapter therefore presents these key elements, supported by examples of historical developments and based on North’s (1990) view of institutions. North states that institutions consist of formal written rules and unwritten codes of conduct that underlie and supplement formal rules. The formal rules can change suddenly as a consequence of political or judicial decisions, but informal constraints – cultural elements like customs and traditions that stem from socially transmitted information – develop and change incrementally and/or as a reaction to changes in the formal rules. The consequence is a tension between the altered formal rules and the persisting informal rules. North (1990, p. 47) identifies the following features of formal constraints:

- They are political, judicial, and economic rules;
- They can complement and increase the effectiveness of informal constraints, and may also modify, revise, or replace informal constraints;

- There is mutual influence between the economy and politics.

North states that institutional constraints are a combination of formal and informal constraints, whereby major changes in the formal rules are only possible when this is in the interest of those parties which have the power to initiate such changes.

The complex set of informal and formal constraints makes incremental changes possible, such that the institutional framework will offer a different set of choices over time. This is reflected in the historical examples presented below that signify the development towards the current, key elements of the US corporate governance system.

3.4.1 The role of US legislation within the US corporate governance system

General

An important feature of the US corporate governance system is the role of legislation. This section shows that it took a long time for US legislation to become a generally accepted part of the US context (the ‘C’ in Searle’s formula ‘X counts as Y in C’) and an important external disciplinary measure. US legislation is characterized by:

- (1) the long resistance of the US business sector towards legislation;
- (2) the separation of securities (federal) and corporate law (state);
- (3) the trend to use new legislation as a reaction to a financial or an economic debacle; and
- (4) the significant position of the shareholders within legislation.

Note to (1). The long resistance of US businesses towards legislation and governmental influence in general seems to be the consequence of certain values within US culture. Heilbroner and Singer (1999) describe that the first European immigrants who settled in America wanted to work hard and have freedom. Their strong drive for liberty rejected interference from other parties, in particular from government. This ‘cowboy mentality’ of free spirits, adventurous entrepreneurship, and dominant businessmen achieving huge renown and capital was the characteristic of the pre-New Deal era (before the Great Depression of the 1930s), in which government had little influence because business simply neglected it. The ‘cowboy mentality’ could be seen as giving rise to values that were part of American business culture and were transmitted from one generation to the next.

At the end of the 19th century, there were several attempts to restrict the freedom of US business as a reaction against the excessive power of companies: the so-called *trusts*. This was, in other words, an attempt to use formal rules to put an end to the ‘cowboy’ values, but at first it was not overly successful.

The Sherman Antitrust Act of 1890, according to Skeel (2006), prohibited any combination in the form of trust or otherwise in restraint of trade or commerce, as well as any attempt to monopolize trade or commerce. In the previous year, the incorporation laws in New Jersey had been amended, authorizing corporations to own stock in other corporate entities. It was for this precise reason that the Sherman Act had been enacted. Therefore, the New Jersey statute served “as a welcome mat for large corporations” (Skeel 2006, p. 137); a new strategy for setting up a trust. Many corporations, for example the Rockefeller Group, moved to New Jersey to avoid complying with the rules of the Sherman Act. In other words, the new legislation had set “a stage for a major clash between state corporate legislation and the Sherman Act” (Skeel 2006, p. 137). Under state legislation, businesses could steer clear of the influence of the formal rules included in the Sherman Antitrust Act.

The zenith seemed to have been reached with the ‘Knight Sugar’ case in 1895. In this case, the Sugar Trust, which covered 97% of the United States’ sugar refining capacity, had been sued under the Sherman Act. The Supreme Court rejected the claim because “the Sugar Company’s purchase of its competitors’ stock affected only manufacturing, not commerce”

(Skeel 2006, p. 138). Although this could be seen as a case of the court protecting large businesses, it was more likely a call for state regulation. Thanks to the railroads, businesses could easily relocate to a state with favorable corporate law. However, at the end of the 19th century, “the state’s abandonment of the fight against corporate combinations shifted the campaign against corporate monopoly from the states to Congress and federal regulators” (Skeel 2006, p. 139). The Sherman Act was amended in 1902, leading to the end of the cartels and restriction of the ‘cowboy mentality’. The Federal Trade Commission and the Clayton Act, both passed in 1914, strengthened the influence of government with respect to corporations; the antitrust issues had been separated from the rest of corporate law.

Note to (2). Nowadays, corporate law is a state rather than a federal matter. The fact that the state of Delaware took over New Jersey’s position in 1913, however, exemplifies that the traditional values of freedom and no governmental influence remained, at least in Delaware. This was enhanced by the fact that although the President wanted the Federal Trade Commission, established in 1914, to have the right to require uniform financial reports from industrial and trade companies, this attempt failed (Heilbronner and Singer 1999).

Note to (3). The ‘cowboy mentality’ that sought the values of freedom and rejection of governmental influence came to an end after the economic and social drama of the 1930s. Legislation – and thus formal rules – was the only instrument to turn the tide, and President Roosevelt understood this. He enacted several laws, and businesses found themselves simply having to accept governmental influence. This sowed the seeds of the trend to use new legislation in response to a financial or an economic debacle. The following sections further elaborate on this trend, and shed light on the central position of the shareholder within US legislation (point 4 above).

Legislation as ‘trend’

Skeel (2006) holds the view that a pattern is visible within the US corporate governance developments over time, in which the massive financial scandals throughout history are a crucial characteristic. American corporate regulation seems to consist of periodic, dramatic regulatory interventions by federal lawmakers after a major scandal, together with more nuanced ongoing regulation by the states:

For better or worse, the historical cycle of periodic waves of Icarus Effect scandals followed by a federal regulatory response is part of the inevitable push and pull of American business. (Skeel 2006, p. 150)

The first US financial scandal that Skeel (2006) sees as the starting point of the typical American pattern of a stock market bubble, moving on to scandals, and ending with legislation as regulation, was the bankruptcy of Jay Cooke in 1873. Cooke was a renowned businessman who had introduced the door-to-door sales of bonds first to finance the Union cause, and after the Civil War to finance the Northern Pacific Railroad. Cooke continued pumping money into the railroad even when it had become too risky. The stock market collapsed, and the government’s response entailed new legislation, namely the Interstate Commerce Act, to regulate the trusts and railroad companies. The trust was a legal arrangement under which stockholders gave their stock, in exchange for a trust certificate, to a central board of directors “in trust”. The board members were authorized to vote the stock as they wished, and the stockholders continued receiving the dividends. Naturally, this was bound to lead to corporate governance problems. In 1882 Dodd, the Chief Counsel of the Rockefeller company Standard Oil, established a trust for Standard Oil that permitted its board of directors to control the policies of 40 corporations from Standard Oil’s headquarters. Needless to say, the power of such companies was huge. Banks in particular, for example J.P.

Morgan, dominated the capital market, because they held management positions as well as control over other financial institutions. These institutions (saving banks, commercial banks, life insurance companies) emerged because Americans had more savings due to the rising incomes, and served as intermediaries between the investors and the corporations. Banks often had a management position within insurance companies, which largely determined the demand of the stock exchange. This dominance by the banks was called “Money Trust”¹³. Whereas most industries in 1865 were competitive, by 1904 only a few companies dominated half the output of most industries. The antitrust movement started when the railway pools began to squeeze out the small businesses and farms, around the time of the 1873 crisis. This transformed American politics such that regulation emerged and began increasing incrementally (Skeel 2006). In 1887, Congress passed the Interstate Commerce Act, which included the establishment of the first federal regulatory and enforcement agency, the Interstate Commerce Commission (ICC).

Heilbroner and Singer (1999) point out that the first railways were financed and constructed by local entrepreneurs, who had personal interests with regard to the transportation of their products. In contrast, local businessmen in sparsely populated areas were not interested in financing railways after the Civil War. This brought about the mergers of railway companies, most of which were bundled into very large companies, like the New York Central Railroad established in 1853. In response, the Interstate Commerce Act tried to regulate the abuses taking place by requiring financial disclosure. This seems to be an important ‘American solution’ to corporate governance problems. The US corporate governance system is a shareholder system, in which the shareholders should hold a central position. As they are outside shareholders, information disclosure and in particular financial disclosure is very important for the investors in order to make decisions about their investments (cf. 3.3).

Thus, as stated, the Interstate Commerce Act was meant to regulate the trusts, specifically the Money Trust and the railroads, by demanding financial disclosure. The Act also established the ICC, which was charged with enforcing the Act, and declared that railroad rates must be “reasonable and just”, that the railroads had to publish their rate schedules, and that some of their practices were unlawful (e.g. granting rebates). The terms “reasonable and just”, however, were not explained further, and thus remained unclear. The ICC was initially unsuccessful, but in the early 1900s, it was given more powers, such as the authority to inspect the books of railroad companies. The governmental attempts to regulate the business sector, and in particular the trusts, by imposing formal rules met with problems as businesses tried to escape compliance with those rules. However, the formal rules included in the Interstate Commerce Act seemed to have become institutional rules by the beginning of the 20th century: the Act was having real effect, because its rules seemed to have been accepted.

Federal legislation: Securities laws

The formal rules included in the securities laws of the 1930s, too, were accepted by the US business sector. For example, the Securities Act of 1933 was Roosevelt’s reaction to the Great

¹³ Heilbroner and Singer (1999) mention in their book *The Economic Transformation of America Since 1865* that the lawyer Brandeis wrote several articles reflecting the resistance against “Money Trust” in the US. Brandeis described the US corporate governance system as “financial capitalism” in which the interlocking directorates had to be seen as underlying the huge financial power. Brandeis’s articles heralded the end of “financial capitalism” and therefore the end of financial mediators as monitors. The bankers not only were representatives of the capital providers, but also had become financers themselves. Further, they received common shares as remuneration, and consequently they themselves had an interest in maintaining a stock market. Both of these developments led to conflicts of interest.

Depression of the 1930s. He wanted to make radical changes in order to improve the economic situation, telling the American people: “I pledge you, I pledge myself to a new deal for the American people” (Heilbroner and Singer 1999, p. 288) – hence the term “the New Deal”. The Securities Act is a federal law, highlighting the fact that securities legislation had become federal law. It includes financial disclosure requirements and regulations for mediators with regard to inside knowledge, but also, for the first time, accountants were disciplined by the Act’s rules. It made them accountable for their services, and they could be taken to court if they failed. The consequence was that the accountants now required management to account for the financial reports to be reviewed by the accountants. This became an expensive procedure for smaller firms, which consequently led to a separation between companies that could afford the disciplinary role of the accountants, and those that could not. The Securities Act also required disclosure in the case of issuance of shares, which made it possible for the capital market to discipline management. Roosevelt referred to the core of corporate governance when he stated that:

What we seek is return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people’s money are trustees acting for others. (Heilbroner and Singer 1999, p. 290)

The Securities Exchange Act of 1934 included the financial disclosure requirements for companies that had already issued shares to the public. Investors could decide to monitor or not monitor management based on the disclosed information. Raaijmaker and McCahery (2000) provide the following general description of the essence of securities regulation and thus of the Securities Act and the Securities Exchange Act:

Securities regulation aims at creating a fair and transparent financial industry and markets, so as to ensure the confidence of the public and prevent disasters such as that which occurred in 1929 and other similar crashes. It does this by screening and supervising professional parties in the market and by protecting the public through appropriate rules to prevent fraudulent and manipulative issues and ensuring precise and constant information once (and as long as) securities are being traded publicly. this entails proper disclosure of all relevant data and the regulation of the introductory process. (Raaijmakers and McCahery 2000, p. 29)

These Acts make clear that the shareholder holds a significant role within this federal legislation, since information disclosure as well as financial reports are regulated on behalf of the investors. The accountant’s role is also regulated for the first time, which emphasizes the importance of the auditor as a safeguard for correct financial information (which works in the favor of the investors). The Acts can thus be seen as a form of protection for shareholders as the firms are required to disclose financial information, whereby the shareholders hold a central position within federal securities legislation (cf. 3.4.2).

The establishment of the Securities and Exchange Commission (SEC) (1934) stressed the importance of regulating the financial markets. The SEC has broad powers, namely:

- (1) to oversee the issuance of new securities;
- (2) to insist on the disclosure of full information regarding new issues; and
- (3) to establish an agency to maintain a “watchful eye” over the operation of the stock exchange.

The SEC represented a means to finally break the grip that J.P. Morgan and other Wall Street banks had over American finance. Skeel (2006) states that the SEC was to limit the ability of banks, insurance companies, and other institutional creditors to hold substantial blocks of stock in US companies. This recurrent process of Congress intervening “crisis by crisis, following years of relative silence with dramatic intervention in the crucible of a wave of major corporate scandals” (Skeel 2006, p. 142) seems to be characteristic of the American approach. The business sector was not overly enthusiastic about the reforms of the New Deal, and this discontent resulted in the establishment of the American Liberty League. Yet despite this resistance, the new role of government and thus the formal rules imposed by government had finally been accepted as necessary rather than a threat.

The next phase was introduced by the Williams Act of 1968. This law included amendments to sections 13(d) and 14(d)–(f) of the Securities Exchange Act, and was a reaction against the hostile takeovers of the 1960s. The ‘attacking’ company had to disclose its intentions about whether and how it would organize the takeover in order to enable shareholders to make an appropriate decision. Information disclosure about the takeover process was the key objective. The SEC reacted in 1983 to hostile takeovers by establishing the Advisory Committee on Tender Offers. This Committee was to provide recommendations on takeovers which should lead to an improvement of the Williams Act. Businesses and politicians, however, made clear that they were against the amendment.

The Securities Act and the Securities Exchange Act of the 1930s seemed to have brought about acceptance of the formal rules imposed by the government, which in turn became institutional rules, but the reaction of businesses in the 1960s showed that the new formal rules included in the Williams Act had not yet been accepted. It would take until the turn of the century for new securities legislation to be enacted, namely the Sarbanes-Oxley Act in 2002 as the US government’s latest response to a financial debacle (cf. Chapter 5).

3.4.2 Shareholder focus

Sub chapter 3.3 described the features of the ‘ideal’ insider and outsider systems. The US system is regarded as an outsider system, one feature of an ‘ideal’ outsider system being the shareholder’s very important position within society’s values and norms, legal rules, and specific institutional organizations. This is also visible in US legislation, and in particular in US securities legislation (cf. 3.4.1). Regulatory bodies play a supervisory role with respect to the market process, and public courts serve to solve problems in an outsider system. This means that federal and state legislation and the courts can be seen as safeguards for the investors’ interests. This is in line with the US view of investors as creditors.

Corporate financial law is based on creditors taking care of their own interests and negotiating their relationship. This is an important difference to the European, and in particular the Dutch, view of law. Raaijmakers and McCahery (2000) point out that Europeans find it difficult to understand why investors would attempt to claim more than their securities at issuance entitle them to. Europeans want to protect both creditors and shareholders. Investors, however, are assumed to enter into the contract with full knowledge of what they have acquired. To claim that the position of the general meeting of shareholders and the investors in particular should be strengthened since they are the ‘owners’ of the corporation would therefore seem questionable. It would result *ex post facto* in a change of the internal governance of private organizations. The State of Delaware holds a leading position with respect to corporate law (cf. 3.4.1) that protects businesspeople, or as Skeel puts it, “Delaware is sensitive to managers’ interests but market pressures force it to take shareholders concerns into account as well” (2006, p. 140). Further, Delaware corporate law seems to be very clear, and because more clarity leads to more certainty, significant cost savings are the result.

The management’s principal internal responsibility thus concerns the company’s shareholders, because the shareholders determine the value of the firm, and a decrease in that value leaves the shareholders the possibility of an ‘exit strategy’. The takeovers of the 1980s forced the shareholders to sell their shares if they considered the firm’s value too low. The shareholders disciplined management by using the ‘exit strategy’, and the market for corporate control turned out to be effective. This market for control in the US system is a generally accepted external disciplinary measure.

Deakin and Konzelmann (2006) explain that financial economists in the early 1980s made shareholder value the ‘lodestar’ of corporate governance. In the 1990s, shareholder value became even more important due to the influence of institutional investors: Prior to this, managements were engaged in ‘income smoothing’, which means that the cash-based remuneration system encouraged them to roll the peaks in one period over into the valley of the next period. Coffee (2006) states that this was done to mask the volatility of earnings and reassure investors who might have been alarmed by rapid fluctuations. In the 1990s, however, managerial behavior changed. Managers had ‘stolen’ earnings from future periods in order to create an earnings spike that potentially could not be sustained. This led to increasing restatements of financial statements. The companies had high market expectations for future growth, which forced them to show a high rate of earnings growth. Coffee holds the view that institutional investors understood that in a system of dispersed ownership, executive compensation is probably their most important tool to align managerial incentives with shareholder incentives. Another stimulus was the tax laws, which restricted corporate deductibility of high cash compensation. Coffee points out that stock options became part of the compensation and encouraged management to take all possible measures to increase the share values – and by doing so, the firm’s value increased too. The huge remunerations had brought about opportunism and encouraged management to take enormous risks and use manipulative techniques to maximize short-term stock prices. Risk taking was the result of competition forcing management to stay successful. These developments reached their zenith – to date – in the Enron debacle, with Deakin and Konzelmann stating that Enron “took the logic of shareholder value to its extreme” (2006, p. 157).

American society seemed to accept huge remunerations – and thus income inequality – as Heilbronner and Singer state “So long as their companies are profitable, CEOs who pay themselves winner-take-all remunerations are not likely to incur oppositions from their shareowners”, and “American society accepts a much higher degree of inequality than other capitalist countries” (1999, p. 351). Their conclusion is that this American way of thinking can probably be explained by the fact that other countries are smaller and more culturally homogeneous than the United States, and “the American cowboy self-image” (1999, p. 351) perhaps reflects this difference. The stock option remuneration however, combined with hard targets, led inevitably to “fraud, earnings management and profit manipulation” (Cools 2007, p. 38).

The developments towards huge management remuneration were caused in part by the institutional rules included in tax laws, as these rules tried to regulate corporate deductibility – but by doing so they in fact prompted businesses to look for an escape. One of the major causes of the Enron debacle was that managers simply believed that they deserved high remuneration.

The Enron scandal

Enron was a gas pipeline company which developed into an energy company and further into a company that also sold metals, water, telecommunications, internet, insurance, and other products. De Bie (2004) states that Enron transformed from an energy company into a kind of bank. In 2000, Enron established its first Special Purpose Entity, managed by Andrew Fastow as CFO. Many such Entities followed, and were used as safeguards for Enron investments. Fastow transferred Enron assets and liabilities via these ‘partnerships’, which financed the assets and came to own them (and the accompanying risks). Enron became the ‘general partner’ of the partnership and, together with ‘limited partners’, provided capital for the partnership, which also borrowed extra capital from the market. Enron as general partner assured itself the right to exploit the assets, and together with the limited partners and creditors arranged how the gross profits would be distributed. This led to a prolongation of the balance sheet with equity capital and without debt. Moreover, if after payments to the limited partners and deduction of interest a certain capital amount was left, this amount was counted as benefit.

Enron had many of these partnerships, but this led to conflicts of interest between Enron and the partnerships as Fastow was one of the leading ‘limited partners’, meaning that Enron employees had to negotiate with the person who was also the company’s CFO. Further, Enron did not comply with rules concerning the consolidation of external partnerships. The interweaving of partnerships was a highly complex network, and De Bie suggests that creditors and limited partners were probably only interested in financing the assets under tough conditions. Further, De Bie claims that agreements must have been made between Enron and the limited partners which entailed huge financial risks for Enron in the case of a decrease in share value. This explains why, at an analysts’ meeting in October 2001, Enron declared unexpectedly that it had to write off \$1.2 billion of its equity capital to fulfill obligations with regard to some of its partnerships. The analysts thus became aware of the devastating financial situation, and Enron lost the markets’ trust. This was the beginning of its fall.

Enron’s auditor, Sherron Watkins, expressed her concerns about the entities to the CEO as early as August 2001, adding: “I am incredibly nervous that we will implode in a wave of accounting scandals” (De Bie 2004, p. 7). She became the whistleblower; the SEC announced an investigation into Enron’s related-party transactions, and Enron’s external accountancy company Arthur Andersen decided to destroy all Enron-related documents. Enron established a committee consisting of members of the management board. The committee’s findings resulted in a restatement of the financial statements over 1997–2001, which led to a decrease in net income and a debt increase of \$2.6 million.

At the end of 2001, Enron provided an income warning and a credit rating decrease which jeopardized a debenture of \$690 million. The consequence was ‘junk status’ for Enron debentures, followed by a fall in exchange rates. Enron appealed for bankruptcy protection in New York, and a month later about 4,000 employees were dismissed. The Enron committee published its report in 2002, stating that the CEO, CFO, and the accountancy company Arthur Andersen were the main actors accountable for the debacle. Kenneth Lay, the CEO, had sold his Enron shares shortly before the bankruptcy for \$40 million, and another top manager, Lou Pai, had done the same for \$354 million. De Bie (2004) states that Enron had used tax ‘paradises’, one of them being the Netherlands. Enron had 140 subsidiaries in the Netherlands, and used the country as an ‘intermission’ for the establishment of foreign subsidiaries, which led to beneficial tax regulations. Yet even this was not enough: De Bie claims that Kenneth Lay’s influence reached to the highest political level, given that he was a personal friend of President Bush. Lay had financed Bush’s election campaign and pushed Bush to lower taxes, but Bush’s tax proposal had been rejected by Congress. The Vice President had asked Enron for advice concerning the energy report for Bush’s administration, but would not mention publicly what companies he had contacted. What’s more, 212 of the 248 members of the Congress committees that investigated the Enron case had received money from Enron.

The analysts had played an important role within the Enron scandal as well. De Bie (2004), based on the findings of Langendijk, states that Enron’s annual reports had already signaled important deficiencies. One important ‘red flag’ was the fact that off-balance obligations had barely made an appearance, although the annual report mentioned in many sections that Enron was accountable in certain circumstances for risks and the resulting debts. To round off the debacle, Enron brought down with it Arthur Andersen, which had been one of the Big Five accounting companies.

The Enron scandal is one of the largest accounting scandals in US history, but just one of several that occurred around 2000. Cools (2007) holds the view that the main factors in these scandals were the greed and egos of top managers. The CEO, according to Cools (2007, p. 41), acts like a “Sun King”: very powerful, highly reputed, enormously popular, and unwilling to accept the objections of those around him. As the CEO becomes more successful and therefore more powerful, the number of ‘yes-men’ increases, while the necessary ‘counter pressure’ of his three most important counterparts – the chair of the board of directors, the CFO and the auditor – does not increase in proportion. Skeel sees the 2000 scandals as characterizing American corporate governance developments for over a century, which he calls the “‘Icarus Effect’ scandals” (2006, p. 131). The metaphor makes sense, since the powerful and successful CEO, unimpeded by his counterparts – the chair of the board of directors, the CFO, and the auditor – takes risks while ‘flying towards the sun’, until this success is shown to be based on fictitious figures and he suffers a fall.

As stated, one of the major causes of the Enron debacle was the huge management remuneration. This is explained in the next section.

3.4.3 One-tier board system

The US corporate governance system is characterized by a one-tier board system, which means that the board consists of executives and non-executives. The latter monitor the former, and are thus responsible for the internal monitoring.

Hopt (2002) states that there seems to be a tendency towards independent outside directors who still are part of the board, but have special functions. This enables the management to divide management and control in critical situations. To achieve further independence, the CEO should not be the board chair (cf. 3.3). Skeel (2006) adds that the listing rules of the NYSE and NASDAQ also include independence rules with regard to the directors, one of them being that listed companies should have a majority of independent directors on their boards. State law, however, could be in contrast with the stock exchange rules. In particular, Delaware legislators see the stock exchange rules as going against the US tradition of state law regulating internal governance; they prefer the dominance of state rules. The fact that firms have to deal with both kinds of rules, however, creates the danger that boards are subject to different definitions of independence in different contexts (Skeel 2006). According to Skeel, the different sets of formal rules about the directors' independence, namely the state and stock exchange rules, have different content, which is not only confusing but might also affect acceptance of the rules – which in turn might affect the internal disciplining function of the non-executive directors.

3.5 The Dutch corporate governance system

An understanding of historical developments is important in order to understand the path taken by the Dutch economy and how the key elements of the current Dutch system came into existence. This chapter therefore presents these key elements, supported by examples of historical developments and based on the formal and informal rules in accordance with North's (1990) view of institutions.

3.5.1 Two-tier board system

The Dutch system is characterized by a two-tier board system, with a separate management board and supervisory board. This system is embedded in corporate law. Section 3.5.3 presents the example of the Dutch East India Company (Vereenigde Oost-Indische Compagnie, or VOC), which illustrates how and when the foundations for the internal control mechanism (i.e. the supervisory board's monitoring role) were laid.

In the early 1960s, the Dutch government asked the Verdamp Committee to revise corporate law to include labor participation. The Committee's report, published in 1964, recommended the revision of the corporate structure and the embedding of labor participation in the corporate structure of large corporations with a certain societal importance. The Committee proposed that such corporations should be required to establish a supervisory board to represent labor participation. The Social Economic Council (SER) first discussed the

appointment of the supervisory board members and the equal influence that shareholders and employees should have on this appointment. Besides the works council¹⁴, this would thus entail an extra means of employee participation. Finally, in 1969 the SER provided the government with its advice on the Committee's proposal, and in 1971 the 'structure law' (*structuurwet*) was enacted. This stipulated that the supervisory board should monitor the management's policy and the general state of affairs within the corporation, taking the corporation's and the related companies' interests into account in doing so. Further, the general meeting of shareholders and the works council may exert influence on the composition of the supervisory board, in order to be able to trust in the supervisory board's monitoring task.

Heemskerk (2007) states that the law's aim was that neither labor nor capital should be able to control the firm unilaterally. Civil Code (book 2, articles 152–164) establishes that the supervisory board consists of at least three members, and its tasks are the following:

- (1) to appoint and dismiss the members of the management board;
- (2) to approve the annual financial statements; and
- (3) to approve important decisions, for example, the issuance of shares, large investments, and changes in the rules of procedure.

We saw in sub chapter 3.2 that the concept of corporate governance is about controlling power. Cools (2007) regards the control of power to be primarily the supervisory board's duty. The monitoring role of the supervisory board requires the independence, expertise, and commitment of each supervisory board member, which means that they should possess a variety of competences. According to Cools, the key word with regard to the functioning of the supervisory board is information, since "information functions as a quality measure" (2007, p. 74). The management board should therefore ensure that the supervisory board is very well informed at all times.

3.5.2 Concentrated share owner system

The Dutch corporate governance system is a concentrated share ownership system (cf. Figure 3.2). Banks have always played an important role, because bank representatives have often held positions in the supervisory boards, enabling them to control and monitor their investments. The role of banks and the network of interrelations between different corporations as a consequence of, for example, managers' supervisory board memberships in other companies, can be regarded as part of Dutch business culture. This also means that internal monitoring of management in industry corporations by bank representatives can be seen as something of a tradition.

Heemskerk (2007) focused on the "old boys network" that is considered to be the core of the interrelations between corporations in the Netherlands, stating that the corporate elite network was part and parcel of the Dutch form of capitalism. This network represented the status group, and to become a member, lifelong friendships, shared educational backgrounds, and family ties were needed. Most members originally belonged to the aristocracy, which was

¹⁴ The following aspects are important with respect to the works council: Corporations may ask the Minister of Economic Affairs to be excluded from introduction a works council. There are two possibilities: either complete exemption, or a partially or 'weakened' regime. The first option applies for service corporations or corporations that focus on financing and administering group companies. The second concerns corporations of which the majority of their employees work abroad. Because many large Dutch companies and multinationals have most of their work force in other countries, the latter option is very common among those enterprises. This means in practice that such companies have a supervisory board, but no works council – at least, not at the level of the limited liability corporation.

characterized by an awareness of social and political responsibility. However, the aristocratic members were replaced incrementally in the 1960s by meritocratic members, who had no traditional obligations towards society. In the 1970s, an entire network of corporate board interlocks was exposed, and the accumulation of many corporate board positions by the corporate elite led to concerns about the concentration of too much power in the hands of a few. Of the presumed power and influence of the “old boys network”, Heemskerk states:

The bottom line is that for those outsiders without power, the ‘old boys network’ of corporate directors appears as a cohesive and highly powerful and influential group. Those who are inside these elite circles, however, typically have a different view altogether. They stress the limits of their influence, and the lack of cohesion in their community. (2007, p. 22)

The existence of such a network seems to be a path dependency factor, because the practice of organized capitalism was able to arise in the Netherlands since cartels and mergers were not prevented by the government. The US, in contrast, had always had an aversion against trusts and cartels because they were considered to impede the proper working of the liberal market system. Thus, although the ‘traditional’ corporate elite (i.e. the “old boys network”) has declined, another corporate elite still exists today, its members now being part of “a meritocratic economic elite in society” (Heemskerk 2007, p. 156). This means that the old corporate elite network as part of the Dutch ‘tradition’ of living up to informal rules has transformed into a new corporate elite network characterized partially by old informal rules – as the new corporate elite still “settles and prevents conflicts, disseminates information and ‘best practices’, and tries to form consensus on topical issues through the informal network” – and partially by new informal rules, according to which the new corporate elite has to carry out its activities “in concealment and secrecy” (2007, p. 156).

Heemskerk states that in “the inter-firm network of interlocking directorates, corporate boards are the nodes in the network, connected through interlocks” (2007, p. 59), whereby one interlock between two companies exists when they share a board member. In this way, companies can have more than one interlock, as they can share more than one board member. The “executive interlock” – which exists if an executive is a supervisory director in at least one other firm – is the most common board interlock, though there is also the “outside interlock”, when a person is a supervisory board member in two corporations. The figure below presents Heemskerk’s comparison of all executive and outside interlocks between 1976, 1996 and 2001:

	1976	1996	2001
All interlocks	1112	825	514
Executive interlocks	272	205	77
Outside interlocks	840	620	437

Figure 3.2: Executive and outside interlocks, based on Heemskerk (2007)

These figures concern only the top 250 firms in the Netherlands, and show that the number of interlocks decreased between 1976 and 2001.

The Dutch corporate governance system, thus, is characterized by the concentration of power in the hands of a small circle of corporate directors. In the early 1990s, this concerned only the relationships between banks and industry. It had increased due to the wave of bank mergers in the 1960s, then further still when companies could no longer finance their investments from retained earnings and were forced to rely on the banks for credit. The Dutch banks were never able to achieve as strong a position as the German bank traditionally held because the Dutch Central Bank did not encourage large concentrations of financial power; moreover, a 1952 law stipulated that each merger had to be approved by the Central Bank.

Another law, passed in 1978 (the ‘Wet Toezicht Kredietwezen’), determined that new banks had to ask for approval for all participation in corporations, both financial and non-financial. In the decades thereafter, these restrictions on participation were weakened incrementally. The role of banks became less important, because capital was increasingly being attracted from the capital market.

Heemskerk (2007) shows the decline of the interrelations between banks or financial institutions and ‘industry’ through percentages of executives from financial institutions who were supervisory board members of ‘industrials’, and vice versa. The following figure presents an overview of these percentages from 1976 to 2001:

	1976	1996	2001
Executive interlocks from finance to industry	73	41	10
Executive interlocks from industry to finance	47	31	16
Total interlocks between finance and industry	467	279	176
Percentage of all interlocks in the network	42.0	33.8	34.3

Figure 3.3: Interlocks between financial institutions and industry, based on Heemskerk (2007)

Heemskerk concludes that these percentages confirm the decline of relationships between financial institutions and industry after 1996, and that by 2001 the banks had clearly lost their strong and central position within the industry.

Ownership and control

The Dutch corporate governance system takes an ambivalent position with respect to ownership and control. Many Dutch companies are listed and hence issue shares at the market, but do not want this market to discipline them. Most Dutch companies still have protection measures in order to defend themselves against disciplinary actions from the market. Heemskerk (2007) concludes that companies using protection measures preclude the management board from being disciplined, which leads to a stronger position for the board. The Dutch corporate ownership structure still dominates. Heemskerk (2007) states that by 2001, concentrated ownership had increased even more: 56% of the top 50 non-financial firms had a majority shareholder. This was caused by the increase in foreign investments – which mostly occurs in large blocks – as a consequence of more foreign-owned subsidiaries being in the top 50. According to Heemskerk, only the Dutch government strives to have fewer major shareholders as it sells off the equity of state-owned companies.

3.5.3 Stakeholder model – Shareholders’ position (un)important

The Dutch corporate governance system is a stakeholder model in which companies should take into account the interests of all parties related to the company. This means that shareholders are – in contrast with the US corporate governance system – ‘just’ one party among other parties. In the Preamble to the Dutch corporate governance code, the Tabaksblat Committee refers in particular to the importance of the Dutch stakeholder model as follows:

The code is based on the principle accepted in the Netherlands that a company is a long-term form of collaboration between the various parties involved. The stakeholders are the groups and individuals who directly or indirectly influence (or are influenced by) the achievement of the aims of the company. In other words employees, shareholders and other providers of capital, suppliers and customers, but also government and civil society. The management board and the supervisory board have overall responsibility for weighing up the interests, generally with a view to ensuring the continuity of the enterprise. In doing so, the company endeavours to create long-term shareholder

value. The management board and supervisory board should take account of the interests of the different stakeholders. The confidence of the stakeholders that their interests are represented is essential if they are to cooperate effectively within and with the company. Good entrepreneurship, including integrity and transparency of decision-making by the management board, and proper supervision thereof, including accountability for such supervision, are essential if the stakeholders are to have confidence in the management board and the supervision. These are the two pillars on which good corporate governance rests and on which this code is based.

The stakeholder model thus entails that the position of the shareholders is not as important as in the US corporate governance system. In fact, shareholder interests barely seem to have figured in Dutch history at all until the Tabaksblat Code was established.

The Dutch government and the shareholders' influence

Throughout history, the Dutch government has tended to neglect the shareholders' position in favor of management, and the few attempts to strengthen the shareholders' influence failed. The examples below show that government did not pay attention to those formal rules that included some shareholder influence. Frentrop (2002), for instance, points out that this phenomenon occurred as early as the 1600s, when the Dutch East India Company (VOC) was established. The government had provided the VOC with a charter with several 'articles', including:

- (1) the method of investing;
- (2) the governance structure of the VOC;
- (3) the stipulation that every Dutch person could subscribe; and
- (4) a 21-year license for a monopoly position in East India.

To start with the first point, the investors could be divided into three groups: merchant-managers, being merchants with management responsibility; merchants who, together with the merchant-managers, invested 50% of the capital; and finally, the individual shareholders (over 1000) who invested the remaining 50%.

The second point about the governance structure includes the position of the merchants and merchant-managers. Those merchants who had invested a certain capital percentage in the company had the opportunity to be appointed as managers. The VOC governance structure consisted of six 'chambers' (*Kamers*) which represented the six 'investing' cities or provinces, of which Amsterdam was the largest¹⁵. Each Chamber was governed by wealthy merchants, and these merchant-managers chose a further 17 merchants to coordinate the activities. The latter were called the 'Lords XVII' (*de Heren XVII*), and they held a great deal of influence. Their key activity was to determine the policy that the merchant-managers were to execute.

People from all sections of the population subscribed, yielding 6.45 million Dfl. This huge capital combined with many individual shareholders stimulated the trading of stocks. Within ten years, shareholders were to receive their part of the profit, as described in another article of the charter. That article stated that they could receive a payment if 5% of the capital had been earned. However, the investors had no means to control or monitor management's compliance with this article, because the managers only had to account for their activities after ten years. They wanted to create a permanent enterprise, but this continuity could only be achieved if dividend and other payments could be reinvested rather than paid out to the investors. In other words, the management did not want to take the shareholders' interests into account, which led to unsatisfied shareholders. The lack of a proper description of either the VOC's strategic goal (warfare or trade?) or its financial-contractual aim (how should management use the invested capital?) within the charter contributed to the causes underlying

¹⁵ The 'investing' cities, besides Amsterdam, were Zeeland, Enkhuizen, Delft, Hoorn and Rotterdam (Frentrop 2002, p. 66).

the first corporate governance problems. The investors appealed to the Dutch government for help, but it supported the management because it could use the VOC investments for its own warfare goal. By doing so, the government thus neglected the formal rules included in the VOC charter.

After the first ten years, therefore, the investors expected their dividend payments but instead received a dividend that consisted mainly of spices. The shareholders were naturally unsatisfied with this payment and the lack of information about the company's performance. The situation worsened when in the following years the dividend payments became unstable. The major investors set down their wishes in a paper and presented it to the managers and the government, but to no avail. The government even prohibited judges from listening to the investors. Their only chance to achieve changes was to threaten not to invest in the soon-to-be-established Dutch West India Company. These threats led to changes in the new 1622 charter, which reflect corporate governance requirements with regard to the governance structure, including that the major shareholders should choose nine people from among their number to execute internal control. Further, the management should ask these nine men for advice with respect to important issues. In essence, they could be considered a kind of supervisory board, charged with investigating the accounts of the equipment in order to prevent opportunistic behavior by management. They were also allowed to attend the Lords XVII meetings, but were obliged to keep the proceedings confidential.

In short, the investors had brought about the establishment of a new charter, in which the formal rules concerning the governance structure included the supervisory role of the nine chosen men. This example illustrates how and when the foundations for the internal disciplinary mechanism by a supervisory board were laid. It also determined the path that the Dutch system was to follow.

Protection mechanisms

The Dutch government made attempts in the 1980s to reduce the protection mechanisms, which had been used around 1900 to protect companies from takeovers, but served at the same time to undermine the influence of shareholders. The Protection Mechanisms Committee (1986) appealed in its report for fewer protection constructions and a role for the court, and asked the Dutch Association for Securities Trade to check the "protection mechanisms with regard to the interests of shareholders, listed companies and the development of an active capital market" (Frentrop 2002, p. 358, author's translation). The Association's report (1988) included an appeal for fewer protection mechanisms per company. Interested parties were able to respond to the report, an invitation that did not fall on deaf ears: the business sector resisted, and the advice was rejected.

More shareholder power

The 1990s saw the first steps towards a final cut with management power – and thus the influence and power of the "old boys network" in the Netherlands – when the government called for formal rules.

The two-tier board system, the protection mechanisms, and the lack of transparency of the accounting and transparency of the management board had been criticized. The government established the Peters Committee to investigate the problems. The Committee's report was published in 1997 and included 40 recommendations, mainly concerning the role, tasks, and independence of the supervisory board. However, compliance with the recommendations was voluntary and the Committee did not provide proposals for legislation; thus, the report turned out to be insufficient to bring about a fundamental change.

The financial scandals – in particular the Ahold scandal – around 2000 accelerated the development of new corporate governance rules. This scandal showed that the formal rules

included in the Peters' recommendations were not having the effect needed as they had not been accepted by Dutch businesses.

The Ahold scandal

To continue its growth, Ahold, in particular its CEO Cees Van der Hoeven, had to expand urgently; in 1999, for example, Ahold had to double its returns within five years. Van der Hoeven tried to achieve this goal through takeovers in Europe and South America. Ahold owned 50% of ICA Ahold in Scandinavia and, according to Barrezeele. (2004), Ahold stated in its 2001 annual report that it had 'substantial control' over ICA. Consequently, it added ICA's complete turnover to its own results, and drew up a side letter to 'prove' to its external accountant, Deloitte, that it had complete control. The same occurred in Portugal, where Ahold owned 49% of JMR (Jerónimo Martins Retail), but Ahold added the complete turnover to its own figures. In Brazil, Ahold forced the CEO of the Bempreço supermarket chain to sign two letters, the first stating that if both parties disagreed the Ahold solution would be decisive, the second consisting of only one sentence: that Ahold would not agree with Bempreço's interpretation of Ahold's shareholder agreement. Other Ahold actions also took place in Argentina and Guatemala.

The ultimate fraud was revealed with respect to US Foodservice, and amounted to \$856 million. Barrezeele (2004) points out that it is common for food producers to provide distributors with bonuses; US Foodservice booked bonuses before they had been paid, and thus booked much higher discounts in order to pump up its figures and fulfill the expectations of the Dutch head office. The most evident similarity between Ahold and Enron is that both companies used the Special Purpose Entities maneuver, whereby the entities sell debtor accounts to financial parties. In the Ahold case, these accounts amounted to \$985 million. By doing this, the companies borrowed capital which increased their actual debt. Further, there was a lack of information disclosure. The Dutch company had agreed on a joint venture with the ICA but with the financial obligation that Ahold could be forced to buy out one or both partners. This obligation, however, had never been disclosed publicly. Ahold and Enron both deceived the investors by providing false information.

Ahold's fraudulent activities came to an end in 2003, when an anonymous whistleblower sent a letter to the media about the fact that Ahold's accountant had refused to provide the required auditor's statement on the financial statements. The investigations concerning the accountancy scandal revealed that the auditor had recommended that the CFO establish the side letters. However, Ahold had secretly drawn up contradictory side letters which enabled it to include all turnover with the approval of the auditor. Although the auditor had been deceived by false information, he, too, had to be blamed for not sufficiently checking the internal control. Van der Hoeven and Meurs (Ahold's CFO) settled with the SEC, because it is legally prohibited to be sued and punished in two different countries for the same act. The Ahold enterprise also settled with the SEC, and because the company cooperated, the SEC did not penalize it. In the Netherlands, the legal proceedings are ongoing. Neither Van der Hoeven nor Meurs have been imprisoned, though they have been given penalties. Both wanted to receive dismissal payments – a golden handshake, so to speak – but Ahold refused, and demanded that the ex-CEO pay the company €5 million and the ex-CFO €400,000. It seems that the accounting company Deloitte will be the only actor to be genuinely punished. Current news reports state that, from 2004, the auditors had in their possession a report about Ahold's internal control. Deloitte initially denied the existence of this document, but as the company relies on its exemption right the document will not be published.

The Ahold scandal ultimately led to the establishment of the Tabaksblat Committee, whose task was to develop a corporate governance code.

The Tabaksblat Code: Enhanced shareholders' powers

The Tabaksblat Committee was asked to establish a corporate governance code in which the shareholders' powers were clearly increased. This was the first time that the Dutch government had called for a better position and more powers for the shareholders. The Ahold scandal had shown what the government already knew in the 1990s: that management had too much power at the expense of the other stakeholders. The Tabaksblat Code (2003) thus aimed to increase shareholders' powers and diminish management powers.

3.5.4 Legislation and regulation

The Dutch corporate governance system is, besides for example corporate law and Civil Code legislation, not explicitly characterized by legislation, like the US system, but by self-regulation. Dutch regulation and attempts to use legislation as external disciplinary measures have often failed. The formal rules that are part of regulation with respect to the Tabaksblat Code consist of the principles and best practice provisions included in the Code, and of the rules in legislation. This indicates a preference for a mixture of formal rules to achieve ‘good governance’. The Dutch context is clearly a different *C* than the US context.

The Tabaksblat Committee pointed out in its Code that a ‘principle-based’ approach cannot do without a number of concrete rules. This is reflected in the Dutch ‘rule-based’ accounting and reporting rules, and the European ‘rule-based’ IFRS. Cools (2007) describes the difference between the rule-based (Sarbanes-Oxley Act) and principle-based (European codes) approaches. The disadvantage of rule-based codes is that the detailed rules apply without exception to all situations, and that they lead to immoral behavior because people act according to what is prohibited and what is not. A further consequence of rule-based codes is high legal costs. On the other hand, as stated, the Dutch corporate governance code, like all European codes, is principle-based. Cools considers the uncertainty about the exact meaning and interpretation of the principles in concrete cases a disadvantage of principle-based codes. The Code has legal status, which could point towards a rule-based approach; but it involves a kind of self-regulation, which applies to principle-based approaches; and finally it includes the ‘comply or explain’ rule, which is essentially a European approach. Chapter 4 elaborates on the establishment, legal embedding, and main content of the Tabaksblat Code.

Cools (2007) emphasizes the effects of the Ahold/Enron scandals on Dutch boards of management; boards were willing to evaluate voluntarily their own governance structures, and non-listed companies wanted to comply voluntarily with the Tabaksblat Code.

3.6 Development of the Anglo-Saxon and Rhineland models

Although the Ahold scandal and the scandals involving other European companies were caused by a similar pattern as the US scandals – in that US listed companies’ accounting problems emanated from US-based subsidiaries or had transformed themselves into American-style conglomerates – there are differences with respect to European corporations with a controlling shareholder or shareholder group. Coffee (2006) states that these controlling shareholders, in contrast to dispersed shareholders, have the possibility to monitor and replace management. They also have no concerns about the daily market price, in contrast with dispersed shareholders, because they rarely sell their controlling blocks, and if they do so, it will be a “privately negotiated sale at a substantial premium over the market price” (Coffee 2006, p. 224) to a new controlling shareholder. These premiums are much higher in Europe than in the United States. Coffee points out that restatements of financial statements do not occur in Europe either, because there are unlikely to be institutions to mete out punishment, and if the market were to discover the fraud, the company would collapse. Coffee regards only the extraction of private benefits of control as a reason for scandal. For example, the Parmalat scandal showed that private benefits were being transferred to controlling shareholders through related-party transactions. Further, the Parmalat gatekeepers, the auditors, were not as independent as they should have been.

Coffee (2006) concludes that the difference between the European and US scandals is that in the European companies the controlling shareholders were generally the perpetrators,

and the minority shareholders the victims, whereas in the US companies, the managers were the offenders and all shareholders the victims.

The repercussions of the financial scandals were obvious in both variations of corporate governance system; the focal points, however, were different. Cools (2007) points out that the European countries favor ‘soft law’ as a means of regulating good governance, whereas the United States opts for tough legislation. Further, Europe focuses on rules for good governance, whereas the US focuses on risk management and financial disclosure.

Skeel’s view (2006) of the US corporate governance system, in which the US government reacts to financial scandals through new legislation, could be seen as taking a narrow perspective. The enactment of new laws usually marks the end of a process, and scandals do not appear all of a sudden, but could be seen as the culmination of a previously started process.

It is unclear in which direction the US corporate governance cycle will develop in the future. Some scholars see the need for a change towards the stakeholder model. Deakin and Konzelmann (2006), for example, hold the opinion that corporate governance must no longer confine its analysis to the relationship between managers, boards, and shareholders, because this focus is too narrow and more stakeholders should be involved.

The impact of the Enron scandal prompted some scholars to voice their opinions with regard to optimization of the US corporate governance system. Skeel (2006), for example, states that the management should not abandon its focus on shareholders, because this is “likely to prove loyal to none” (2006, p. 150). Further, he points out that the management’s principal internal responsibility is to the shareholders, but it also has obligations towards employees, creditors, and other third parties, which should be central to corporate performance assessment. Deakin and Konzelmann (2007) claim that this is a temptation to the stakeholder system because managers should be accountable to shareholders alone, leaving other economic and social interests to protect themselves, and social interests – through the interplay of market forces – lie at the root of the present difficulties in the Anglo-American systems of corporate governance.

Wymersch (2002) clearly feels that none of the existing corporate governance systems is the best, but rather an in-between solution would offer new insight. And such a system, in his opinion, already exists: “After all, is that not the model of the Dutch business firm, and a clue to its success?” (2002, p. 243).

3.7 Summary

This chapter started with a short elaboration of the concept of corporate governance. Corporate governance has been defined as the system by which corporations are directed and controlled. The core elements of corporate governance are power distribution, and the roles and authorities of the main participants in the company, namely the management board, the board of directors, and the shareholders. The power distribution and the related distribution of authorities between the management and shareholders might lead to conflicts of interest. Jensen (2003) holds the Agency Theory view that shareholders (the ‘principals’) delegate some decision-making authority to the management (the ‘agent’), since they engage the management to perform services on their behalf. Since management sometimes acts in its own interests rather than the shareholders’ interests, conflicts can occur.

Corporate governance controls these conflicts through several internal or external control mechanisms. The most important internal control mechanism is the supervisory board’s monitoring role with respect to the management and internal controls. The external control mechanisms are (a) legal/political/regulatory systems, (b) the market for corporate

control, and (c) the capital market. The latter two mechanisms relate only to the US, and include the fact that shareholders may sell their shares and thus discipline management in the case of mismanagement and/or a takeover. Further, voting rights might function as a control mechanism because they determine who has control within the company.

This chapter also explained that corporate governance is an institution, and an institution is a system of constitutive rules of the form '*X counts as Y in C*', whereby *C* is the context in which the corporate governance system is involved. This context is part of a society, implying that corporate governance institutions are thus embedded in society. As societies develop over time, so do institutions, and changes within societies lead to changed institutions. Since institutions determine the path that a country's economy takes ("path dependency"; North 1990), it is clear that the Netherlands has taken a different path than the US, as their corporate governance institutions differ.

Corporate governance systems deal with the control of resources in firms and, therefore, these systems are influenced by institutions. Institutions influence the way in which firms allocate resources and returns. The different corporate governance systems can be classified into two larger groups: the Rhineland (the Netherlands, Germany, and other European countries) and the Anglo-Saxon (US and UK) models. These models can also be divided into an outsider or an insider system based on whether the shareholders are unknown or known. The most important criteria for the classification of corporate governance systems, however, are control and monitoring.

This chapter answered sub question I.2, 'What are the characteristics of the Dutch corporate governance system and the US corporate governance system?' The US system is an outsider system, and the 'ideal' outsider system is characterized by (1) widely held firms with dispersed equity ownership; (2) transparency and information disclosure, because the shareholders are 'outside' shareholders who need information in order to make the right decisions on their investments; (3) shareholders who are considered to be market forces that may use the 'exit strategy' to discipline management in the case of mismanagement; (4) a firm value that is very important to shareholders because they regard the company as a product that can be bought or sold; and (5) regulatory bodies that monitor the market process since the shareholders are not internally involved, and the use of public courts to solve problems.

In practice, the US corporate governance system is characterized by high management remuneration and a one-tier board system, with the board consisting of executive and non-executive directors. The non-executives are expected to be independent, as they monitor the executives.

The US system is further characterized by a separation of securities legislation – federal laws – and corporate law, which is state legislation. This distinction was made in the 1930s as a reaction to the financial debacle of 1929, when President Roosevelt decided to interfere by enacting a great many laws. The business sector refused to accept governmental interference before the Great Crash, but as the economic situation worsened, it had no choice. The Securities Act (1933) and the Securities Exchange Act (1934) were enacted, and the Securities Exchange Commission was established in 1934. These governmental actions seem to have been the start of the US tendency to enact laws in response to financial scandals. The Sarbanes-Oxley Act is also a consequence of this tendency. The securities legislation is mainly characterized by far-reaching financial disclosure requirements. Corporate law is focused on the shareholders as creditors, who take care of their own interests, negotiate their relationship with the firm, and are assumed to enter into the contract with full knowledge of what they have acquired.

The Dutch corporate governance system is a stakeholder system. The 'ideal' system of this kind is characterized by a legally obligatory two-tier board system in which management

and supervision are separated into the management board and the supervisory board. The Dutch system, however, is also a concentrated share ownership system, in which the banks traditionally played an important role as their representatives often held supervisory board positions, which enabled them to control and monitor their investments. This system is further characterized by the strong position of the management board at the expense of the shareholders. It also has a somewhat ambivalent position with respect to ownership and control since many corporations are listed and thus depend on the stock market, but the firms still use protection measures to prevent the market from disciplining. The Dutch corporate ownership structure consists mainly of block holdings.

In this Dutch system, shareholders have been striving since as early as the VOC (1602) for more power, and despite the few governmental attempts to provide this increased power, the management still has a much stronger position than the shareholders. The Dutch governments supported this management position and power until the 1990s, when the Peters Committee was asked to establish a report including recommendations mainly concerning management power. However, companies failed to comply with the recommendations, and the Tabaksblat Committee was required around 2000 to establish a new corporate governance code, which was presented in 2003. For the first time in Dutch history, the Tabaksblat Code includes rules that enhance shareholders' powers at the expense of management powers, which serves to restrict the influence of the "old boys network". Further, the tasks and role of the supervisory board have also been strengthened.

Tabaksblat Code

4.1 Introduction

This chapter sheds light on the Dutch corporate governance code. Chapters 1 and 2 have shown that corporate governance is an institution, and that Searle (2005) views an institution as a system of constitutive rules. Constitutive rules have the form '*X counts as Y in C*', whereby *X* identifies certain characteristics of an object, a person, or a state of affairs, and *Y* is the object, person, or state of affairs to which a certain function has been assigned. This function can only be performed in virtue of the collective acceptance of the corresponding status, which refers to *C* as context. A corporate governance code includes rules that constitute 'good governance'. The constitutive rules included in the Tabaksblat Code have the form '*X counts as 'good governance' in context C*', whereby *C* is the Dutch corporate governance system. The majority of the constitutive corporate governance rules are constitutive communication rules.

This chapter explains why the Tabaksblat Code was established (4.2), how it is legally embedded (4.3), and why this legal embedding is typical for the Dutch legal system. Further, it describes the core content and goal of the Code (4.4), thus covering the following sub question:

- I.3 Why has the Tabaksblat Code been established, how is it legally embedded, and what is its core content and goal?

Sub chapter 4.5 examines the criticism concerning the legal status of the Code, and the effects of the Code as investigated by the Corporate Governance Code Monitoring Committee. Finally, 4.6 provides a summary of the chapter.

4.2 The establishment of the Tabaksblat Code

The need for regulation of corporate governance issues was already recognized in the Netherlands in the 1990s, but the financial and accounting scandals have quickened the process in both the US and Europe. According to Wymeersch (2002), a 'market for corporate governance' can be said to have sprung up.

4.2.1 European efforts concerning the development of corporate governance codes

The European Commission asked the High Level Group of Company Law Experts in 2001 to investigate a number of corporate governance concerns. The High Level Group published its report, 'A Modern Regulatory Framework for Company Law in Europe', in 2002, in which it outlined a European approach to corporate governance. The core elements of this approach were:

- (1) Enhanced corporate governance disclosure requirements;
- (2) Development of national corporate governance codes in the EU Member States based on a 'comply or explain' mechanism;
- (3) EU recommendations for strengthening the role of independent non-executive or supervisory directors and for an appropriate approach to directors' remuneration;

- (4) Confirmation of the collective responsibility of board members for the financial and key non-financial statements;
- (5) Integrated legal framework to facilitate efficient shareholder information, communication, and decision-making on a cross-border basis; and finally
- (6) Setup of a structure to coordinate the corporate governance efforts of Member States.

The most significant element in the EU approach is that corporate governance codes had to be developed at a national rather than an EU level. The Group chose this approach due to the huge diversity in underlying company law structures and the different corporate governance systems in the different Member States. The European Commission had a coordinating role that had been ‘transferred’ to the EU Corporate Governance Forum. The Forum’s objectives were to coordinate the efforts of Member States in order to improve corporate governance, and to operate as a think tank for the Commission with respect to the development of corporate governance. The High Level Group’s report also indicated that all EU Member States had to use soft law, based on the ‘comply or explain’ clause. Hopt (2002) states that the Group held a conference in the Netherlands in 2004, and the majority of the participants felt no need for a European code. Further, Hopt points out that the participants were optimistic about the EU’s role in the world debate and the fact that the EU could even become a global reference for other countries if it could find the right mix of policy instruments and incentives to construct a “top class corporate governance framework” (2002, p. 68).

Regulation of corporate governance can be realized by means of legislation or codes that are called ‘soft law’. Hopt (2002) states that the key differences between the two forms of regulation are that:

- (1) Codes based on ‘comply or explain’ offer flexibility, while legislation tends to be mandatory;
- (2) Codes are produced by or at least with a strong business influence; and
- (3) Codes can be amended more quickly if needed than legislation, which requires a full parliamentary process.

Hopt holds the view that legislation should be used, for example, for disclosure requirements and for the legal infrastructure required to allow shareholders to use their voting rights efficiently through proxy voting or voting by correspondence. Codes are particularly useful where different solutions exist to achieve certain governance goals and companies require flexibility to adapt these to their own particular circumstances.

Hopt observed the following common themes of corporate governance codes:

- Board structure (one-tier and two-tier, committees);
- Role of non-executive directors;
- Executive remuneration;
- Responsibility for financial reporting;
- Role of institutional investors;
- Regulation of audit;
- Corporate governance disclosure;
- Codes as part of national law.

These themes can be seen as elements of ‘good governance’ that are also included in the Tabaksblat Code (cf. 4.4), and all rules included in the Code together constitute the institution ‘good governance’.

4.2.2 The Dutch corporate governance code

The Dutch Tabaksblat Committee was installed on March 10, 2003, named after its chairman Morris Tabaksblat. An attempt had been made to establish a Dutch corporate governance code earlier, when the Peters Committee was asked to investigate whether the balance between supervision, management board, and shareholders within listed companies was appropriate in view of the internationalization of the Dutch economy. The Peters Committee issued its 40

recommendations in 1997, but in 2002 the Dutch Corporate Governance Foundation found compliance with the recommendations to be low and concluded that further improvement was still possible and desirable. This low compliance rate implies that the institution ‘good governance’, whose core elements were made explicit in the Peters Committee recommendations, was apparently not collectively accepted. We saw in sub chapter 1.1 that Searle’s theory of institutions entails that the collective acceptance of an institution in fact brings that institution into existence, but since the 40 recommendations were not collectively accepted, the institution ‘good governance’ had not been constituted.

The task of the Tabaksblat Committee was to improve the Peters Committee recommendations and to establish a corporate governance code. As the Tabaksblat Committee mentions in the Code’s Preamble 1, it had broad support – at least formally – in that it was required by several Dutch institutions to draw up a Dutch corporate governance code¹⁶. There were several reasons for such a Code. First, the European Committee had recommended that all Member States establish principle-based corporate governance codes. Second, the accounting scandals, in particular the Enron and Ahold cases, had had a huge impact on the Dutch business world. Other reasons were, according to the Tabaksblat Committee, that (1) the position of the management board was said to be too dominant, and (2) the supervisory board was not sufficiently involved with the company and failed to properly supervise the management board. The Committee formulated this as follows:

Recent controversial issues have helped to create the perception among the general public and investors of an “old boys network”, a group of people operating within what is, particularly international standards, a small circle of listed companies where everyone knows each other, where management board members are protectively cocooned, and where the supervisory board members are not necessarily in touch with the key issues in society at large. (Tabaksblat Code 2003, p. 51)

Management, in other words, had too much power at the expense of the shareholders, and antitakeover measures and statutory two-tier rules prevented the general meeting of shareholders (GMS) from acting as an effective correcting mechanism in the case of mismanagement and failing supervision. Another focus of the Tabaksblat Committee was the external auditor’s independence and expertise. The Code’s content is explained in sub chapter 4.5.

In the preamble, the Committee further explains the underlying foundations of the Code. First, the Committee bases itself on existing legislation, including the legislation governing the mandatory application of the two-tier board system. Second, the Code is based on the stakeholder view, or as the Committee writes:

[...] on the principle accepted in the Netherlands that a company is a long-term form of collaboration between the various parties involved. The stakeholders are the groups and individuals who directly or indirectly influence (or are influenced by) the achievement of the aims of the company [...]. The management and the supervisory board have overall responsibility for weighing up the interests, generally with a view to ensuring the continuity of the enterprise. In doing so, the company endeavours to create long-term shareholder value. (Tabaksblat Code 2003, p. 3)

Further, the Committee identifies two pillars on which the Code is based, namely good entrepreneurship and proper supervision:

Good entrepreneurship, including integrity and transparency of decision-making by the management board, and proper supervision thereof, including accountability for such supervision, are essential if

¹⁶ The Tabaksblat Code has been developed directly at the request of the certain Dutch institutions, namely Euronext Amsterdam, the Netherlands Centre of Executive and Supervisory Directors, the Foundation for Corporate Governance Research for Pension Funds, the Association of Stockholders, the Association of Securities-Issuing Companies, and the Confederation of Netherlands Industry and Employers, on the invitation of the Ministers of Finance and Economic Affairs.

the stakeholders are to have confidence in the management board and the supervision. (Tabaksblat Code 2003, pp. 3-4)

The Ministers of Finance and Justice and the State Secretary of Economic Affairs installed the Corporate Governance Code Monitoring Committee in December 2004, after the Tabaksblat Code had been published. The tasks of the Monitoring Committee consist of:

- (1) Monitoring the operation of the Dutch corporate governance code and its implementation by listed companies and shareholders;
- (2) Keeping national and international developments in corporate governance generally under review; and
- (3) Indicating any gaps or unclarities in the Code.

The Monitoring Committee publishes an annual report (cf. 4.5) on companies' compliance with the Code, including recommendations.

4.3 The legal embedding of the Tabaksblat Code

Section 4.2.1 indicated that the European Committee required – on the recommendation of the High Level Group – each Member State to establish a corporate governance code based on the ‘comply or explain’ rule. This rule states that companies have to comply with the Code’s rules, but that they may deviate from the rules if they explain these deviations in a separate chapter in their annual report.

The Tabaksblat Code contains a series of principles and best practice provisions to promote self-regulation. The Tabaksblat Committee regarded self-regulation as a means to provide tailor-made solutions and to respond quickly to changing market conditions and practices. Its opinion was that good corporate governance cannot be captured in a one-size-fits-all model. The Code’s first principle refers to the responsibilities of the management, supervisory board, and shareholders with respect to the ‘comply or explain’ rule as follows:

The management board and the supervisory board are responsible for the corporate governance structure of the company and compliance with this code. They are accountable for this to the general meeting of shareholders. Shareholders take careful note and make a thorough assessment of the reasons for any non-application of best practice provisions of this code by the company. (Tabaksblat Code 2003, p. 8)

As of 2005, major changes in the corporate governance structure and in compliance with the Code must be put to the GMS for discussion. In line with the British Combined Code, institutional investors are called upon, on the grounds of their responsibility to their underlying beneficiaries or investors and to the companies in which they are investing, to enter into a dialogue with the company if the motivation for the non-application of any code provisions is unconvincing. Ultimately, the shareholders may take the company to court over whether the company should comply with certain principles and best practice provisions.

The Tabaksblat Code is a principle-based code, and as we see in sub chapter 5.6, Cools (2007) considers the uncertainty about the exact meaning and interpretation of the principles in concrete cases a disadvantage of principle-based codes. His view is that the Code is an in-between solution, because it has legal status, which is typical of a rule-based approach, but it was established by means of a form of self-regulation, which makes it a principle-based approach, and finally it includes the ‘comply or explain’ rule, which is an essentially European approach.

The legal embedding of the Tabaksblat Code concerns the Civil Code, Article 2:391, which indicates that information about compliance with the Tabaksblat Code according to the ‘comply or explain’ rule has to be included in a company’s annual report. This rule concerns all provisions with respect to the management and supervisory boards, but not the GMS. The

Netherlands Authority for the Financial Markets (AFM) may check the annual reports from 2007 onwards to verify that they include a chapter about corporate governance and a code compliance statement, and that the description of the corporate governance structure and the explanation of the Code are mutually consistent.

With respect to relevant Dutch legislation, the Tabaksblat Committee refers to Book 2 of the Civil Code with regard to company law provisions, accounting and reporting law, and the new Financial Reporting Supervision Act. Further, the supervisory role of the AFM as mentioned above is important for the Tabaksblat Code, as are the judgments of the Enterprise Chamber of the Court for Appeal of Amsterdam and the Supreme Court. The Enterprise Chamber can investigate whether a company policy is correct, and the Chamber may take action if necessary.

Although the Tabaksblat Committee (cf. 4.2.2) criticizes the use of protection measures that decrease shareholders' powers, it holds the opinion that the legislator should regulate by law the use of antitakeover measures, and that such measures can be useful when used in the company's interests. It further states that, besides the antitakeover measures, the facilitation of proxy voting and cross-border voting should also be regulated in legislation.

The legal embedding of the Tabaksblat Code might be considered typical for the Dutch legislation system because the Code is not itself a law; rather, only the 'comply or explain' principle – with respect to the best practice provisions concerning the supervisory and management boards – has been legally formalized. Section 3.5.4 showed that the Dutch legislation system only covers what genuinely needs to be covered with respect to business, and in particular to the powers of the management board. Further, the flexibility of the 'comply or explain' principle is specifically useful for the management board.

4.4 The goal and core content of the Dutch code

The Tabaksblat Committee focused on the definition and adaptation of the roles, tasks, and responsibilities of the various corporate bodies and the external auditor. The key points of corporate governance are efficient supervision of the management board (the 'checks') and a balanced distribution of influence and power between the management board, the supervisory board, and the GMS (the 'balances'). The Tabaksblat Committee had several goals in mind in order to avoid an "excessive concentration of power" within the management board (cf. 3.5.2, "old boys network"). As a consequence, it strengthened the positions of the supervisory board and the GMS. This was supported by the 2004 enactment of a Civil Code amendment that stipulated that the GMS nominates (and dismisses) the supervisory board members. Further, the auditor's independence has been strengthened through the requirement that the auditor report directly to the supervisory board. The overall goal of the Tabaksblat Code can be seen as having the right 'checks' and 'balances' within a corporation, whereby the powers of the management board, supervisory board, and GMS have been carefully balanced, together with the role of the external auditor as independent financial monitor. The right 'checks' and 'balances' are expected to lead to transparency.

The structure of the Tabaksblat Code (Appendix A) – in particular its principles – reflects the main elements of the Code. These elements together constitute the institution 'corporate governance' or 'good governance', in which the representation by means of symbolic/linguistic actions (namely, communication) plays a decisive role.

The first principle includes the 'comply or explain' rule. The second principle concerns the management board, and is divided into:

- (1) Role and procedure;
- (2) Remuneration; and

- (3) Conflicts of interest.

The largest section concerns the supervisory board, and consists of:

- (1) Role and procedure;
- (2) Independence;
- (3) Expertise and composition;
- (4) Role of chairman and company secretary;
- (5) Composition of board's committees (audit committee, remuneration committee, and selection and appointment committee);
- (6) Conflicts of interest;
- (7) Remuneration; and
- (8) One-tier board structure.

The fourth section consists of the rules concerning the general meeting of shareholders, including:

- (1) Powers;
- (2) Depositary receipts for shares;
- (3) Information for GMS; and
- (4) Institutional investors' responsibility.

Finally, the last section concerns the financial report audit and the position of the internal and external auditors. This section includes:

- (1) Financial reporting;
- (2) Role, appointment, remuneration, and assessment of external auditor's functioning;
- (3) Position of internal auditor; and
- (4) Relationship and communication between external auditor and company organs.

The next sections include the Tabaksblat Code's key elements represented by the powers of the supervisory board (4.4.1), GMS (4.4.2), and management board (4.4.3); followed by the external auditor's role and remuneration (4.4.4).

4.4.1 Supervisory board

The Tabaksblat Committee based the Code on Dutch law, which requires that certain companies in the Netherlands have to install a two-tier board structure. The supervisory board is a logical consequence of this structure, and thus also a feature of the Dutch corporate governance system (cf. 3.5.1). The supervisory board plays a key role within corporate governance as corporate governance is about controlling power, which is the task of the supervisory board. The Code, in fact, places increased responsibility on the supervisory board. One consequence of this is that a supervisory board member may hold a maximum of five supervisory board memberships in other listed companies, while chairmanship of a supervisory board counts double (III.3.4). The reason for this best practice provision is that the financial and accounting scandals have shown the services of supervisory board members to be particularly necessary in times of crisis, and these demand a member's full attention. Following on from this, the Code also no longer tolerates the frequent absence of supervisory board members (III.1.5).

Restrictions on the number of supervisory board memberships are becoming the norm in international practice, including in the United States. In addition, the Tabaksblat Committee states that there is a wide gap between how the general public and investors in the Netherlands perceive supervisory board members and how most supervisory board members see themselves; i.e. as:

Dedicated experts who give the company the benefit of their vast experience and feel perfectly capable of deciding for themselves how many supervisory memberships they can handle. (Tabaksblat Code 2003, p. 51)

Supervision

The supervisory board holds the controlling power, which means that it should supervise the management's activities. This involves supervision of the following elements:

- Achievement of the company's objectives;
- Corporate strategy and the risks inherent in the business activities;
- The structure and operation of the internal risk management and control systems;
- The financial reporting process;
- Compliance with legislation and regulations. (Tabaksblat Code 2003, III.1.6)

The supervisory board is dependent on the management board and the external auditor in fulfilling its supervision tasks, as it needs to receive all required information from both the management and the external auditor. However, the supervisory board itself is also responsible for obtaining this information.

As stated above, an important change with respect to the old situation is that the frequent absence of supervisory board members will no longer be accepted (III.1.5).

Expertise

Since the supervisory board has become more important, the competences, skills, and experience of its members have become more important as well. The required expertise is described as follows:

Each supervisory board member shall be capable of assessing the broad outline of the overall policy. Each supervisory board member shall have the specific expertise required for the fulfilment of the duties assigned to the role designated to him within the framework of the supervisory board profile. The composition of the supervisory board shall be such that it is able to carry out its duties properly. A supervisory board member shall be reappointed only after careful consideration. The profile criteria referred to above shall also be fulfilled in the case of a reappointment. (Tabaksblat Code 2003, Principle III.3: Expertise and composition)

But expertise alone is not enough; new supervisory board members have to follow a special program, described as follows:

After their appointment, all supervisory board members shall follow an induction programme, which, in any event, covers general financial and legal affairs, financial reporting by the company, any specific aspects that are unique to the company and its business activities, and the responsibilities of a supervisory board member. (Tabaksblat Code 2003, III.3.3)

The expertise requirement further includes that the supervisory board should have at least one financial expert (III.3.2), which is a logical consequence of the fact that the supervision tasks mentioned above revolve around financial elements.

Independence

Naturally, the independence of the supervisory board members is highly important. The Code indicates that each member must act critically and independently of one another, of the management board, and of any particular interests (III.2). It also states that, with the exception of not more than one person, all members should be independent¹⁷. The criteria for independence stipulate that the member may not:

- (1) have been an employee or member of the management board of the company in the five years prior to the appointment;
- (2) have temporarily managed the company in the year prior to the appointment;
- (3) have been an advisor or an employee of a bank related to the company in the year prior to the appointment;

¹⁷ The independence rules concern not only the supervisory board member but also his/her wife/husband, registered partner or other life companion, foster child or relative by blood or marriage up to the second degree.

- (4) receive any compensation from the company other than on behalf of the supervisory board membership;
- (5) be a member of the management board of a company in which a management board member of the company which he supervises is a supervisory board member (in order to prevent the “old boys network” influence);
- (6) hold 10% or more of the company’s shares, or be a member of the management or supervisory board of a legal entity (not being a member of the same company group) which holds 10% or more of the company’s shares (III.2.2.).

Although the supervisory board plays a key role within corporate governance, its duties are somewhat paradoxical, because its main task involves supervising the management, but at the same time it should advise the management as follows:

The role of the supervisory board is to supervise the policies of the management board and the general affairs of the company and its affiliated enterprise, as well as to assist the management board by providing advice. (Tabaksblat Code 2003, III.1, p.15)

The Code requires the supervisory board, in exercising its tasks, to be guided by the interests of the company and its affiliated enterprise.

Performance assessment

Although the supervisory board plays a significant role, it is “responsible for the quality of its own performance” (III.1) by means of an annual self-assessment. This assessment concerns the supervisory board’s and the individual members’ performance and functioning as well as the desired profile, composition, and members’ competences (III.1.7). Further, the supervisory board shall discuss the corporate strategy, the business risks, and the results of the management board’s assessment of its tasks (III.1.8).

The supervisory board report, which should be included in the annual report, could be seen as an indirect accountability statement for the board’s performance. This is enhanced by the obligatory disclosure in the report of personal information on each supervisory board member (e.g. gender, age, profession, principal position, nationality).

The chairman of the supervisory board

The chairman of the supervisory board has specific duties that support the appropriate functioning of the supervisory board. These tasks vary from determining the board’s agenda to arranging for adequate information provision to the members; from ensuring that there is sufficient time to make decisions, to acting on behalf of the supervisory board as the main contact for the management board (III.4).

The supervisory board’s committees

If the supervisory board consists of more than four members, it should appoint from among its members an audit committee, a remuneration committee, and a selection and appointment committee (III.5). The supervisory board determines the committees’ tasks, and reports on how these have been exercised in its report included in the annual report. The main duty of the three committees is to lay the groundwork for the decision-making of the supervisory board (Principle III.5).

The audit committee has at least one member who is a financial expert. The committee’s tasks represent the core supervision tasks of the supervisory board, which are much more extended than in II.1.6 as mentioned above. Namely, they include:

- The operation of the internal risk management and control systems, including supervision of the enforcement of the relevant legislation and regulations, and supervision of the operation of codes of conduct;
- The provision of financial information by the company;
- Compliance with recommendations and observations of internal and external auditors;
- The role and functioning of the internal audit department;

- The company's policy on tax planning;
- Relations with the external auditor, including, in particular, his independence, remuneration, and any non-audit services for the company;
- The financing of the company;
- The applications of ICT. (Tabaksblat Code 2003, III.5.4)

One of the main consequences of the financial and accounting scandals was that the new regulations focused on the importance of internal control systems, financial disclosure, and internal risk management. The abovementioned audit committee tasks reflect these key issues, and it could therefore be stated that the audit committee has to fulfill the core duties of the supervisory board. Further, the audit committee is the central point with regard to the financial auditing process, the external auditor, and the internal audit department (III.5.5). Best practice provision III.5.8 stresses the importance of the relationship between the committee and the external auditor, including that the committee shall meet the external auditor at least once a year without the management board members being present.

The remuneration committee has many duties (cf. III.5.10), but one of its main tasks is to draft a proposal to the supervisory board for the remuneration policy to be pursued, in particular the remuneration of the individual members of the management board. The committee is also responsible for preparing the remuneration report.

The duties of the selection and appointment committee are laid down in best practice provision III.5.13, the main task being to draw up selection criteria and appointment procedures for supervisory board and management board members. Further, the committee assesses the functioning of the individual supervisory and management board members, and reports on this to the supervisory board.

4.4.2 The powers of the General Meeting of Shareholders

Section 3.5.3 showed that, throughout Dutch history, the power of management has been much stronger than that of the shareholders. In the 1990s, the government decided that the power in the hands of a small group, the management, should be decreased in favor of the shareholders. However, companies simply did not comply with the Peters Committee recommendations. The failure of these recommendations and the accounting scandals around 2000 gave rise to the need for a new and better corporate governance code. The resulting Tabaksblat Committee stressed the importance of increased shareholders' powers, and its Code requires that the management board be accountable, in the first instance, to the shareholders. The shareholders therefore hold the top position in the hierarchy of a listed company. Cools (2007) points out that shareholders are not more important than other stakeholders, but their special position within the corporate governance discussion and codes reflects the fact that the rights and obligations of all stakeholders except the shareholders have been laid down in detail. Their only legal obligation is to provide capital, but they have no right on returns. Cools states, therefore, that shareholders should have other means of forcing management to provide them with a reasonable return on their investments. Within Searle's theory of institutions, the fact that Cools holds the view that the shareholders are not more important than other stakeholders has consequences for perspective. It means that the collective assignment of status function – the collective acceptance – becomes problematic if the constitutive rules of 'good governance' include detailed requirements with respect to the overall stakeholders; thus, the constitutive rules do not include detailed requirements concerning the shareholders. Cools's view, consequently, questions the collective acceptance of the constitutive rules included in the Tabaksblat Code. If there is no collective acceptance, the institution 'good governance' has not been constituted.

We saw in section 3.5.3 that the Dutch corporate governance system is a stakeholder system in which the shareholders are just one of several stakeholder parties, whereby the stakeholders as a whole are defined as “the group and individuals who directly or indirectly influence or are influenced by the achievement of the aims of the company” (Tabaksblat Code 2003, Preamble 3). This implies that the shareholders may play an active and/or a passive role within the company concerned, which in turn implies that shareholders might attempt to claim more than their securities at issuance entitle them to. The Tabaksblat Code aims to strengthen the position of the shareholders, as they are regarded to be the “owners” of the company. This is in contrast with the US view of shareholders (cf. 3.4.2): The American corporate governance system is a shareholder system in which the shareholders are regarded to be creditors who look out for their own interests and negotiate their relationship with the company concerned. The US shareholder is assumed to enter into the contract with full knowledge of what he/she has acquired.

The Committee starts with a call for a strong commitment by the shareholders with regard to their presence at and decision-making in the GMS. The Code stresses that shareholders should vote in any event, whether in person or by proxy.

The rights of the shareholders are described in the second part of Principle IV.1¹⁸, namely that the GMS should be able to influence the policy of the management and supervisory boards in order to fulfill its duties with regard to the checks and balances within the company. In addition, the GMS should approve any management decision on a major change in the identity or character of the company. The shareholders may, for example:

Pass a resolution to cancel the binding nature of a nomination for the appointment of a member of the management board or of the supervisory board and/or a resolution to dismiss a member of the management board or of the supervisory board by an absolute majority of the votes cast. (Tabaksblat Code 2003, IV.1.1)

Further, the GMS should vote separately on “resolutions to approve the policy of the management board [...] and to approve the supervision exercised by the supervisory board” (IV.1.6).

A separate principle (IV.3) is devoted to the information provision to the GMS. Both the supervisory and management boards are obliged to inform the GMS with all requested information, unless that information is contrary to an “overriding interest” of the company (in which case, the boards must provide a reasoned explanation; IV.3.5). Price-sensitive information that could emerge at the GMS is to be made public as soon as possible.

Another principle includes the rules with regard to depositary receipts for shares. This principle is in line with the first principle, on the required presence of shareholders at the GMS and the exercise of their voting rights:

Depositary receipts for shares are a means of preventing a (chance) minority of shareholders from controlling the decision-making process as a result of absenteeism at the general meeting of shareholders. (Tabaksblat Code 2003, IV.2)

The proxies shall be issued by the management of the trust office in all circumstances and, therefore, should not be used as antitakeover measures. The management of the office shall operate independently of the company concerned (IV.2.1), and shall be present at the GMS and may (“if desired”) make a statement about how it proposes to vote (IV.2.4).

¹⁸ The first part of Principle IV.1 states: “Good corporate governance requires the fully-fledged participation of shareholders in the decision-making in the general meeting of shareholders. It is in the interest of the company that as many shareholders as possible take part in the decision-making in the general meeting of shareholders. The company shall, in so far as possible, give shareholders the opportunity to vote by proxy and to communicate with all other shareholders.”

The last principle (IV.4) with regard to the shareholders concerns institutional investors. The first part focuses on the duties of the institutional investors, as they are required to act:

primarily in the interests of and have responsibility to the ultimate beneficiaries or investors and the companies in which they invest, to decide, in a careful and transparent way, whether they wish to exercise their rights as shareholder of listed companies.

Thus, institutional investors should not exercise their rights, but may consider doing so. This is in contrast with the previously described appeal for commitment, namely for shareholders to be present at the GMS and to exercise the voting rights of the (apparently) non-institutional investors. It is possible that this rule could be regarded as an attempt to ‘voluntarily’ restrict institutional investors’ powers.

The second part of the principle includes an interesting element, in that the institutional investors in particular are required to enter into a dialogue with the company if they find the company’s explanation of non-compliance with a best practice provision to be unacceptable. The institutional investors should take into consideration that the Tabaksblat Code is not a one-size-fits-all solution, and that (perhaps very acceptable) deviations from best practice provisions are likely to arise. This is described as follows:

The guiding principle in this connection is the recognition that corporate governance requires a tailor-made approach and that it is perfectly possible for a company to justify instances of non-application of individual provisions. (Tabaksblat Code 2003, IV.4)

4.4.3 Management board

The Tabaksblat Code is based on the two-tier Dutch corporate governance system, in which a separate supervisory board exists alongside the management board (cf. 3.5.1). Companies that are not legally bound to adhere to these rules may opt for the one-tier board management structure, in which a single board contains both executive and supervisory (non-executive) directors. In the case of the latter, Principle III.8 states that the executive directors are responsible for the day-to-day running of the company, while the non-executive directors carry out their supervision tasks properly and independently.

Management manages the company

The management board’s task, in general, is to manage the company. Among other things, this means:

that it is responsible for achieving the company’s aims, strategy and policy, and results. [...] the management board is responsible for complying with all relevant legislation and regulations, for managing the risks associated with the company activities and for financing the company. (Tabaksblat Code 2003, II.1)

This quotation shows that some of the main tasks of the management board are managing the risks “associated with the company activities and [...] financing the company”. In order to fulfill its duties, the management board needs an internal risk management and control system, the adequacy and effectiveness of which the board has to declare in the annual report (II.1.4). Also in the annual report, the board should describe any significant changes that have been made and major improvements planned, and confirm that these changes or improvements have been discussed with the audit committee and the supervisory board. However, the Monitoring Committee pointed out in its 2005 report that II.1.4 is unclear for many companies (cf. 4.5.2).

The instruments of the internal risk management and control systems should include:

- Risk analyses of the operational and financial objectives of the company;
- A code of conduct;

- Guidelines for the layout of and procedures to be followed in drawing up financial reports;
- A system of monitoring and reporting. (Tabaksblat Code 2003, II.1.3)

In exercising its duties, the management board should take into consideration the interests of the company, its affiliated enterprise, and the stakeholders. Moreover, management is accountable for its tasks to the GMS (II.1).

Relationship between management and supervisory boards

A close relationship exists between the supervisory and management boards. The supervisory board monitors the management board, and the management should provide the supervisory board with all information necessary for the supervisory board to exercise its monitoring task properly. Further, the management board should not only report to but also discuss any developments regarding the internal risk management and control systems with the supervisory board and the audit committee. The performance of the management board as a whole as well as its individual members is assessed by the supervisory board. Finally, the management board may ask the supervisory board for advice.

Conflicts of interest

To prevent conflicts of interest, management board members may be neither a member of the supervisory board of more than two listed companies, nor the chairman of the supervisory board of a listed company. There is one exception to this rule: a supervisory board membership of another company within the group to which the company belongs is permitted. This is quite remarkable, because it could be expected that the danger of a conflict of interest would be higher if a management board member in one company simultaneously holds a supervisory position in another company from the same group, as opposed to an ‘outside’ company. Principle II.2, on conflicts of interest between the company and management board members, does not cover the management–supervision task of a management board member within the company group. Instead, it emphasizes financial conflicts of interest, for example certain transactions which need the approval of the supervisory board if they could be of “material significance to the company and/or to the relevant management board member”. The supervisory board decides on whether a transaction is of material significance or not (II.3.2)¹⁹.

4.4.4 External auditor

The Code includes two principles and a number of best practice provisions with respect to the external auditor. The first principle concerns the fact that the management board and the audit committee advise the supervisory board on the nomination of the external auditor. The supervisory board nominates the candidate, and the GMS appoints the external auditor. On the one hand, it could be concluded that this rather complex formal procedure would prevent any conflicts of interest or non-independence regarding the auditor since all main parties (the management board, the supervisory board, and the GMS) are required to play a role. On the other hand, however, it could also indicate that no party is in fact accountable.

A similar procedure (but one that does not involve the GMS) has to be followed with respect to the remuneration of and non-audit services provided by the external auditor.

¹⁹ A transaction of material significance has been defined (II.3.2) as a transaction that concerns a legal entity “(i) in which a management board member personally has a material financial interest; (ii) which has a management board member who has a relationship under family law with a management board member of the company, or (iii) in which a management board member of the company has a management or supervisory position” (II.3.2).

According to this procedure, the management board advises the audit committee and the supervisory board gives its approval.

The importance of the relationship between the external auditor on the one hand and the supervisory board and the audit committee on the other hand is reiterated by the fact that the board and the committee assess the functioning of the auditor at least once every four years (V.2.3). The management board and audit committee also report their dealings with the auditor to the supervisory board every year (V.2.2). These findings then form the basis for the nomination and appointment of the external auditor.

The second principle concerns the external auditor's relationship with the other important company bodies, described as follows:

The external auditor shall, in any event, attend the meeting of the supervisory board, at which the annual accounts are to be adopted or approved. The external auditor shall report his findings in relation to the audit of the annual accounts to the management board and the supervisory board simultaneously. (Tabaksblat Code 2003, V.4)

This indicates that the external auditor plays a significant role in the audit, and the findings are provided to the management and supervisory boards.

4.4.5 Remuneration

The remuneration of the management board – including high bonuses in particular, as well as enormous severance payments – was a controversial matter in the accounting scandals around 2000. Sub chapter 3.2 showed that Agency Theory sees the right remuneration for management as very important as a means of controlling the conflicts between the agents and the principals. The ‘right’ remuneration should consist of a fixed and a variable part in order to attract the best managers. Section 3.4.2, however, pointed out that the huge management remuneration, and in particular the remuneration in stock options and shares, turned out to be the main cause of the accounting scandals. The US tax law amendments in the early 1990s restricted corporate deductibility of high cash compensation and, as a consequence, the cash-based system changed into an equity-based system. Further, institutional investors pushed companies to use equity-based remuneration, and thus variable remuneration too, because it would be in the interests of both the investors and the management to achieve the highest share prices. Shareholder value maximization became the most important goal. The stock option remuneration in combination with very tough targets was thus the main reason for the total collapse at the turn of the century.

Although equity-based remuneration was also used in European companies, the compensation was not as excessively high as in the US. However, the Tabaksblat Committee still felt the need to regulate the ‘right’ remuneration for Dutch managers.

The first remuneration requirement included in the Code concerns the amount and structure of the remuneration, which should be such that qualified and expert managers can be recruited and retained (II.2). This compensation seems to be relative, whereby the comparable factors are unknown. It could be presumed that managers will receive remuneration comparable to that of other managers working under the same conditions. This remuneration may contain variable and non-variable components, but this is not a mandatory requirement. The fixed remuneration is to be determined by the supervisory board, based on a proposal by the remuneration committee and within the scope of the remuneration policy adopted by the GMS (II: Determination and Disclosure of Remuneration). Variable remuneration should be “linked to previously-determined, measurable and influencable targets, which must be achieved partly in the short term and partly in the long term” (II.2). The Tabaksblat Committee has clearly tried to impede only short-term targets, which could be seen in the light of stock

option compensation. This probably explains why the variable remuneration has to be clarified in the remuneration report (II.2.12).

The Tabaksblat Committee further described the remuneration structure, which, among other things, should prevent opportunistic behavior by management board members:

The remuneration structure, including severance pay, is such that it promotes the interests of the company in the medium and long term, does not encourage management board members to act in their own interests and neglect the interests of the company and does not ‘reward’ failing board members upon termination of their employment. (Tabaksblat Code 2003, II.2)

This quotation refers to medium- and long-term interests, whereas the variable payments depend partly on short-term and partly on long-term targets. The short-term targets, however, could lead to opportunistic behavior by management board members, which the Tabaksblat Committee wanted to prevent.

The next part of the principle focuses on share price performance, which could be seen as a focus on shareholder value and thus related to short-term strategies, stock option remuneration, and consequently possible opportunism that jeopardizes the company’s long-term interests:

The level and structure of remuneration shall be determined in the light of, among other things, the share price performance and other developments relevant to the company.

The Tabaksblat Committee, however, has tried to regulate the company shares held by management. For example, the company may only grant conditional shares that become unconditional when management board members have fulfilled predetermined performance criteria after a period of at least three years from the grant date, and the number of shares to be granted shall depend on the achievement of pre-specified, clearly quantifiable, and challenging targets. The remuneration report describes the performance criteria, including an explanation of the chosen performance criteria, a summary of the methods to determine whether these criteria have been met, and an explanation for the choice of methods (II.2.10). This best practice provision also indicates that the performance criteria are based on a comparison with external factors (i.e. a peer group). With regard to options, the Code requires that the option exercise price shall not be fixed at a level lower than a verifiable price in accordance with the official listing on one or more predetermined days during a period of not more than five trading days prior to and including the day on which the option is granted. The supervisory board plays an important role here, as it should draw up regulations with regard to securities ownership or transaction in securities of other companies by management board members.

The following rule concerning severance payment is one of the most well-known Tabaksblat Code requirements, yet at the same time one that most companies deviate from:

The amount of compensation which a management board member may receive on termination of his employment may not exceed one year’s salary, unless this would be manifestly unreasonable in the circumstances. (Tabaksblat Code 2003, II.2.2)

The Committee explains “the circumstances” as follows:

If the maximum of one year’s salary would be manifestly unreasonable for a management board member who is dismissed during his first time of office, such board member shall be eligible for a severance pay not exceeding twice the annual salary. (Tabaksblat Code 2003, II.2.7)

This explanation, however, remains vague, because it is unclear who decides what is “manifestly unreasonable”.

The GMS plays an important role with respect to remuneration matters, since it adopts the remuneration policy (included in the remuneration report) and variable payment schemes (Principle II.2 and Determination and Disclosure of Remuneration). It also determines the remuneration for supervisory board members (which is not dependent on the company’s results; Principle III.7).

Finally, the remuneration structure is to be described in the annual accounts.

4.5 The effects of the Tabaksblat Code 2003–2007

The introduction of the Tabaksblat Code has naturally given rise to certain effects; for example, the legal embedding of the ‘comply or explain’ rule has led to a great deal of criticism. The yearly reports of the Corporate Governance Code Monitoring Committee reflect the suboptimal compliance rates on ‘controversial’ rules, in particular that the severance payment should not exceed one year’s salary and regarding the independence of supervisory board members. The reports also include issues that the Committee wants to emphasize or investigate further.

4.5.1 Legal status

As stated earlier, the Tabaksblat Code is a principle-based code, which means that it is based on principles and best practice provisions. Compliance with the rules is mandatory, but at the same time no law exists to enforce compliance. Only the ‘comply or explain’ rule has a legal basis, making it an essential rule of and part of the Dutch institution ‘good governance’. Since an institution is a system of constitutive rules (cf. 1.1), compliance with the constitutive ‘comply or explain’ rule and the other constitutive rules in the Code will lead to formal transparency. If this transparency has been achieved, the institution ‘good governance’ will have been collectively accepted and thus constituted. The ‘comply or explain’ rule, however, indicates that companies are allowed to choose whether to comply with or to deviate from certain Code rules (in which case, they must explain their reasons for deviation). If more ‘explain’ and less ‘comply’ is allowed, this will lead to more or less transparency respectively. The ‘comply or explain’ rule thus entails that the ‘game’ of corporate governance in the Netherlands can be described as an ‘open game’.

The fact that only the ‘comply or explain’ rule is legally embedded has led to a great deal of criticism, in particular by lawyers. Bartman (2004) is one of these, and he states that the Code has no legal force because it was drawn up by the Tabaksblat Committee, which is neither a governmental institution nor a public body with legislation authority. He concludes, therefore, that the Code can only be considered the result of a private initiative. Although the ‘comply or explain’ rule is covered by the Civil Code and the GMS has the highest authority with regard to compliance with the Tabaksblat Code, Bartman indicates that the GMS could decide to deviate from the Code without giving arguments to explain that deviation. Winter (2003), however, stresses the fact that the Committee refers to the principles as modern, generally accepted norms of good corporate governance. This could be seen as a reference to the term “reasonableness and fairness” used by the legislator in order to provide judges with the authority to weigh matters up extensively, but Bartman (2004) and Raaijmakers (2002) do not agree on this. Winter states that if the management board promises to comply with a best practice provision, the shareholders are entitled to expect it to do so.

Raaijmakers (2002) criticizes the position of the GMS, since the Code calls on the institutional investors to become more active. Further, Raaijmakers states that the GMS does not have a genuine “monitoring” task concerning compliance with the Code, because the Code only indicates that there should be a “dialogue” between the GMS and the management and supervisory boards. Winter (2003), however, points out the authorities of the GMS, namely:

- (1) They may speak up with regard to the way the company complies with the Code;

- (2) They may make a decision with regard to approval or refusal an agenda item (supported by Civil Code, art. 2:114a);
- (3) They may refuse to discharge the board of management and the supervisory board;
- (4) They may influence the remuneration policy (Civil Code, art. 2:135);
- (5) They may sell their shares.

Winter (2003) holds the opinion that the legal force of the Tabaksblat Code lies in (1) the procedures concerning the cancelling of decisions; (2) the procedures on determining accountability; and (3) the inquiry procedures. The authorities of the corporate bodies are primarily laid down in the Civil Code and the rules of procedure. Bartman's (2004) view is that the principles and best practice provisions could only amend the law and the rules of procedure.

Another critical point is the introduction of the report of the supervisory board alongside the management report. Raaijmakers (2002) points out that this rule does not clarify whether the auditor should assess the report, or how the GMS should deal with it.

Winter (2003), however, is a member of the European High Level Group, and is positive about the Code's 'comply or explain' rule, which he sees as uniting the public's need for regulation and the companies' need for flexibility.

4.5.2 Corporate Governance Code Monitoring Committee reports

The Corporate Governance Code Monitoring Committee has been established in order to monitor compliance with the Code (cf. 4.2.2). Its yearly reports include conclusions about the compliance rate, the deviations and explanations for them, and recommendations on specific topics to which the Committee wants to draw attention. This section starts with an overview of the main content elements of each of the reports, followed by an overview per report of the 'hot' topics, namely remuneration, internal risk management and control systems, the role of the external auditor, and the role of the supervisory board.

2005 report

The Monitoring Committee's first report was published in 2005 concerning the first financial year (2004) in which companies had to comply with the Code. The Committee was satisfied with the average of 88% compliance rate with the provisions. However, it criticized the fact that a quarter of the surveyed companies provided no information about antitakeover measures, and no explanation for this omission. A second critical point concerned the low compliance rate of trust offices in particular, as well as institutional investors.

2006 report

In its 2006 report, the Committee observed an improvement in compliance (96% in 2005 compared to 88% in 2004), but emphasized strongly that compliance should be 100%. The Committee concluded that 85% of the explanations of the deviations could be classified as *understandable*, and 47% as *verifiable*. It stressed that any explanation given should be sound, i.e. both understandable and verifiable.

The Committee regarded the 56% attendance rate at the GMS (which was as low as the 2004 rate) to be insufficient, because it allows shareholders who do attend to influence the course of the meeting "disproportionately". The 2006 report did show improvements with regard to the issues of depositary receipts for shares – because most trust offices were granting voting proxies without limitations – and antitakeover measures. However, the institutional investors still had a low compliance rate (30%).

The Committee emphasized that the role of the external auditor is to identify deficiencies, not to check or verify the internal risk management and control systems. In the

case of serious deficiencies, which should be included in the auditor's report to the supervisory board, the auditor should check whether these deficiencies are also included in the annual report. If not, the auditor should mention the deficiencies in his own report.

2007 report

The 2007 report indicated that compliance with the Code seemed to have stabilized at 95%. The Committee again emphasized that compliance should be 100%, because all parties are responsible for ensuring that the Code remains an effective alternative to legislation. Compliance with the best practice provisions on remuneration was still low, and thus comparable to the previous years. The Committee therefore called for better compliance with these provisions. The 2006 report had already showed some convergence with regard to the explanations for deviation from best practice provisions. In the 2007 report, the Committee referred to a comparable, even more far-reaching, and undesirable development of standardization with respect to the explanations for deviations from rules. It had turned out to be common for companies to use rules of their own instead of adhering to the Code's rules. The Committee stated that companies should motivate and clarify these actions. The average GMS attendance was 57%, which was higher than in 2005. As of January 1, 2007 the use of electronic means (proxy voting) would be legally embedded, and therefore the Committee expected increased attendance.

Also a striking element in the 2007 report, besides the recommendations with regard to the remuneration process and structure, is the diversity in the supervisory boards (see 'Supervisory board' section).

Specific topics – Remuneration

2005 report

Most companies did not comply with Provision II.2, about the level of remuneration for management board members. This provision stipulates that the remuneration should be such that qualified and expert managers can be recruited and retained, but does not provide additional information concerning this level. The Committee held the view that because there is a strong international market in the Netherlands, the introduction of a national criterion would not be effective "in this environment". It further stated that the reporting on actual remuneration should be simpler and more uniform, and advised companies to consult other companies and stakeholders on this matter.

The Committee indicated that, according to the Code, the supervisory board should explicitly report on the effectiveness of the company's remuneration policy and, to this end, make clear the relationship between remuneration and performance both before and after the fiscal year concerned. The Committee very clearly interpreted the term "performance" as "the contribution to long-term value creation by the enterprise" (2005 Monitoring Committee report, p. 6). Further, in order to perform its duties well, the remuneration committee should be assisted by a remuneration expert, who follows the committee's instructions in exercising his tasks.

The structure of the remuneration, in particular the variable part, was another important element. The Committee held the view that the remuneration report should include the following information about the variable remuneration:

- (1) The maximum variable remuneration, for example, as a percentage of the fixed income;
- (2) What part is linked to measurable quantitative performance criteria and targets, and what part is determined at the discretion of the supervisory board;
- (3) A description of the measurable quantitative performance criteria insofar as their disclosure would not harm the firm's competitive position.

Although the last element is very reasonable, it could also provide an ideal reason for companies not to comply with this provision.

The Committee referred to a development towards more option and share plans, and stressed that these plans only may be granted if clearly quantifiable and challenging targets, specified beforehand, have been achieved, and these targets should be directly related to the creation of long-term value for shareholders.

2006 report

The Committee again stressed that the remuneration policy should be transparent and uniform. It emphasized that this is the supervisory board's responsibility, whose task is to

Monitor the complexity of remuneration contracts. (2006 Monitoring Committee report, p. 6)

The remuneration policy for the next financial year should be covered in a separate section of the annual accounts. The Committee pointed out that the relationship between remuneration and performance should be made clear *ex ante* and *ex post*.

2007 report

The Committee had asked the University of Groningen and Towers Perrin to conduct a study²⁰ on the relationship between remuneration and performance. The Committee emphasized that self-regulation is a better instrument for determining the level and structure of remuneration than legislation, but:

Self-regulation can be a serious alternative for legislation only if everyone makes an effort to comply with the code: in other words, self-regulation requires self-discipline. (2007 Monitoring Committee report, p. 8)

The Committee provided new recommendations for the supervisory board's remuneration, concerning the fact that the remuneration committee and the remuneration advisor should be independent. In addition, it described enhanced supervisory board activities with regard to remuneration.

Further, the Committee recommended that best practice provision II.2.7, including severance payments in the case of dismissal, should be extended to include all reasons for termination of employment. It also indicated that the main elements – including severance payments – of the agreement reached with the management board member be disclosed immediately (II.2.11). Severance payments should be in accordance with the company's remuneration policy, and the remuneration committee should clarify the severance payments in its report. Finally, the conditions of the 'change of control' clauses in management contracts should be disclosed, and any related payments should be based on a rule in the remuneration policy.

The remuneration report should describe and explain the performance criteria. The relationship between the remuneration and performance criteria on the one hand, and the strategy goals maintained on the other, should be visible in the remuneration report. And finally, the performance criteria should be highly ambitious, and thus also concrete, quantified, and specific.

²⁰ The conclusions to the study included the following: The amount of the remuneration of Dutch managers is comparable to the remuneration of their counterparts in other European countries; a significant increase of the total amount of remuneration between 2002–2006 could be observed, which was considered to be a European development; companies themselves were growing as well; and the remuneration of CEOs seems to be increasing more strongly than that of other management board members.

Specific topics – Internal risk management and control systems

2005 report

Many companies did not comply with best practice provisions II.1.4 and argued that they needed more guidance²¹. The Committee defined “reasonable assurance” as a degree of certainty that would be satisfactory for a prudent manager in the management of his affairs in the given circumstances. Unfortunately, it did not provide further clarifications of “a prudent manager” or “given circumstances”.

2006 report

Compliance with II.1.4 had strongly improved. However, the Committee criticized the fact that few companies had quantified the risk factors identified, and stressed the importance of doing so.

The framework for internal risk management had led to some confusion with respect to the relationship between II.1.4 and the comparable provisions abroad (SOX404). The Committee stressed that the present system should be and remain principle-based, but at the same time, it stated that:

Where the SOX provision on internal control and reporting in relation thereto is applied in full, the Committee considers that this meets the Dutch requirements in respect of the internal control objective and financial reporting. (2006 Monitoring Committee report, p. 63)

This is quite remarkable, first because the rule-based regulation of the SOX apparently sufficiently meets the principle-based Tabaksblat Code regulation. Second, US listed companies have to use Form 20-F in order to comply with the SOX rules. This means that compliance with the internal control rules of the SOX is to be checked by the Monitoring Committee in the relevant Forms 20-F. However, it might seem more logical for the Committee to adopt a rule stipulating that a reference be made in the Dutch annual report with respect to the company’s SOX404 compliance in Form 20-F.

2007 report

Compliance with II.1.4 had improved slightly, and the Committee provided recommendations with respect to the description of the risk profile and the internal risk management and control system²². The latter description should show which actions the company has taken to control the identified risks. These actions concern not only the system itself but also its implementation within the organization.

Cools (2007) points out that employees, investors, and clients in Europe are very vulnerable to unreasonably high top-level salaries that lack any relationship with management performance. This can give rise to a feeling of unfairness, which undoubtedly leads to negative consequences for the company’s performance, and in turn, the investors’

²¹ The Committee provided the following clarifications: (1) Financial reporting risks – a. It is declared that the risk management and control systems provide reasonable assurance that the financial reporting does not contain any material inaccuracies; b. That the systems have worked properly in the year under review and that there are no indications that they will not work properly in the current year; and c. That any material weakness which is discovered in the year under review or the current year is specified, together with any changes made or improvements planned; (2) Other risks – a. A description of the risk management and control systems is given on the basis of the identified important risks and if applicable, important failings which are discovered in the year under review are specified, together with any changes made or improvements planned.

²² The description should include: (1) Identification of the main risks related to the strategic company goals and the attitude with regard to these risks (“risk appetite”); (2) Description of the qualitative impact of the company’s main strategic, operational, financial, legislative and regulatory, and financial reporting risks; (3) The sensitivity analysis of the identified risks.

dissatisfaction leads to decreased exchange rates. The Tabaksblat Code's remuneration provisions should lead to transparency in top salaries, but unfortunately, this transparency has negative side-effects in that the benchmark lists have the effect of continuously driving salaries upwards.

Specific topics – The external auditor

2006 report

The Dutch Civil Code (Article 2:393, paragraph 4) requires the external auditor to report on the audit of the annual accounts to the supervisory and management boards. Best practice provision V.4.3 contains a similar requirement. The Committee and the external auditors held the view that the auditor should identify deficiencies, but should not check or verify the internal risk management and control system.

Specific topics – The supervisory board

2007 report

The Monitoring Committee stressed that diversity in the composition of the supervisory board is a means of achieving independence. The Committee therefore recommended diversity, distinguishing the five dimensions of gender, nationality, age, expertise, and social background. The most important dimension seems to be gender, as the Committee appeared to (indirectly) presume that women have a different view of business than men. Although the Committee emphasized that it would be in the interest of companies to attract women for top positions, it did not want to decide on a quota for the number of women on supervisory boards. The age dimension was brought up because the average age was in fact 62.

To increase diversity, the Committee recommended that the selection and appointment committee should take the Committee's diversity policy into account (III.5.13), and pursue a more open process of recruiting candidates from outside the existing networks. And finally, it recommended that companies give management board members and employees more scope to accept supervisory board memberships with other companies, "provided this does not conflict with their own interests as employer" (2007 Monitoring Committee report, p. 13). This can be considered a rather striking recommendation, because the Code has restricted the number of supervisory board memberships per supervisory board member in order to foster higher quality (more time per member per company) and fewer "old boys network" effects.

4.5.3 Stakeholder system – shareholder system

The Tabaksblat Committee wanted to impede the effects of the "old boys network", and Heemskerk (2007) concludes that it has succeeded, although the development towards a less cohesive network in fact started earlier. Instead of the "social interaction network" of the corporate elite, an informal network remains in place. This, according to Heemskerk, is the consequence of the fact that "Notions of transparency and accountability are difficult to reconcile with the use of social networks that transcend the eye of the public and the media" (2007, p. 128). Heemskerk concludes that there are three causes for the formalization of governance, which leads to the "codification of formerly informal common norms" that had always characterized the "old boys network". First, the internationalization of corporate boards gives rise to memberships of foreign directors with no special interest either in the Netherlands or the Dutch business community. Second, the shorter tenure of executives leads to decreased commitment to the company and colleagues, from which one can draw the

conclusion that outsiders are helpful in times of crisis, but for long-term performance executives need “firm-based knowledge and social capital”. And finally, increased accountability and risks also serve to formalize governance.

Heemskerk links the decline of the directors’ network – which was brought about by the formalization process, itself introduced by the Code – with a change in the Dutch corporate governance system, because “dense governance networks are associated with coordinated market economies, while sparse networks are associated with liberal market economies” (2007, p. 48). This would mean that because the network has become sparser, the Dutch corporate governance system seems to be turning towards the Anglo-American system. Heemskerk points out that corporate governance has become more formal due to the inflow of foreign directors, the decrease in tenure, and the call for accountability. This formalization effectively implies an incremental shift from principle-based governance towards rule-based governance.

Raaijmakers (2002) observes a trend towards a one-tier board system as the supervisory and management boards have a joint and collective accountability, despite their separate reports. He believes the fact that financial statements do not include the annual report and the supervisory board report but instead are separate points on the agenda also leads to the situation in which the discharge of the management is not linked to the financial statements. The GMS could abuse this change, because not discharging the management could be used as a means of pressure if the management and supervisory boards do not fulfill the wishes of the GMS. Raaijmakers considers this to be a shift towards disclosure instead of accountability to the GMS.

Both Heemskerk and Raaijmakers observe a trend towards a more Anglo-Saxon model in which rule-based governance, a one-tier board system, and financial disclosure are key elements. This would mean that the Dutch institution ‘good governance’ includes Anglo-Saxon elements that are typically core elements of the US institution ‘good governance’ and that correspond with the US corporate governance system (cf. 3.4). In turn, this situation implies that the nature of the original set of constitutive rules has changed in practice: The ‘game’ of corporate governance has been played in a different way to what the Tabaksblat Committee originally had in mind. This would mean that the Dutch corporate governance ‘game’ is partially played in a Anglo-Saxon way, that the collective acceptance of the institution ‘good governance’ as reflected in the Code’s constitutive rules might be at stake, and thus that the institution ‘good governance’ may not have been constituted.

4.6 Summary

This chapter covered sub question I.3, namely ‘Why has the Tabaksblat Code been established, how is it legally embedded, and what is its core content and goal?’ It showed that the Tabaksblat Code was established for several reasons. First, few companies were complying with the Peters Committee recommendations, and thus the Dutch government asked the Tabaksblat Committee in 2003 to establish a firmer code. The main focus was an improved balance between the management, supervisory board, and shareholders. Second, the European Committee required EU Member States to establish corporate governance codes that would lead to ‘good governance’. These codes were to be based on the ‘comply or explain’ rule, which allows companies to deviate from the rules if they explain their deviations (and their reasons for deviating) in the annual report. Third, the management board had too dominant a position at the expense of the shareholders, which was enhanced by the antitakeover measures, and further, the two-tier board system had caused the transfer of

shareholders' powers to the supervisory board. Fourth, the external auditor's independence and expertise had to be clarified.

The Code's 'comply or explain' rule has been included in the Civil Code, but the relevant section only applies to the provisions concerning the management and supervisory boards. The legal embedding of only the 'comply or explain' rule is typical for principle-based regulation. In addition, the rule is further typical for the Dutch legislation system, as this system has historically only covered what is genuinely needed with respect to business. The Tabaksblat Committee refers to Dutch legislation in terms of company, reporting, and accounting legislation as well as international accounting rules.

The goal of the Tabaksblat Code is to achieve a proper balance between the 'checks' – efficient supervision of the management board – and the 'balances' – the balanced power distribution between the management board, the supervisory board, and the GMS. The right balance should increase shareholder powers and lead to transparency.

The Tabaksblat Committee stressed the importance of the supervision task of the supervisory board, which entails that the supervisory board members are independent and qualified. Further, each member should attend all supervisory board meetings. Given significance of the supervision task, it requires full attention of the supervisory board members, and thus the number of each member's supervisory board memberships in other listed companies has been restricted. In addition, separate board committees should be established – namely an audit committee, a remuneration committee, and a selection and appointment committee – to lay the groundwork for the decision-making of the supervisory board. The audit committee's tasks represent the core supervision tasks of the supervisory board.

The Tabaksblat Code further stresses that the shareholders are to be seen as the top of the company's hierarchy, and should be able to influence the management and supervisory boards' policies. The GMS has certain important tasks, for example discharging the management and supervisory boards. Given this important position, the Tabaksblat Code requires shareholders to make use of their voting rights.

The management board should manage the company, and in particular the company's risks. The management should therefore declare in the annual report that the company's internal risk management and control systems are effective and adequate, and that possible changes to or improvement of the systems concerned have been discussed with the audit committee and the supervisory board.

The Code's rules with respect to the external auditor include complex communication processes concerning (1) the appointment procedure, (2) the remuneration procedure, and (3) procedures for non-audit services.

The remuneration consists of a fixed and a variable part. The importance of the remuneration issue is reflected in the quite complex procedure for the approval of the fixed part, in which the remuneration committee, supervisory board, and GMS are involved. At the same time, the variable part is also considered to be something of a tricky issue. The Tabaksblat Committee has tried to regulate the variable remuneration by stipulating that companies should connect variable compensation with performance criteria and targets. A further problem concerns the Code's rule that severance payments should not exceed one year's salary; few companies comply with this rule.

This chapter also examined the effects of the Tabaksblat Code between 2003 and 2007. Two elements have been criticized: specifically, that only the 'comply or explain' rule has been legally embedded, and that the Code is not a law. The yearly reports of the Monitoring Committee show that the compliance rate improved each year, but for institutional investors it remained low. Further, the explanations for deviations were not

always sound. The low attendance rate at the GMSs motivated the Committee to call upon the shareholders to use their voting rights.

The last part of this chapter concerned the developments with respect to the stakeholder and shareholder systems as a consequence of the Tabaksblat Code. Heemskerk (2007) holds the view that the Dutch system is moving towards the Anglo-American system, given the decline of the “old boys network” due to increased internationalization and rule-based governance, among other things. In line with this, Raaijmakers (2002) states that a trend can be observed towards disclosure instead of accountability, and towards a one-tier board system.

This chapter thus showed that the constitutive rules included in the Tabaksblat Code make explicit what the Dutch institution ‘good governance’ entails. Compliance with all rules included in the Code would lead to formal transparency, and if transparency has been achieved, the Dutch constitutive rules of ‘good governance’ have been collectively accepted and, in turn, the institution ‘good governance’ has been constituted.

However, practice shows that two important elements of the Code jeopardize the collective acceptance of the institution ‘good governance’. The first is the ‘comply or explain’ rule, which is a key constitutive rule of the Code that allows for the playing of an ‘open’ corporate governance ‘game’. If the parties in the Dutch context allow less ‘compliance’ and more ‘explain’, this will lead to less transparency, which will jeopardize the collective acceptance of the institution ‘good governance’, and thus cast doubt over the constitution of the institution. The second element concerns Cools’s view that the constitutive rules include detailed requirements for all stakeholders, but less detailed rules with respect to the shareholders in particular, although the Tabaksblat Code was meant to enhance the shareholders’ powers. This means that, in the sense of Searle’s theory of institutions, the Code in all its aspects seems to have partially failed as a constitutive regulation.

Sarbanes-Oxley Act

5.1 Introduction

This chapter sheds light on the US corporate governance code, namely the Sarbanes-Oxley Act (henceforth referred to as “the SOX” or “the Act”). Chapters 1 and 2 have shown that corporate governance is an institution, and that Searle (2005) views an institution as a system of constitutive rules. Constitutive rules have the form ‘*X counts as Y in C*’, whereby *X* identifies certain characteristics of an object, a person, or a state of affairs, and *Y* is the object, person, or state of affairs to which a certain function has been assigned. This function can only be performed in virtue of the collective acceptance of the corresponding status, which refers to *C* as context. A corporate governance code includes rules that constitute ‘good governance’. The constitutive rules included in the SOX have the form ‘*X counts as ‘good governance’ in context C*’, whereby *C* is the US corporate governance system. This means that the core characteristics of the US corporate governance system are reflected in the rules of the SOX; moreover, the rules included in the Act constitute the US institution ‘good governance’.

The SOX is also known as the Accounting Industry Reform Act 2002, which highlights its focus on accounting firms. The US government felt the need to extend its most important section, SOX404, and the additional rules have been included in the Auditing Standards that focus mainly on the accounting firms’ and the companies’ roles with respect to financial disclosure. Since this dissertation focuses on the 2006 Form 20-F of the case study company, Auditing Standards 2 and 3 (AS2 and AS3) are also taken into account given their relevance for the Form 20-F.

This chapter explains why the SOX was established (5.2), how it is legally embedded (5.3), and why this legal embedding is typical for the US legal system. Further, it describes the core content and goal of the SOX (5.4). This chapter thus covers the following sub question:

- 1.4 Why has the Sarbanes-Oxley Act been established, how is it legally embedded, and what is its core content and goal?

Sub chapter 5.5 includes the most relevant information with respect to the Auditing Standards. Subsequently, 5.6 describes the effects of the SOX as well as AS2 and AS3 after their enactment, plus the effects of the SOX and the Tabaksblat Code on specific issues. And finally, 5.7 provides a summary of the chapter.

5.2 The establishment of the Sarbanes-Oxley Act

The Securities Act of 1933 and the Securities Exchange Act of 1934 were President Roosevelt’s response to the economic depression of the 1930s (cf. 3.4.1). The aim of both laws was that companies should disclose the truth about their business, their securities, and the risks involved in investing in them, and further that the securities sellers and traders should treat investors fairly and honestly. The Securities Exchange Commission (SEC) was established in 1934 in order to monitor compliance with the laws and to protect the investors. Interestingly, the investors themselves, according to the SEC’s website, are one of the major sources of information on which the SEC relies to bring about enforcement action.

More recently, the Enron and WorldCom scandals forced the government and the SEC to take action once again. Cools (2007) states that the effects of the post-Enron crisis were huge, and the government therefore decided to take drastic measures. Congress worked together with the New York Stock Exchange and agreed on reforms, resulting in the Accounting Industry Reform Act 2002, known as the Sarbanes-Oxley Act (SOX). The SOX represents the biggest change in law concerning the capital markets since the Securities Acts of the 1930s.

One of the key aims of the SOX is to enforce the independence of external auditors by imposing strict penalties for misrepresenting the financial position of their companies in quarterly and annual reports. It further aims to prevent a repeat of the earlier situation, in which auditors had also provided non-audit services to their clients, which had led to conflicts of interest.

Skeel (2006) states that the Act focuses on the accounting industry, particularly the responsibility of top corporate executives. The enactment of the SOX also entailed the establishment of the Public Company Accounting Oversight Board (henceforth “the PCAOB” or “the Board”) to monitor the accounting industry. The Board can be compared to the Dutch AFM, and operates as a non-profit corporation, installed by the Act. With respect to the nature of the Board, the SOX states the following:

The Board shall not be an agency or establishment of the United States Government, and [...] shall be subject to, and have all the powers conferred upon a non-profit corporation [...]. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service. (Sarbanes-Oxley Act 2002, section 101(a)/(b))

The budget of the PCAOB, as a non-profit organization, is paid from annual accounting support fees and registration fees from each registered public accounting firm (RPAF). The SEC approves these budgets. The SEC and the Board also have a social role, in that the funds generated from the collection of monetary penalties finance a merit scholarship program for undergraduate and graduate students in accounting degree programs. Thus, the monetary penalties serve a moral goal, also in the hope that the scholarship program will prevent the younger generation of accountants from making severe mistakes in their future jobs. Further, Title III (cf. section 308) indicates that fair funds for investors are established out of civil penalties paid for violation of rules. These funds should exist for the benefit of the victims of that violation, which could again be considered a social responsibility action.

The SEC has a great deal of influence, because it has oversight and enforcement authority over the Board (cf. section 107). Since the Board should establish rules and standards additional to the SOX, which focuses on auditing, quality control, and ethics relating to the preparation of audit reports, it is clear – including from the transparency perspective – that the Board itself will be audited and monitored by the SEC. The SEC thus supervises the Board, approves the rules established by the Board, and may influence the sanctions imposed by the Board. The Board consists of five members, who are:

Appointed from among prominent individuals of integrity and reputation who have demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers [...] and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures. (Sarbanes-Oxley Act 2002, section 107)

Only two members of the Board should be or have been certified public accountants. If one of these two members is the chairperson, then they may not have been a practicing accountant for at least five years prior to their appointment to the Board (cf. section 3).

The Board, like the SEC, has a great deal of power, focused on monitoring the audit of public companies that are subject to the securities laws, and:

Related matters, in order to protect the interests of investors, and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. (Sarbanes-Oxley Act 2002, section 101)

The Board's concrete duties vary from the registrations of public accounting firms to conducting inspections of such firms²³. The Board also has certain powers, the two most effective of which are:

(1) to sue and be sued, complain and defend [...] with the approval of the Commission, in any Federal, State, or other court; (2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State. (Sarbanes-Oxley Act 2002, section 101)

The Board's power to sue and penalize RPAFs pertains not only to firms that do not comply with the SOX rules, but also to:

Intentional or knowing conduct [...] that results in violation of the applicable statutory regulatory or professional standard or repeated instance of negligent conduct. (Sarbanes-Oxley Act 2002, section 105, p. 19)

If a company does not adhere to the rules, the penalties may vary from \$100,000 to not more than \$750,000 for a natural person, or \$2,000,000 to not more than \$15,000,000 for any other person. As stated, section 105 indicates that these penalties not only apply to the action itself but also to "intentional or knowing conduct" that results in violation of the applicable statutory regulatory or professional standard.

The SOX thus clearly focuses on the external auditor's duties, with the Board having been established to issue rules that regulate the auditor's tasks, and the SEC monitoring the Board as well as the RPAFs.

Coffee (2006) points out that the SEC's investigation of all its enforcement proceedings over the years 1997–2002 revealed the most common financial and accounting irregularities to be "improper revenue recognition". Coffee states that the SOX focuses on gatekeepers, auditors, securities analysts, and credit-rating agencies, whose job it is to notice irregularities in an early phase.

Skeel's (2006) view is that the SOX reform was so clearly inspired by the 2000 accounting scandals that it might well be called the "Future Enron Prevention Act".

5.3 The legal embedding of the Sarbanes-Oxley Act

The SOX is a federal law, as are all securities laws in the US (cf. 3.4.1). The US corporate governance code is thus a rule-based code, unlike the Dutch code which combines self-regulation by means of compliance with (1) best practice provisions and principles, and (2) legislation ('comply or explain' rule). While the Tabaksblat Code is only meant for Dutch

²³ SOX101(c) sets out the PCAOB's duties, namely that it shall "(1) register public accounting firms that prepare audit reports for issuers, [...]; (2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, [...]; (3) conduct inspections of registered public accounting firms [...]; (4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms [...]; (5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof [...]; (6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto [...]; and (7) set the budget and manage the operations of the Board and the staff of the Board."

listed companies in the Netherlands, the SOX applies to all companies listed at American stock exchanges, including foreign companies and the subsidiaries of foreign multinationals listed in the US. Foreign public accounting firms registered with the PCAOB also have to comply with the SOX.

Sub chapters 3.4 and 3.5 described a number of historical corporate governance developments within the US and the Netherlands, and showed that there is a trend for the US government to respond to financial-economic debacles by enacting new laws. This corresponds with the US corporate governance system, which has been typified as a shareholder model, a debtor-oriented system, or an outsider system. The shareholder holds a central position within this system and within society's legal rules (cf. 5.3). Since the shareholders are outside shareholders, the regulatory bodies play a supervisory role with respect to the market process, and public courts serve to solve problems. Laws and the enforcement of them are seen as the most suitable and effective means of regulation within the US corporate governance system.

5.4 The goal and core content of the Sarbanes-Oxley Act

The SOX starts by stating its goal, which revolves around the importance of shareholders (investors) in American business:

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities law, and for other purposes. (Sarbanes-Oxley Act 2002, p. 1)

Sub chapter 5.2 indicated that the SOX – like any securities law in the US – was enacted as a response to the accounting scandals around the turn of the century. As the auditors were involved in conflicts of interest by also providing non-audit services to their clients, the SOX targets accounting firms and the functioning of the external auditors (after all, it is officially an accounting reform act). Proper and reliable financial disclosure is the means by which shareholders are expected to be protected, and the external auditor naturally plays an important role in this. Financial disclosure is also seen as the means by which transparency can be achieved.

The structure of the SOX consists of eleven titles that have been sub divided into sections (cf. Appendix B). The most important titles are about Auditor Independence (II), Corporate Responsibility (III), Enhanced Financial Disclosures (IV), and White-Collar Crime Penalty Enhancements (IX). These reflect what 'good governance' within the US context is all about. The core content of the SOX concerns:

1. The role and tasks of the external auditor, which the SOX calls "the registered public accounting firm";
2. The role and tasks of the board of management, including the CEO and CFO, which the SOX calls "the issuer";
3. The role and tasks of the audit committee; and
4. The role and tasks of the investors.

Clearly, the main content elements concern the core corporate bodies. The terms used to indicate the corporate bodies are directly derived from the US corporate governance system, which, as mentioned above, is a shareholder model or debtor-oriented system. The company – including the management board and the CEO and CFO – is referred to as the issuer because the SOX is a securities law, which emphasizes the role of the issuer of securities. The external auditor is referred to as the registered public accounting firm because the SOX requires accounting firms to register with the PCAOB (cf. 5.2) in order to be able to monitor and investigate them. The shareholders have been referred to as investors because in the debtor-oriented corporate governance system, investors play a key role; they regard the company as a 'product' which can be sold or bought depending its performance, and thus the company's

value is of utmost importance for the investors (cf. 3.3). The roles and tasks of these main corporate bodies can be seen as the core content of the SOX, and are elaborated on in the following sections.

5.4.1 The registered public accounting firm

Cox (2006) states that the highly concentrated structure of the accounting industry meant it was not a diligent and independent gatekeeper of financial reporting, and thus contributed to its failure to serve the public interest. He explains that the accounting industry is an oligopoly. First, there was the ‘Big Eight’, but as a consequence of the mergers in the 1980s and 1990s, only the ‘Big Five’ remained. Then the Andersen accounting firm, Enron’s external auditor, went bankrupt, and the ‘Final Four’ have since remained. Clients have become more specialized, global, and complex, and auditors have consequently had to develop in the same direction. The instrument set up to assess the potentially anti-competitive effects of concentration within an industry (the HHI²⁴) showed that the industry’s HHI score was more than 10% higher than the normal level, and had increased to 40% above the “anti-competitive warning level”. This situation affected the prices for auditing services and the non-auditing services which had been combined with them, and thus led to conflicts of interest.

Definitions

Section 2 of the SOX defines the registered public accounting firm as:

- A. a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports²⁵; and B. to the extent so designated by the rules of the Board, and associated person of any entity described in subparagraph (A). (Sarbanes-Oxley Act 2002, section 2)

The term “audit” is explained in the SOX as follows:

An examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission [...] for the purpose of expressing an opinion on such statement. (Sarbanes-Oxley Act 2002, section 2)

These definitions summarize the core elements of the RPAF: it is required to perform an audit, and must therefore be independent and registered with the Board; it prepares and issues the audit report; and finally, it decides whether to agree or disagree with the opinion of the audited company on the financial statements. Generally speaking, the RPAF audits the accuracy and reliability of corporate financial disclosures.

Registration

Public accounting firms should be registered with the PCAOB, which will assess their degree of compliance (cf. section 104). If firms do not comply, the Board may impose sanctions, varying from a temporary suspension or permanent revocation of registration and required additional professional education/training combined with a civil money penalty for each violation of not more than \$100,000 for a natural person or \$2,000,000 for any other person. These sanctions only apply to:

²⁴ HHI means the Hirschmann-Herfindahl Index. It is a metric commonly used by the US Department of Justice to assess the potentially anti-competitive effects of concentration within an industry. (Cox 2006, p. 298).

²⁵ An audit report is defined in section 2(a)(4) as: “A document or other record: A. prepared following an audit performed for purpose of compliance by an issuer with the requirements of the securities laws; and B. in which a public accounting firm either: i. sets forth the opinion of that firm regarding a financial statement, report, or other document; or ii. asserts that no such opinion can be expressed.”

A. intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or B. repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard. (Sarbanes-Oxley Act 2002, sections 105(5)(A) and (B))

Terms like “intentional conduct”, “knowing conduct” and “repeated instances” remain unexplained, though if any of these are found to be involved, the highest possible sanctions are increased to \$750,000 for a natural person or \$15,000,000 for any other person. According to section 105(d)1(A), the Board reports all sanctions to the SEC, (105(d)1(B) any appropriate State regulatory authority or foreign accountancy licensing board with which such firm or person is licensed or certified, and to the public (105(d)1(C).

Registration with the Board also means that the registered firms have to pay a registration fee and an annual fee, to cover the costs of processing and reviewing the applications and annual reports. This might involve the Board in advance counts with possible processing RPAFs.

Which accounting firms are involved?

The SOX rules concern only the large RPAFs, as section 209 indicates that the standards and rules are not applicable to small- and medium-sized non-registered public accounting firms. However, the Act does not define a small-, medium-, or large-sized firm. Further, the rules are applicable not only to large RPAFs in the US, but also to foreign public accounting firms (cf. section 106), which are defined as “a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof”. Thus, any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer is subject to the rules of the SOX, the Board, and the SEC “in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the US or any State”. There is one exception, however; namely, that the registration “shall not by itself provide a basis for subjecting such a [...] firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board” (cf. section 102). This means that not the registration itself, but any possible controversies can be the basis for subjecting the firm to the jurisdiction of the US courts. Section 102, on registration with the Board, also includes the rule that accounting firms should pay an annual fee in order to recover the costs if proceedings do go ahead.

Independence

One of the causes of the accounting scandals was that the independence of the auditors was compromised through the provision of non-audit services. Therefore, SOX section 201 indicates those non-audit services that are prohibited for RPAFs. Non-audit services that are not included in section 201, including tax services, are permitted if the issuer’s audit committee has approved them in advance.

Another new element is that an auditor may provide his or her auditing services to a company only once in five years (cf. section 203). This means that the audit partners are required to rotate, though they may be employees of the same auditing company. Their independence is also further enhanced by the rule prohibiting an accounting firm from providing audit services to an issuer if:

The lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer. (Sarbanes-Oxley Act 2002, section 203)

Section 206 points out that it is unlawful for a RPAF to perform any audit service for an issuer if a CEO, CFO, or controller employed by that accounting firm participated in any capacity in the audit during the year preceding the date of the initiation of the audit.

Finally, another new but core element of the SOX (section 301) concerns the independence of the external auditor, specifically the fact that the external auditor has to report directly to the audit committee.

Financial disclosure

Title IV includes the most significant sections with respect to financial disclosure, which is one of the main focuses of the SOX. Of these, the most important is section 404 (also known as SOX404). This section stipulates that the annual report include not only the financial statements, but also a new element, an internal control report. This report should:

1. State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
2. Contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting. (Sarbanes-Oxley Act 2002, section 404(a))

SOX404(a) describes the significant role of the RPAF with regard to the internal control report, namely that the accounting firm should attest to and report on the management's assessment of the effectiveness of the internal controls and procedures. This indicates that the accounting firm is regarded to be the most important monitor of the issuer, but the auditor is, at the same time, involved in auditing the results of the internal controls and procedures as he/she audits the issuer's financial state of affairs.

Conduct of public accounting firms

Section 602 states that the SEC is allowed to censure an auditor if it finds the auditor in question:

Not to possess the requisite qualifications to represent others or to be lacking in character or integrity, or to have wilfully violated any provision of the securities laws or the rules and regulations of the SEC or engaged in unethical or improper professional conduct.

Although the SOX attempts to stress the need for auditors to be adequately qualified and to behave appropriately, it does not explain the terms "character" and "integrity". However, it defines "improper professional conduct" as follows:

1. Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; and
2. Negligent conduct in the form of
 - (A). a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted; or
 - (B). repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

Despite this extended explanation, some elements, like the terms "repeated instances" and "a lack of competence" still offer scope for interpretation.

Punishments for fraud/altering of audit documentation

A separate Act within the SOX (the Corporate and Criminal Fraud Accountability Act of 2002 in Title VIII) stresses the importance of audit documents that represent the financial situation fairly. The maximum penalty for destruction, alteration, or falsification of records is 20 years' imprisonment. Another important element of this Title is that any accountant who conducts an audit has to retain all audit or review work papers for five years from the end of the fiscal period in which the audit or review was conducted. Registered and non-registered Public accounting firms, that are responsible for altering, destroying, mutilating, or concealing a record or document in the case of an official proceeding will also face a maximum penalty of 20 years' imprisonment.

5.4.2 The issuer

Definitions

The definition of an issuer as included in the SOX in fact encompasses most public listed companies, as it includes:

An issuer [...], the securities of which are registered under section 12 of that Act (SEA of 1934) (15 U.S.C. 78l), or that is required to file reports under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 [...] and that it has not withdrawn. (Sarbanes-Oxley Act 2002, section 2(7))

The critical element with respect to companies that can be defined as issuers consists of whether the securities are registered under the ‘old’ securities laws, namely the Securities Exchange Act of 1934 and the Securities Act of 1933.

Relationship between issuer and registered public accounting firm (RPAF)

The relationship between the issuer and its accounting firm is very close, and in fact almost all SOX sections and the rules included in Auditing Standards 2 and 3 concerning the RPAF either directly or indirectly affect the issuer. This is because, on the one hand, the accounting firm is in the service of the issuer, and on the other hand, the issuer depends on the auditor’s services. Section 303 stresses the importance of the auditor for the issuer, stating that no officer or director of an issuer may take any action to:

fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading. (Sarbanes-Oxley Act 2002, section 303(a))

Financial disclosure

The US corporate governance system is an outsider system, and in the ‘ideal’ outsider system the investors are ‘outside’ the firm and unable to monitor the management inside the company. This means that the monitoring role is in the hands of regulatory bodies (cf. 3.5). The fact that the shareholders are ‘outside’ the firm also means that they depend heavily on information disclosure – and in particular on financial disclosure – to determine the value of the firm and consequently what to do with their investments. We saw in sub chapter 7.4 that the main goal of the SOX is to protect the investors by improving the accuracy and reliability of corporate disclosures. Once the auditor has perform a proper audit, it is the issuer’s responsibility to publish accurate and reliable financial information about the company.

Section 401 contains the required disclosures concerning financial reports and off-balance sheet transactions. With regard to the financial reports, accuracy is a key aspect:

Each financial report that contains financial statements, and that is required to be prepared in accordance with [...] generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission. (Sarbanes-Oxley Act 2002, section 401)

The most important section is section 404, which includes the following text:

- (a) The Commission shall prescribe rules requiring each annual report [...] to contain an internal control report, which shall—
 - (1) State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
 - (2) Contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.
- (b) Internal Control Evaluation and reporting. —With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for

attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement. (Sarbanes-Oxley Act 2002, section 404)

SOX404 requires an issuer to include in the annual report an internal control report, which contains:

- (1) A statement that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting;
- (2) Management's assessment of the effectiveness of the internal control structure and procedures as mentioned above.

The issuer is further required to include the auditor's attestation as described in section 404 in the annual report (Form 20-F). This section has prompted a great deal of criticism, which is discussed in sub chapter 5.6.

Title IV, on financial disclosure, contains another very important rule (section 408), which indicates that the SEC will review the financial statements of issuers every three years "for the protection of investors".

Conflicts of interest

No issuer should directly or indirectly extend or renew an extension of credit, in the form of any personal loan to or for any director or executive officer in order to prevent conflicts of interest (cf. section 402). Further, directors, officers, and principal stockholders (cf. section 403) who are directly or indirectly the beneficial owner of more than 10% of any class of any equity security, should file the statements required by the SEC. Filing should take place at the time of the registration of such security or within 10 days after the person concerned becomes a beneficial owner, director, or officer; a filing should also be made if there has been a change in such ownership or if the person has purchased or sold a security-based swap agreement involving such equity security before the end of the second business day following the day on which the subject transaction has been executed.

Not only the moments when filing is required have been described in detail, but so too has the content of the required statements. All required statements under section 403 have to be filed electronically, and the SEC posts each statement on a publicly accessible Internet site, while the issuer should also publish the statement on its corporate website.

Code of ethics

The issuer is required to include in its financial reports a 'comply or explain' paragraph about whether or not (and if not, the reason therefore) the issuer has adopted a code of ethics for senior financial officers. The PCAOB defines "code of ethics" as follows:

- Standards that promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- Full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer;
- Compliance with applicable governmental rules and regulations. (Sarbanes-Oxley Act, section 406)

Further, the issuer should immediately disclose any change in or waiver of the code of ethics by filing Form 8-K and disseminating the information via the Internet.

Disclosure of audit committee financial expert

The issuer should disclose in the annual report that the audit committee financial expert (cf. section 407). This section also includes a 'comply or explain' paragraph, which states that the issuer should disclose whether its audit committee has a financial expert or not (and the reasons therefore). A financial expert has been defined as follows:

Whether a person has [...]:

1. An understanding of generally accepted accounting principles and financial statements;

2. Experience in:
 - a. The preparation or auditing of financial statements of generally comparable issuers; and
 - b. The application of such principles in connection with the accounting for estimates, accruals, and reserves;
 - c. Experience with internal accounting controls; and
 - d. An understanding of audit committee functions. (Sarbanes-Oxley Act 2002, section 407)

Review of financial statements by SEC

As stated above, the SEC will regularly and systematically review the financial statements of an issuer, “for the protection of the investors” (section 408). Each issuer shall be reviewed at least once every three years. However, the SEC prioritizes the review of certain issuers, starting with issuers that have issued material restatements of financial results, followed by issuers that have experienced significant volatility in their stock price as compared to other issuers. Issuers with the largest market capitalization are reviewed third, emerging companies with disparities in price-to-earning ratios fourth, then finally those issuers whose operations significantly affect any material sector of the economy. The SOX does not explain its reasons for this ordering.

Whistleblowers regulation

The whistleblower rule (section 806) is about the protection of employees who provide evidence of fraud. This section prohibits issuers, officers, employees, contractors and subcontractors, or any agent of such company from discharging, demoting, suspending, threatening, harassing, or discriminating in any other manner against an employee in the terms and conditions of employment because of any lawful act by the employee, such as providing information; assisting in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of the SEC rules or any provision of Federal law relating to fraud against shareholders; or filing, causing to be filed, testifying, or participating in a proceeding filed or about to be filed relating to an alleged violation of said rules and provisions.

Section 806 further stresses the position of the whistleblower, stating that “an employee prevailing in any [such] action shall be entitled to all relief necessary to make the employee whole”. The Act explains the term “relief” as follows:

Reinstatement with the same seniority status that the employee would have had, but for the discrimination; the amount of back pay, with interest; and compensation of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees. (Sarbanes-Oxley Act 2002, section 806)

The expression “make the employee whole” should be seen in the light of the definition of “relief”.

CEO/CFO

The CEO’s and CFO’s tasks are described in Title III of the Act, section 302, on the corporate responsibility for financial reports. The core element is that the CEO and CFO certify the annual report, which means that they have reviewed the annual report and are indicating that – based on their best knowledge – it does not contain any untrue statements of a material fact. While this section indeed specifically refers to their “knowledge”, it does not explain what the content of that knowledge could or should be. If the officers certify the annual report, they are automatically attesting to responsibility for establishing and maintaining internal controls, which have been designed in such a way that material information relating to the issuer and its subsidiaries is made known to the officers, and to responsibility for evaluating the effectiveness of these internal controls. This should take place 90 days before publication of the report.

Section 302(b) also explicitly states that:

Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required [...] by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

The inclusion of this statement was probably necessary: the criminal penalties for non-compliance are \$1,000,000, imprisonment for not more than 10 years, or both, if the certifying officer knows that the report does not comport with all the requirements; and \$5,000,000, imprisonment for not more than 20 years, or both, if the signing officers *wilfully* certified knowing that the report does not comply with all requirements. In other words, certain individuals – the CEO and CFO, for example – are personally responsible for signing each financial report.

Title IX, also called the White-Collar Crime Penalty Enhancement Act of 2002, concerns the penalties for persons who conspire or attempt to commit any offence. Its main section is section 906, which includes the certification of periodic financial reports by the issuer's CEO or CFO. The officer(s) should submit a written statement which certifies that the periodic report complies with the requirements, and that the information fairly presents the issuer's financial condition and results of operations. As above, the criminal penalties are, in contrast with the Dutch regulations, extremely high: \$1,000,000 or imprisonment for not more than 10 years, or both, in the case of a CEO or CFO certifying a statement in the knowledge that the accompanying periodic report does not comply with all requirements. If the officer *wilfully* certifies such a statement, the penalties are even higher: \$5,000,000, a maximum of 20 years' imprisonment, or both. This section is clearly a result of the huge impact of the accounting and financial scandals.

The responsibility of the CEO/CFO is further enhanced by the fact that they should reimburse the issuer for any bonus or other incentive-based or equity-based compensation that they receive from the issuer and any profits realized from the sale of the issuer's securities during the 12 months following the first public issuance or filing with the SEC, if the issuer has to prepare an accounting restatement as a consequence of non-compliance with the financial reporting requirements (cf. section 304).

The CEO's and CFO's importance is also stressed in section 1105, which states that the SEC may prohibit persons from serving as officers or directors if they have violated section 10(b) or the rules or regulations thereunder, or section 17(a)(1) or the rules or regulations thereunder, if "the conduct of that person demonstrates unfitness to serve as an officer or director". However, the terms "conduct" and "unfitness" are not explained.

We have seen above that the issuer is required to include a code of ethics with respect to the CEO, CFO and other senior officers in the annual report. Further, section 1103 indicates that if the issuer is involved in a lawful investigation of potential violations by the issuer or any of its directors, officers, partners, controlling persons, agents, or employees, the SEC requires the issuer to make extraordinary payments to any of the mentioned persons, and may petition a Federal district court for a temporary order requiring the issuer to escrow those payments, subject to court supervision, in an interest-bearing account for 45 days.

5.4.3 The audit committee

The audit committee plays a key role within the SOX, which is a logical consequence of the fact that prior to the SOX, as previously stated, the auditors were not exercising their duties properly. The SOX defines the audit committee as:

- A. a committee established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial

statements of the issuer; and B. if no such committee exists with respect to an issuer, the entire board of directors of the issuer. (Sarbanes-Oxley Act 2002, section 2(a)(3))

The importance of the audit committee's role is stressed in section 302, which requires the "signing officers" (i.e. the CEO/CFO) to disclose any significant weaknesses and fraud identified with respect to internal control that involves management or other employees to both the audit committee and the issuer.

Audit committee members

Section 301 stipulates that the audit committee members are members of the board of directors, and must be independent. "Independence" is defined such that a member may not, other than in his or her capacity as member of the audit committee (or the board of directors or any other board committee), accept any consulting, advisory, or other compensatory fee from the issuer; or be an affiliated person of the issuer or any subsidiary thereof.

We saw in 7.4.2 that the audit committee should have at least one member who is a financial expert.

Audit committee's mediator role

The audit committee plays a very important role as a mediator between the issuer and the auditor. Section 202 indicates that the audit committee must preapprove all audit and non-audit services provided by the auditor, and these preapprovals must be disclosed to investors in periodic reports. Section 204 includes further reporting requirements, including that the RPAF should, in a timely manner, report the following elements to the audit committee:

1. All critical accounting policies and practices to be used;
2. All alternative treatments of financial information; and
3. Other material written communications between the RPAF and the management of the issuer, e.g. management letters.

Audit committee's tasks

The SOX's section 301 stipulates that the audit committee is directly responsible for the appointment, compensation, and oversight of the work of any RPAF employed by the issuer, and the accounting firm must report directly to the audit committee. This is a direct consequence of the accounting scandals, because the fact that the auditor previously reported directly to the management board led to conflicts of interest.

Section 301 further states that one of the audit committee's tasks, besides overseeing the accounting and financial reporting processes and audits, is to establish a complaints procedure regarding accounting, internal accounting controls, or auditing matters, as well as procedures for the confidential, anonymous submission by employees of the issuer of concerns about questionable accounting or auditing matters. Another important task is determining the funding for payment of the RPAF for the audit report, and for payment of any advisors employed by the audit committee.

5.4.4 The investors

The protection of investors is one of the main issues within the SOX, as seen in its very first sentence:

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

The importance of protecting investors is further stressed by the fact that it is the PCAOB's task to:

Promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors [...]. (Sarbanes-Oxley Act 2002, section 3)

And to:

Oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. (Sarbanes-Oxley Act 2002, section 101)

Given the importance of protecting the investors, all rules and regulations included within the SOX have been developed in order to achieve this protection.

Although the investors are more subjects of the SOX – section 202, for example requires that the audit committee's approval of a non-audit service be disclosed to investors – some sections require the investors to act themselves. Section 308 is about the fair funds for investors, and stipulates that the SEC shall add the amount of a civil penalty which a person has to pay for violating securities laws or regulations to the disgorgement fund for the benefit of the victims of such violation. Section 403 concerns disclosures that investors have to make, namely that:

Every person who is directly or indirectly the beneficial owner of more than 5% of any class of any equity security [...], shall file the statements required by this subsection with the Commission. (Sarbanes-Oxley Act 2002, section 403)

The statements are to indicate the amount of all equity securities of such issuer, of which the filing person is the beneficial owner; further, they shall indicate ownership by the filing person at the date of filing, any changes in ownership, and any relevant purchases and sales. The statements are required to be filed:

- (A) at the time of registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g);
- (B) within 10 days after he or she becomes such beneficial owner [...];
- (C) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement [...] involving such equity security, before the end of the second business day following the day on which the subject transaction has been executed. (Sarbanes-Oxley Act 2002, section 403)

The statements will be made available on the Internet by the SEC, and on the corporate website by the issuer.

The Act's aim of protecting the investors is repeated in many sections, for example in section 408 about enhanced review or periodic disclosures by issuers, including that the SEC reviews "disclosures made by issuers on a regular and systematic basis for the protection of investors". Another example is section 409, which states that each issuer shall disclose to the public on:

A rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English [...], as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.

Yet another example is section 807, about criminal penalties (i.e. maximum imprisonment of 25 years) for defrauding shareholders if a person:

Knowingly executes, or attempts to execute, a scheme or artifice to defraud any person in connection with any security of an issuer or to obtain, by means of false or fraudulent pretences, representations, or promises, any money or property in connection with the purchase or sale of any security. (Sarbanes-Oxley Act 2002, section 807)

Section 501 mentions that the SEC will adopt rules to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information. The analysts should therefore disclose, in public appearances and in each research report, any conflicts of interest that are known or should be known by them to exist at the time of the appearance or date of distribution of the report. This may

include, among other things, whether the analyst received any compensation from the issuer concerned, and disclosure of any other conflicts of interest that are material to investors.

The important role of the investors is highlighted again in section 806, on protection for employees of publicly traded companies who provide evidence of fraud by filing, testifying at, or participating or otherwise assisting in a proceeding relating to a violation of any rule concerning “fraud against shareholders”.

5.5 The accounting standards

Section 103 indicates that the PCAOB was established by the SEC to monitor the RPAFs in particular, and to establish accounting standards that include rules for the accounting firms. These standards, according to section 108, should be kept current:

in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

The PCAOB established Auditing Standards 1, 2, and 3, and the following rules:

- Section 1: General Provisions;
- Section 2: Registration and Reporting;
- Section 3: Professional Standards;
- Section 4: Inspections;
- Section 5: Investigations and Adjudications;
- Section 6: International; and
- Section 7: Funding.

Sub chapter 5.1 already mentioned that AS2 and AS3 were enacted in addition to the SOX, in particular to SOX404(b) and 103(a)(2)(A)(iii), which are relevant for the scope of this dissertation.

The following sections are structured according to content of the rules and Auditing Standards related to the main corporate bodies, namely the RPAF (5.5.1), the issuer (including the CEO/CFO) (5.5.2), and the audit committee (5.5.3). They serve to demonstrate how extremely detailed the Standards are.

5.5.1 The registered public accounting firm

After the Act was enacted in 2002, the PCAOB issued bylaws, rules, and standards. For the RPAFs, referred to as “the auditor”, the following are relevant (and are described in more detail below):

1. PCAOB rules, section 2: Registration and Reporting;
2. PCAOB rules, section 3: Professional Standards, including rule 3100: Compliance with Auditing and Related Professional Practice Standards;
3. Auditing Standard 2 (additions to SOX103(a)(2)(A)(iii) and 404): An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements;
4. Auditing Standard 3 (additions to SOX103(a)): Audit Documentation

I. PCAOB rules, section 2: Registration and Reporting

These rules include the very important rule 2105 about conflicting non-US laws, which stipulates that a foreign public accounting firm may withhold information from its application to the Board for registration when the submission of such information would cause the applicant to violate a non-US law.

2. *PCAOB rules, section 3: Professional Standards, including rule 3100: Compliance with Auditing and Related Professional Practice Standards*

Rule 3101 is significant here, as it explains terms in the PCAOB's Standards which describe the degree of responsibility that the Standards impose on auditors. The Board distinguishes three levels of responsibility:

1. "Unconditional responsibility", which is indicated by the words: "*must*", "*shall*" and "*is required*". The auditor must fulfill these kinds of responsibilities in all cases in which the circumstances exist to which the requirement applies.
 2. "Presumptively mandatory responsibility", which is indicated by the word "*should*". The auditor must comply with such requirements unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard. The Board demands documentation of the information which demonstrates that the objectives were achieved.
 3. "Responsibility to consider", which is indicated by the words "*may*", "*might*", "*could*", and other terms and phrases. Matters described in this fashion require the auditor's attention and understanding. How and whether the auditor implements these matters in the audit will depend on the exercise of professional judgement in the circumstances consistent with the objectives of the standard. Further, if a standard provides that the auditor "*should consider*" an action or procedure, the Board distinguishes between the consideration of the action or procedure and the action or procedure itself: the former is presumptively mandatory, while the latter is not.
3. *AS2 (additions to SOX103(a)(2)(A)(iii) and 404): An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*

The Board held a public roundtable discussion on July 29, 2003 to discuss issues and hear views related to reporting on internal control over financial reporting. The participants included representatives from public companies, accounting firms, investor groups, and regulatory organizations. Based on the comments and other input, the Board developed and issued on October 7, 2003, AS2: An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements. AS2 is an addition to one of the core SOX sections, 404b, as the PCAOB believed that effective controls provide the foundation for reliable financial reporting. AS2 section E5 describes the opinion of the PCAOB as well as US Congress that internal control over financial reporting enhances a company's ability to produce fair and complete financial reports, which are needed to make good judgements and decisions about the company; and further that the auditor's reporting on management's assessment of the effectiveness of internal control over financial reporting provides important assurance about the reliability of the company's financial reporting. The internal control reporting requirement was not particularly new: a similar requirement had existed for over 10 years in federal financial institutes (cf. AS2, E13). Nonetheless, the Board put a great deal of effort into developing this standard for two reasons: (1) it wanted to provide clear directions for the auditor consistent with investors' expectations that the reliability of financial reporting will/should be significantly improved; and (2) it recognized that the standard must appropriately balance the costs of implement its directions with the benefits of achieving the goals. It is questionable whether the Board achieved the latter goal, because the high costs (and large number of accounting and auditing regulations) led to a steady withdrawal of foreign accounting firms from US stock exchanges.

AS2 also relates to SOX103(a)(2)(A)(iii) and SOX404, both of which demand a level of assurance of the reliability of financial reports, and the auditor must therefore evaluate both management's assessment process and the effectiveness of internal control over financial reporting. This means that the auditor must express two opinions in all reports on internal control over financial reporting. Regarding the terms "audit of internal control over financial reporting" and "attestation of management's assessment of the effectiveness of internal

control over financial reporting”, AS2 indicates that both terms refer to the same professional service, but the first refers to the process itself, while the second refers to the result of that process. AS2 also provides a definition of “internal control over financial reporting”:

A process designed by [...] the company’s principal executive and principal financial officers [...] and effected by the company’s board of directors, management [...] to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: pertain to the maintenance of records [...] that accurately and fairly reflect the transactions and dispositions of the assets of the company; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements [...]; provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effect on the financial statements. (PCAOB bylaws and rules – Auditing Standard 2, p. 153)

Reasonable assurance

In connection with the definition of internal control over financial reporting as quoted above, AS2 describes in detail the auditor’s objective in an audit of such control; specifically, to express an opinion on management’s assessment of the effectiveness of the company’s internal control over financial reporting, and to obtain reasonable assurance that no material weakness exists as of the date specified in management’s assessment. To underpin this opinion, the auditor must plan and perform the audit to obtain reasonable assurance about whether the company maintained, in all material respects, effective internal control over financial reporting as of the date specified in the management’s assessment. The auditor must also audit the company’s financial statements, because the information obtained in this manner is relevant for the auditor’s conclusion about effectiveness. The expression “maintaining effective internal control over financial reporting” means that no material weakness exists. AS2 rule 8 indicates that the auditor may find a control deficiency if the design or operation of a control does not allow the management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements in a timely manner. Rule 8 defines the term “significant deficiency” as follows:

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company’s ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company’s annual or interim financial statements that is more than inconsequential will not be prevented or detected.

Similarly, AS2 rule 10 uses the term “material weakness” to refer to a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The Board uses specific words with regard to the likelihood that a misstatement will appear again in the future, including “probable”, “reasonably possible”, and “remote likelihood”, whereby “probably” indicates the highest possible chance and “remote likelihood” indicates the lowest possible chance that a misstatement will recur in the future.

Rules 130 and 133 require the auditor to evaluate any control deficiencies identified and to determine whether these are significant deficiencies or material weaknesses. In evaluating their likelihood of recurrence, the auditor should also evaluate how the controls in question interact with other controls.

Obtaining evidence: audit documentation

AS2 rule 42 states that the auditor should obtain evidence from a number of sources, including using the work performed by others and by performing his/her own auditing procedures. As part of understanding and evaluating the management’s process, the auditor should conduct an inquiry of management and others as a starting point, but also evaluate

management's documentation as to whether it includes particular information. In addition, the auditor should analyze the design of the controls related to each component of internal control over financial reporting, namely:

- (1) Control environment;
- (2) Risk assessment;
- (3) Control activities;
- (4) Information and communication; and
- (5) Monitoring.

The reasons for analyzing the abovementioned components are included in AS2 rule 49.

The PCAOB states that inadequate documentation of the design of controls over relevant assertions is a deficiency in the company's internal control over financial reporting, to be evaluated by the auditor. Furthermore, AS2 rule 143 indicates that inadequate documentation could cause the auditor to conclude that there is a limitation in the scope of the engagement.

AS2 rules 159–161 describe the audit documentation requirements, which include the “understanding obtained” and “the evaluation of the design of each of the five components of the company's internal control over financial reporting”. The auditor's report on the management's assessment of the effectiveness of internal control over financial reporting must include the elements a–p. Examples of these elements are the following:

- e. A statement that the auditor's responsibility is to express an opinion on the assessment and an opinion on the company's internal control over financial reporting based on his or her audit;
- g. A statement that the audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board;
- i. A statement that an audit includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control;
- l. The auditor's opinion on whether management's assessment of the effectiveness of the company's internal control over financial reporting is fairly stated;
- m. The auditor's opinion on whether the company maintained, in all material respects, effective internal control over financial reporting.

Many rules included in AS2 concern “what if” scenarios; for example, what the auditor's report should include in certain situations. Further, rules 190–194 indicate when the auditor should disclaim an opinion or discuss certain items with the management; for instance, if the misstatement remains, the auditor should notify the management and the audit committee in writing about his/her views concerning the information. Rule 21 stipulates that, if the auditor concludes that the audit of internal control cannot be satisfactorily completed and that he/she is required to disclaim an opinion, the auditor should communicate this, in writing, to the management and the audit committee.

Auditor's communication responsibilities

The PCAOB aims to describe the auditor's responsibilities as clearly as possible. These responsibilities are partly described as “communication responsibilities”, for example rule 206 states that if the auditor considers it necessary to alter the disclosures about changes in internal control over financial reporting, the auditor should communicate this with the management as soon as possible. If the management does not respond appropriately within a reasonable period of time, in the auditor's judgement, the auditor should inform the audit committee. Likewise, if the audit committee does not respond in time, in the auditor's judgement, the auditor should consider consulting his/her attorney. In this case, the auditor should modify his/her report to include an explanatory paragraph explaining why he/she believes management's disclosures should be modified.

There are also many other communication requirements for the auditor; in fact, a complete AS2 section (rules 207–214) is dedicated to these, thus representing the auditor's

core communication demands. Examples of the most important elements include the following:

- The auditor must communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit;
- The auditor must communicate that specific significant deficiency or material weakness in writing to the board of directors;
- When timely communication is important, the auditor should communicate the preceding matter during the course of the audit rather than at the end of the engagement.

4. AS3 (*additions to SOX103(a)*): Audit Documentation

Although the PCAOB aimed to give the auditor clear directions, AS2 was considered impractical by some commentators as it would increase the volume of documentation but not the quality. Thus, the PCAOB again held a public roundtable discussion, this time particularly about section 103(a), concerning audit documentation. The discussion was held on September 29, 2003, and resulted in AS3: Audit Documentation, which came into effect on November 15, 2004. The new audit document requirements aimed to bring about more effective and efficient oversight of RPAFs.

AS3 starts by explaining the term “audit documentation” as a written record of the basis for the auditor’s conclusions, thus providing support for the auditor’s representations, whether those representations are contained in the auditor’s report or otherwise. Auditor documentation, also called work papers or working papers, includes records of the planning and performance of the work; procedures performed; evidence obtained; and conclusions drawn. The audit documentation is reviewed by members of the engagement team performing the work, and possibly also by others. It should be:

- Prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached;
- Appropriately organized to provide a clear link to the significant findings or issues;
- Recorded in hard copy, electronic files, or other media.

The auditor must retain audit documentation for seven years from the report release date.

AS3 rule 12 also stipulates that if the auditor does identify significant findings or issues that are important to the procedures performed, evidence obtained, or conclusions reached, the auditor must include them in an “engagement completion document”, which contains all information necessary to understand those findings, issues, cross-references, etc.

One of the most significant rules, rule 6, states that the audit documentation must demonstrate that the work was in fact done. To this end, it must contain sufficient information to enable an experienced auditor to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached; to determine who performed the work and that the work was in fact completed; and to identify the person who reviewed the work and the date of such review. This documentation does not include oral explanations, as oral evidence may only be used to clarify other written evidence. In other words, the PCAOB believes that oral communication concerning evidence is less important than written communication (cf. rule 59), that oral explanation should not be the primary source of evidence or contradict the documented evidence, and, moreover, that appropriate consideration should be given to the credibility of the individual providing the oral explanation.

Another important component of AS3 concerns changes to audit documentation (cf. rule 59). The PCAOB distinguishes between the report release date, by which the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor’s report, and the documentation completion date, which falls 45 calendar days after the report release date and during which the auditor can

assemble the documentation. The auditor should not discard any previously existing documentation after report release date, nor any audit documentation after the documentation completion date. Any additions must indicate the date on which the information was added, the name of the auditor, and the reason for the addition. Worth noting is the PCAOB's remark that documentation added well after completion of the audit is "likely to be of a lesser quality than that produced contemporaneously when the procedures were performed" (AS3 rule 59).

5.5.2 The issuer

AS2's position on the audit of internal control over financial reporting performed in conjunction with an audit of financial statements includes rule 2, which requires the issuer to include a management report in its annual report. This report is required to contain management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year, including a statement as to whether this control is effective. AS2 rule 7 defines internal control over financial reporting as follows:

A process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

The management is required to base its assessment of the effectiveness of the company's internal control over financial reporting on a suitable, recognized control framework established by a body of experts following due-process procedures, including the broad distribution of the framework for public comment. One such framework has been established by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission, and the rules in AS2 are based on this framework. The COSO framework identifies three primary objectives of internal control:

- 1) Efficiency and effectiveness of operations;
- (2) Financial reporting; and
- (3) Compliance with laws and regulations.

Although the auditor should report on internal control over financial reporting, the management is always responsible for assuring readers of its financial reports of the effectiveness of internal control over financial reporting (cf. AS2 rule 19). AS2 rule 20 sets out the management's responsibilities in an audit of internal control over financial reporting, stating that the auditor can only satisfactorily complete an audit if management does:

- a. Accept responsibility for the effectiveness of the company's internal control over financial reporting;
- b. Evaluate the effectiveness of the company's internal control over financial reporting using suitable control criteria;
- c. Support its evaluation with sufficient evidence, including documentation; and
- d. Present a written assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year.

The management should further determine which controls the auditor should test to gain an understanding of and to evaluate the management's process for assessing the effectiveness of the company's internal control over financial reporting (cf. AS2, rule 40). In addition, when the auditor inquires the management in an effort to obtain an understanding of this process, the management should cooperate in full and provide documentation to the auditor. AS2 rules 42 and 43 describe in detail what the content of this documentation should be and what form it may take (i.e. it may be in hard copy, electronic files, or other media, and it might include information such as policy manuals, process models, flowcharts, job descriptions, documents, and forms). Rule 43 stresses further that "the form and extent of documentation will vary depending on the size, nature, and complexity of the company".

AS2 also considers at length the importance of the management's documentation. This documentation has the status of evidence (AS2 rule 44), because it shows that controls related to the management's assessment of the effectiveness of internal control over financial reporting have been identified and "are capable of being communicated to those responsible for their performance". Another very important purpose of this documentation is that it provides the foundation for appropriate communication concerning responsibilities for performing controls, and for the company's evaluation and monitoring of the effective operation of these controls. Inadequate documentation is considered to be a deficiency in the company's internal control over financial reporting, and therefore leads to a limitation in the scope of the engagement of the auditor.

Management should also provide the auditor with written representations for the benefit of his/her audit (AS2 rule 142). These written representations include:

- a. A statement that it is management's responsibility to establish and maintain effective internal control over financial reporting;
- b. A statement that management has performed the previously mentioned assessment and specified the control criteria;
- c. A statement that management did not use the auditor's procedures performed during the audits or the financial statements as part of the basis for management's assessment;
- d. A statement that management's conclusion was based on the control criteria;
- e. A statement that management has disclosed to the auditor all deficiencies;
- f. A description of any material fraud and any other fraud;
- g. A statement about whether control deficiencies are identified and communicated to the audit committee; and
- h. A statement about whether there were any changes in internal control over financial reporting.

The importance of this rule was stressed in section 5.5.1, since the scope of the audit may be limited if the management does not provide the required representations.

AS2 rule 162 is dedicated to the required content of the management's report, which consists of the following elements:

- A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- The framework used by management to conduct the required assessment;
- The assessment including an explicit statement as to whether that internal control over financial reporting is effective; and
- A statement that the external auditor has issued an attestation report on management's assessment.

This content should also be included in the management's representation letter to the auditor. The management cannot provide its report if a material weakness has been discovered. In that case, it must disclose this material weakness. The auditor must inform the management (and board of directors) in writing before issuing the auditor's report about any significant deficiencies and material weaknesses. Further, the auditor must inform the management of any fraud or potentially illegal acts. This means that if management does not do what it is required to do, the auditor cannot perform the audit, and vice versa.

AS2 rules 55 and 56 stress that although the audit committee plays a very important role, the responsibility for maintaining effective internal control over financial reporting remains the management's responsibility.

The CFO/CEO

AS2 rule 200 states that the company's management, with the participation of the principal executive and financial officers, has to make quarterly and annual certifications with respect to the company's internal control over financial reporting. This is in line with SOX302, on the officers' certifications (cf. 5.4.2).

5.5.3 The audit committee

With regard to the audit of internal control over financial reporting performed in conjunction with an audit of financial statements, AS2 clearly distinguishes between the responsibilities of the audit committee, the board of directors, and the auditor. We saw in the previous section that AS2 rule 56 points out that although the audit committee plays a very important role within the control environment and in monitoring components of internal control over financial reporting, the board of directors remains responsible for evaluating the performance and effectiveness of the audit committee. The auditor's task is to assess the effectiveness of the audit committee as part of understanding and evaluating the components as mentioned above.

The importance of the issuer's audit committee with respect to the auditor is expressed in several rules. First, if the auditor expresses an adverse opinion after determining that the management's process for assessing internal control over financial reporting is inadequate, the auditor should "communicate in writing to the audit committee that the material weakness was not disclosed or identified as a material weakness in management's report" (AS2 rules 174–175). Second, if there are significant changes, the auditor should communicate this with the management, but if the management does not react appropriately "to the auditor's communication within a reasonable period of time" (AS2 rule 205) the auditor should inform the audit committee. Third, the auditor must communicate all significant deficiencies and material weaknesses in writing to the audit committee. Finally, the auditor must also communicate any fraud or potentially illegal acts to the audit committee (AS2 rule 213). The importance of this is stressed by the phrase: "the auditor must assure himself of herself that the audit committee is adequately informed, unless the matter is clearly inconsequential".

AS3 contains no specific rules for the audit committee.

5.6 The codes' effects

5.6.1 The effects of the Sarbanes-Oxley Act and the Auditing Standards

Cools (2007) states that the SOX and the strict approach by the SEC serve to partly restore the public's confidence. He holds the view that mandatory accountability has been increased in several fields, and that companies listed in the US have had to comply with the rules on financial reporting and internal risk management systems. He also points out that the costs for compliance are high, involving three types of costs:

- (1) Costs associated with the introduction of section 404;
- (2) The yearly returning costs; and
- (3) The high insurance costs for directors.

Cools states that the Johnson Group estimated the initial costs to be \$3.5–9 million per company (with a turnover of at least \$3 billion). The annual costs for subsequent years have been estimated at \$3–8 million. In particular, the audit trails that companies are required to perform cost between several thousands to tens of thousands per company. Skeel (2006) holds a relatively positive view of the costs for introducing SOX404, pointing to the benefits of having accurate financial information produced at every level of the company. The last group of costs, concerning costs for insurance claims against directors, has according to Cools doubled after the introduction of the SOX, making the costs for cross-listed companies even higher. Further, Cools indicates that indirect costs are also incurred, for example due to bureaucracy, risk-avoidance behavior, and too strong a focus on risk control.

With respect to the effects of the SOX, Skeel (2006) states that there is a risk that the new requirements will simply add more internal bureaucracy – that companies will hire a new internal compliance officer and essentially keep doing what they were doing before. Further, Skeel stresses that there is also a risk that companies will focus narrowly on financial compliance, while ignoring other kinds of potential misbehavior within the firm. He criticizes the fact that foreign accounting companies and foreign companies listed in the US are forced to adopt a US-style structure in order to list shares on US markets.

5.6.2 The effects of the Tabaksblat Code and the Sarbanes Oxley Act (2002–2007)

This section discusses the effects of the Dutch and the US corporate governance codes on specific topics, namely (1) independent directors/supervisory board members, (2) the role of the audit committee, (3) the CFO, (4) remuneration, and (5) the accounting firms.

Independent directors/supervisory board members

Cools (2007) holds the opinion that the Tabaksblat Code and the SOX have particularly affected three groups, namely the non-executive directors/supervisory board members, the external auditors, and the CFOs. Cools interviewed 30 CEOs and found that the majority believe that the non-executives have become more alert and committed, and that the independent directors put in more time, are sharper and more critical, and provide (even) more added value than previously. In Cools's view, it is mainly the market influence that has brought about these changes, because the scandals showed that non-executives were considered to be accountable too.

Audit committee

Both codes enhance the importance of the audit committees. However, the CEOs that Cools (2007) interviewed hold the view that the audit committee has little added value and spends too much time on paperwork.

CFO

The last group, the CFOs, now play a key role. Financial disclosure and risk control have become their main tasks, which is enhanced by their certification responsibility. Their accountability has also increased. According to Cools (2007), the CFO has become the "financial conscience" of the company, and thus the counterbalance to the CEO.

Other effects of the SOX and Tabaksblat Code are that unknown risks have been reduced and the quality of decisions has improved. Further, the Letters of Representation mean that not only a few managers, but managers at all levels of the company declare that the financial statements are satisfactory, that the company genuinely possesses certain assets, and that the internal control and risk management systems function adequately.

Remuneration – fixed and variable parts

The division between fixed and variable remuneration has given rise to much debate. According to Cools (2007), there is a relationship between the extent of stock option and share remuneration of top managers and the share performance of a company. However, there seems to be no relationship between remuneration and performance: performance does not lead to pay and pay does not lead to performance, at least with respect to top managers. The financial stimuli are not usually related to the quality of the work, but to quantitative measurable output. Consequently, this leads to ‘bonus blindness’: people receiving performance-based remuneration will do only those tasks for which they get paid extra. In turn, this leads to value damage, because such people will exercise duties which will obviously damage the company. Further, performance-based remuneration damages cooperation, which also leads to value damage. Another negative side effect is gaming or accounting fraud, which is the manipulation of the *measured* performance, without performance genuinely improving. Cools lists a few examples, such as pushing certain costs down or adjusting accounting rules in order to make earnings look better than they in fact are. As stated above, there is a relationship between stock option remuneration and fraud by top managers: Cools states that a 25% increase in stock option remuneration increases the chance of fraud to 68%. Cools does, however, offer a solution for the remuneration problems – his view is that targets as well as the link between budget and remuneration should be abolished. If performance payments are used, the remuneration committee should determine the standards together with the management board, and should remain completely independent when negotiating the amount of the payments.

Accounting industry

The accounting industry is the party most affected by the SOX; the extended and extremely detailed rules appear to have made accountants the ‘enemies’ of corporate managers. The CEOs interviewed by Cools (2007) consider the external auditors to have become more fearful, afraid of answering questions before consulting their superiors.

5.7 Summary

This chapter addressed sub question I.4, namely ‘Why has the SOX been established, how is it legally embedded, and what is its core content and goal?’ In doing so, it described how the Enron and WorldCom scandals forced the US government and the SEC to take action to restore investor confidence. The result was the Accounting Industry Reform Act 2002, known as the Sarbanes-Oxley Act. This was the biggest change in securities legislation since the Securities Acts of the 1930s. The main cause of the accounting scandals was that the auditors provided non-audit as well as audit services, which compromised their independence and ultimately led to conflicts of interest. The focus of the SOX is therefore on the accounting industry. The Public Company Accounting Oversight Board was installed through the Act in order to monitor the accounting firms. Public accounting firms that perform audits must be registered with the PCAOB, and the PCAOB has the authority to sue and penalize registered firms if they intentionally or knowingly violate the rules. US listed companies, foreign companies listed in the US, and subsidiaries of foreign multinationals in the US are required to comply with the SOX rules.

The SOX is a federal law, as are all securities laws in the US (cf. 3.4.1). It is thus a rule-based corporate governance code, which applies to all domestic and foreign companies

(and the subsidiaries of foreign multinationals) listed at American stock exchanges. Foreign public accounting firms which are registered with the PCAOB also have to comply.

The goal of the SOX is to protect the investors by ensuring that corporate financial disclosures are accurate and reliable. Its core content concerns the tasks and responsibilities of the four main corporate bodies, namely the RPAF, the issuer (including the CEO and CFO), the audit committee, and the investors. Because auditors should be independent, the SOX prohibits certain non-audit services. It also requires that the lead auditor be replaced every five years; that the issuer's CFO, controller, or CEO may not have been employed by the accounting firm concerned one year before the initiation of the audit; and that the auditor report directly to the issuer's audit committee.

SOX404(b) stipulates that the accounting firm should attest to and report on management's assessment of the effectiveness of the internal control structure and procedures. Further, the auditor should prepare and issue the audit report, in which he/she either agrees or disagrees with the issuer's opinion on the financial statements.

The SOX shows the close relationship between the issuer and RPAF, as the rules mainly focus on the audit to be performed by the auditor for the issuer. This mutual relationship forms the core of the rules. SOX404(a) requires an issuer to include in its annual report an internal control report, which itself includes (1) the management's statement that it is responsible for establishing and maintaining adequate internal controls and procedures for financial reporting, and (2) the management's assessment. In this regard, the issuer's financial statements will be reviewed by the SEC at least once every three years. The issuer should also include in its annual report (3) the auditor's attestation, (4) a statement about whether the issuer has adopted a code of ethics for the CEO and CFO, and (5) a statement about whether the audit committee has a financial expert. One of the most important rules included in the SOX concerns the certifications by the CEO and CFO, which make the officers personally responsible for establishing and maintaining the internal controls and for evaluating the effectiveness of those controls.

The audit committee should consist of members of the board of directors who are independent, in that they may not receive any compensation from the issuer besides their remuneration as director and member of the audit committee. The audit committee's main task and responsibility is the preapproval of non-audit services. The committee also determines the auditor's appointment and remuneration, and monitors the auditor's work. Finally, the committee should establish procedures for complaints (involving the management or employees) with respect to accounting and auditing matters.

The investors' most important 'role' is a passive one, in the sense that the SOX considers the protection of the investors as its most significant goal, which can be achieved by way of accurate and reliable financial disclosure. All SOX rules aim at this goal.

The three Auditing Standards and the seven groups of rules established by the PCAOB shortly after the enactment of the SOX cover all the details not covered by the SOX. For the RPAs, rule 3101 is very important as it describes the degree of responsibility that the Standards impose on the auditor. Certain rules require unconditional responsibility, indicated by the verb forms "must", "shall", and "is required"; presumptively mandatory responsibility, indicated by the verb "should"; or responsibility to consider, indicated by the verbs "may", "might", and "could".

Auditing Standard 2 is an addition to SOX404(b) and SOX103(a)(2)(A)(iii), which both require a level of assurance of the reliability of financial reports. The auditor must therefore evaluate the management's assessment process as well as the effectiveness of internal control over financial reporting as a result of that assessment process. To do so, the auditor must obtain sufficient evidence from different sources. The internal control is determined to be effective if no material weaknesses or significant deficiencies are detected.

Further, AS2 includes the required content elements of the auditor's report on management's assessment, and the auditor's communication requirements.

AS2 requires the issuer's management to determine what controls the auditor should test, and to provide the auditor with certain documentation and written representations. It stipulates that the management's assessment of the effectiveness of internal control over financial reporting should be based on the COSO framework. It also sets out the content elements that should be included in the management's report.

Finally, AS2 describes the audit committee's important role with respect to the control environment and monitoring components of internal control over financial reporting. Management, however, remains responsible for maintaining effective internal control over financial reporting. The auditor is required to inform the audit committee of any material weaknesses.

Auditing Standard 3 is an addition to SOX103(a), and mainly includes audit documentation requirements. The most important of these is that the documentation demonstrates that the work was in fact done; it must therefore contain sufficient information to prove this. The majority of the rules concern changes to audit documentation as a consequence of specific circumstances.

The effects of the SOX mainly concern the high costs of implementing SOX404. Other effects are that the accounting firms seem to have become much more cautious, the number of unknown risks has been reduced, the quality of decisions has improved, the Letters of Representation may have promoted accountability for financial disclosure among management at all levels within the company, and finally, the internal risk management and control systems are more adequate. Another effect is that the CEO's and CFO's certifications have led to increased accountability, and these officers have essentially become the company's "financial conscience". A negative effect might be the risk of more internal bureaucracy and that companies have simply kept doing what they were doing before.

Both the Tabaksblat Code and the SOX have led to improved responsibilities of the independent directors and the supervisory board members respectively. Further, both codes have enhanced the importance of the audit committee, although some scholars indicate that the committees have little added value in practice, and are also now involved in more paperwork.

This chapter has thus shown that the constitutive rules included in the SOX (and AS2 and 3) make explicit what the US institution 'good governance' entails. Given that the SOX is officially called the Accounting Industry Reform Act 2002, these constitutive rules are in fact mainly financial disclosure rules. Compliance with all rules included in the Act ought to lead to formal transparency, and if such transparency has been achieved, the US constitutive rules of 'good governance' must therefore have been collectively accepted, meaning that the institution 'good governance' will have been constituted. Since the SOX is a law, compliance is not expected to be an issue. Therefore, there is no doubt about the collective acceptance, and in turn, the US institution 'good governance' is expected to have been constituted.

Analysis Step 1: Analysis of Constitutive Communication Rules included in Tabaksblat Code

6.1 Introduction

Chapter 3 provided background information on what corporate governance is and how the Dutch and US corporate governance systems have developed over time, and further what their characteristics are. Chapters 2, 4, and 5 showed that the Dutch and US corporate governance codes are to be seen as products of their respective corporate governance systems, since their rules make explicit what constitutes ‘good governance’ within their particular context. The corporate governance codes include constitutive rules of the form *X counts as Y* (*‘good governance’*) *in C*, whereby *C* is the context, namely the corporate governance system concerned. This means that these rules constitute the relevant institution ‘corporate governance’ or ‘good governance’. In essence, therefore, the Tabaksblat Code includes constitutive rules that bring the Dutch institution ‘good governance’ into existence, and the Sarbanes-Oxley Act (SOX) includes constitutive rules that bring the US institution ‘good governance’ into existence.

We saw in 1.1 that since ‘good governance’ consists mainly of communication, the majority of the constitutive rules are communication rules. The constitutive communication rules have the form *X counts as ‘good governance’ (Y) in C*. Searle’s (2005) view of institutions places a strong emphasis language (cf. 2.2), as language is the condition *sine qua non* for institutions to exist at all because the status function *Y*, namely ‘good governance’, can only be represented by language (or other symbols). Language in this dissertation revolves around communication in texts and communication actions that are included in the codes’ rules. This dissertation focuses on a specific text type, namely the annual report genre, and this chapter as well as Chapter 7 show what the generic integrity of the Dutch annual report genre and of the US Form 20-F genre should include according to the Dutch and US corporate governance codes respectively. The analyses of the constitutive communication rules included in these codes will result in the description of both ‘ought’ situations, namely the ‘ought’ situation with respect to the Dutch annual report genre and the ‘ought’ situation concerning the US Form 20-F genre²⁶. This means that these analyses cover ‘analysis step 1’ (cf. 1.1).

However, before analysing the constitutive communication rules of the two codes, an initial preparation phase is needed. This chapter starts with that preparation phase, before proceeding with the analysis of the Tabaksblat Code (also included in this chapter) and the analysis of the SOX (included in Chapter 7). The preparation phase consists of identifying and analyzing the constitutive communication rules. The analyses themselves involve two stages, namely (1) structuring the identified communication rules per selected corporate body; and (2) using the results of this structuring of the communication rules per corporate body as the basis for establishing which rules determine the generic integrity of the Dutch annual

²⁶ Chapters 8 and 9 present the ‘is’ situations of both the Dutch and US annual reports in order to compare them with the ‘ought’ situations. Companies should comply with the rules of the codes, and if they do so – whereby both ‘is’ situations cover completely the ‘ought’ situations – formal transparency will have been achieved, meaning that the Dutch and US institutions ‘good governance’ will have been brought into existence.

report genre and the US Form 20-F genre. The following sections further explain both the preparation phase and the structure of the analyses.

Preparation phase

The preparation phase lays the groundwork for the Tabaksblat Code analysis (later in Chapter 6) and the SOX analysis (Chapter 7). It consists of identifying and analyzing those rules that have a major influence on the annual report, which reflects the wider corporate communication. These are the constitutive communication rules that determine the integrity of the Dutch annual report genre and the US Form 20-F genre. Therefore, the following sub question will be answered:

- II.1 How can the rules included in the Tabaksblat Code and the Sarbanes-Oxley Act be identified and analyzed as communication requirements?

The preparation for the actual analyses of the Dutch and US codes consists of several steps. The first is to detect which of the Tabaksblat Code's and SOX's rules can be considered to be constitutive communication rules. Second, the question 'which CCU should communicate with which other CCU(s)?' will be elaborated in order to determine which communication lines are required according to the Code and the Act. Third, the question 'what should the CCU communicate about with the other CCU(s)?' will be examined in order to gain an indication of the content of the communication rules. This content is expected to relate to what 'good governance' is all about, since the constitutive communication rules make explicit what 'good governance' entails (cf. 1.1).

The first part of this chapter therefore consists of the preparation phase, focusing on how to detect and structure the constitutive communication rules included in the codes. Since the annual report genre is a genre network (cf. 2.3) and thus a complex genre in which different text parts are included and interrelated, this preparation phase is an important step. Concretely, the first part of this chapter lays the groundwork for analysis step 1, which was visualized in sub chapter 1.1 as follows:

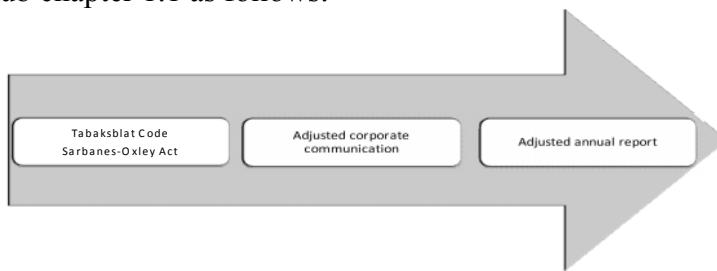


Figure 1.5: Focus of analysis step 1

Analysis step 1

The preparation phase is followed by the actual analyses of the codes, with this chapter including the analysis of the Tabaksblat Code's constitutive communication rules, and Chapter 7 including the analysis of the SOX's communication rules. Thus, analysis step 1 concerning the Dutch code covers sub question II.2, 'How do the communication requirements included in the Tabaksblat Code determine corporate communication (communication structure including communication lines, and communication processes), and how do the communication rules determine the annual report genre?' Chapter 7 includes analysis step 1 with respect to the SOX, therefore covering sub question II.3, 'How do the communication requirements included in the SOX determine corporate communication (communication structure including communication lines, and communication processes), and how do the communication rules determine the Form 20-F genre?' Each of these analyses – covering analysis step 1 – consist of two stages, as described below.

Stage 1

The preparation phase is needed in order to understand which rules have been identified as communication rules, and which corporate bodies should be involved in the corporate communication according to the codes. This dissertation focuses on four selected corporate bodies per code, the Corporate Communication Units (CCUs) (cf. 1.2). The CCUs concerning the Dutch code are the management board, the supervisory board, the general meeting of shareholders (GMS), and the external auditor. The CCUs with respect to the US code are the issuer, the registered public accounting firm, the audit committee, and the investors. This means that the first stage of the analyses involves structuring all identified constitutive communication rules with respect to the selected CCUs. In other words, which rules concern which CCU will be investigated by answering question (1), ‘which CCU should communicate with which other CCU(s)?’, which will already have been elaborated in the preparation phase. The answers to this question will make visible the communication lines²⁷ between the selected CCUs. But not only the communication lines are relevant; even more important to know is what the CCUs should communicate with each other about. This will be clarified by answering question (2), ‘what should the CCU communicate about with the other CCU(s)?’, which, too, will have been elaborated in the preparation phase. The answers to these questions will allow for the structuring of the communication rules per CCU and provide insights with respect to the content of the required communication. Concretely, therefore, the first stage of each analysis shows (1) the communication lines per CCU and (2) the content of the required communication.

Stage 2

Stage 2 consists of categorizing the findings from the first stage with respect to the characteristics of the annual report’s generic integrity. This means that the findings will be categorized based on whether a finding is to be seen as a text-internal factor or a text-external factor determining the integrity of the Dutch annual report genre or the US Form 20-F genre respectively. The text-internal factors of the annual report’s generic integrity (cf. 2.3) consist of:

- (a) Situational context;
- (b) Communicative purpose;
- (c) Move structures;
- (d) Themes; and
- (f) Intertextual aspects.

The text-external factors comprise:

- (1) Discursive procedures, consisting of: (a) Annual report contributors; and (b) The structure of the annual report process; and
- (2) Disciplinary culture, consisting of generic norms; and finally
- (3) Discursive practices concerning: (a) Choice of genres; and (b) Communication modes.

These factors determine the integrity of the Dutch annual report genre network and the US Form 20-F genre network respectively. If an annual report shows the factors required by the relevant code, it thus shows the specific integrity which constitutes the institution ‘good governance’. The results of the categorizing of the findings into the generic integrity’s individual factors or elements together construct the ‘ought’ situation of the Dutch annual

²⁷ The relevant rules containing the communication requirements per relevant CCU and each of its communication partners can be found in Appendix A, which shows all communication lines of and between the supervisory board, the chairman of the supervisory board, the audit committee, the remuneration committee, the selection and appointment committee, the management board, the general meeting of shareholders, and the external auditor. These overviews also present the main content and content theme of the rules.

report genre network as determined by the Tabaksblat Code (Chapter 6) and the US Form 20-F genre network as determined by the SOX (Chapter 7).

Chapter outline

Sub chapters 6.2–6.4 cover the first part of this chapter, namely the preparation phase for analysis step 1 with respect to the constitutive communication rules included in the Tabaksblat Code and SOX. Sub chapter 6.2 clarifies how the constitutive communication rules can be identified. Sub chapter 6.3 elaborates on question 1, ‘which CCU should communicate with which other CCU(s)?’, which enables the detection of the communication lines between the four selected CCUs determined by the codes. Subsequently, sub chapter 6.4 clarifies the second question, namely ‘what should the CCUs communicate about with each other?’ Thus, sub chapters 6.2–6.4 cover the preparation phase for the actual analyses of the corporate governance codes to identify the ‘ought’ situation of the Dutch annual report genre and the US Form 20-F genre.

Sub chapters 6.5–6.8 cover stage 1 of analysis step 1 of the constitutive communication rules included in the Tabaksblat Code, in order to identify the ‘ought’ situation of the Dutch annual report genre network. These sub chapters each include the analysis of the communication rules of one of the Tabaksblat Code’s Corporate Communication Units: 6.5 covers the analysis of the communication rules concerning the CCU supervisory board, 6.6 does the same for the CCU management board, 6.7 for the CCU GMS, and 6.8 for the CCU external auditor. Each of these sub chapters starts with the communication lines of the CCU concerned, followed by the content of the communication as related to the Dutch view of ‘good governance’, and finally the output (A- and B-rules) as required by the communication rules.

Sub chapter 6.9 provides an overview of how the communication rules determine the integrity of the annual report genre network according to the Tabaksblat Code. This overview is divided into the text-external factors (6.9.1) and the text-internal factors (6.9.2). Therefore, sub chapter 6.9 covers stage 2 of the analysis.

Finally, sub chapter 6.10 presents a summary of this chapter.

6.2 Preparation phase – How to identify the constitutive communication rules?

Which rules are constitutive communication rules?

The analysis of the Tabaksblat Code and the SOX revealed that the constitutive communication rules include specific key words indicating that communication should take place. These key words could be regarded as the determinants of communication action. An investigation of the communication key words in the Tabaksblat Code resulted in the following examples:

Report related developments	Advise the supervisory board
Provide all information necessary	Disclosure of remuneration
Obtaining all information	Request a delegation of powers
Draw up regulations	Pass a resolution
Vote on	Respond to all information (half year/quarterly figures)
State the composition of each committee	Discuss the main items
Draft a proposal about remuneration policy	Communicate the main conclusions [...] for the appointment of the external auditor

Evaluate the functioning of the management board	Meet with the external auditor
Supervisory board has proper contact with the management board	Advise about remuneration and instructions to provide non-audit services

Figure 6.1: Examples of Tabaksblat Code key words

These key words are calls for communicative action, and are sometimes accompanied by specifications including, for example, the quality of communication or the time span in which communication has to take place, or both. The following figure shows some examples of specifications:

Communication quality	Time span
The <i>quality and the completeness</i> of publicly disclosed financial reports	Shall immediately report
Provide all <i>relevant</i> information	Report to the management board and the supervisory board <i>simultaneously</i>
<i>Provide in good time all information necessary</i>	
<i>Provide with equal and simultaneous</i> information	
<i>The timeliness, completeness and correctness</i> of the external financial reporting	

Figure 6.2: Communication specifications

It is very likely that these additions emphasize the importance of the specific communication rules, but the specifications are not explained further.

Two kinds of key words

Two kinds of key words can be distinguished, namely (1) key words including explicit references to communication actions, and (2) key words including an implicit call for communication. An example of an explicit reference to a communication action is included in the following rule:

The auditor must communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit. (AS2, 204-217, pp. 219-221)

An example of key words that include an implicit call for communication included in the Tabaksblat Code is the procedure with respect to the appointment of the external auditor:

The supervisory board shall nominate a candidate for this appointment, for which purpose both the audit committee and the management board advise the supervisory board. The remuneration of the external auditor [...] shall be approved by the supervisory board on the recommendation of the audit committee and after consultation with the management board. (Tabaksblat Code 2003, V.2, p. 31)

This example shows how a certain process, the nomination of the external auditor, is in fact a communication process, or at least should be. Several corporate bodies are involved in this process and the Code determines the tasks of each corporate body. This process could not take place without the separate bodies communicating with one another.

Other examples of key words that include an indirect call for communication are the following:

- Approve decisions to enter into transactions;
- Nominate an external auditor;
- Ensure that all major financial information is known;
- Every material change in the remuneration policy shall be submitted; and so on.

The next figure shows examples of key words included in the SOX and the related Auditing Standards 2 and 3.

Report material written communications such as any management letter	Evaluate the effectiveness of the company's internal control over financial reporting
Present a written statement	Evaluate management's documentation
Documentation [...] and disclosures [...] are capable of being communicated	Evaluate documentation deficiency
Dismiss an opinion	State a direct conclusion
Provide in its report [...] and in its representation letter	Notify a material misstatement

Figure 6.3: Examples of Sarbanes-Oxley Act key words

The key words clearly focus on the internal control over financial reporting and on financial documentation. This is obviously the consequence of the key topic of Auditing Standard 2, entitled ‘An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements’. This is an amendment to SOX103(a)(2)(A)(iii) and 404 (cf. 5.5), both of which include the requirement that financial reports have a certain level of assurance of reliability and, therefore, the auditor must evaluate both the management’s assessment process and the effectiveness of internal control over financial reporting. This means that the auditor must express two opinions in all reports on internal control over financial reporting. Likewise, Auditing Standard 3 is an addition to SOX103(a) (cf. 5.5) about audit documentation. Both Standards, therefore, are expected to include detailed documentation and thus rules about written communication.

The key words included in the SOX are sometimes accompanied by further specifications concerning the time span in which the communication action should take place, for example, ‘*timely report*’ and ‘*disclose on a rapid and current basis*’. Another specification concerns the quality of the communication action, for example, ‘*appropriate communication*’ and ‘*disclose in plain English*’. Few of these have been explained in any detail, though the latter clearly needed elaborating, as can be seen in the fact that the SEC established ‘A Plain English Handbook: How to create clear SEC disclosure documents’, which has been available on its website since 1998.

In the foregoing, we have detected the constitutive communication rules, including calls for communication actions, through the use of key words. The next step is to structure these constitutive communication rules, as described in the next sub chapter.

6.3 Preparation phase 1. Which CCU should communicate with which other CCU(s)?

The answers to this question will identify the communication lines between the CCUs. The communication lines might involve communication processes, for example with respect to Tabaksblat Code rule III.1.9, including that:

The supervisory board and its individual members each have their own responsibility for obtaining all information from the management board and the external auditor that the supervisory board needs in order to be able to carry out its duties properly as a supervisory organ [...]. (Tabaksblat Code 2003, III.1.9)

The abovementioned rule shows a communication line from the supervisory board (and its individual members) to the management board as well as to the external auditor. The communication process included here concerns obtaining relevant information, which implies asking for information via email or telephone, for example, and which should consequently

lead to a reply email or telephone call. A communication process in fact consists of a communication action and a reply or response to that action. Another example concerns Auditing Standard 2, rule 205:

If, in the auditor's judgment, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform the audit committee. If, in the auditor's judgment, the audit committee does not respond appropriately, the auditor should evaluate whether to resign from the engagement

The communication process described in the abovementioned Auditing Standard 2 rule concerns the communication action from the auditor to the management board, and the subsequent communication action (i.e. the auditor informing the audit committee) if the management does not react adequately (or at all) to the initial action. If there is also no reaction to the second communication action, the third communication action (i.e. announcing the resignation) should be put into action.

One of the most complex communication processes is included in the following Tabaksblat Code principle:

The external auditor is appointed by the general meeting of shareholders. The supervisory board shall nominate a candidate for this appointment, for which purpose both the audit committee and the management board advise the supervisory board. The remuneration of the external auditor, and instructions to the external auditor to provide non-audit services, shall be approved by the supervisory board on the recommendation of the audit committee and after consultation with the management board. (Tabaksblat Code 2003, V.2)

Here, the entire appointment procedure is captured in communication processes. First, the communication line between the GMS and the external auditor includes the official appointment of the external auditor – which is the communication action – by the GMS. Second, the communication processes before the official appointment include (1) the communication actions of the management board and audit committee, which advise the supervisory board; and (2) the response (i.e. the communication action) of the supervisory board, namely the nomination of the external auditor based on the proposal of the management board and the audit committee. Another process concerns the remuneration and the approval of non-audit services, which have been recommended by the audit committee – one communication action – to the supervisory board. The supervisory board approves the remuneration and non-audit services – as a response to the communication action, but in itself also a new communication action – after consultation with the management board, which is a communication action as well.

It will be obvious that each communication action leads to a reaction in the form of another communication action. A simple communication process consists of one communication action and one reaction, but complex communication processes such as those described above consist of multiple communication actions that lead to various reactions, which in turn are new communication actions themselves. The network of all communication lines between the four selected CCUs – which often include communication processes – is the communication structure as determined by the Tabaksblat Code or the SOX respectively. These communication lines will ultimately show which CCU should perform which communication action on behalf of the annual report genre. Since the annual report genre is a genre network (cf. 2.3.1), multiple communication rules will likely be needed to construct such a network.

Tabaksblat Code – Corporate Communication Units

The analysis of the constitutive communication rules included in the Tabaksblat Code reveals the answer to the first 'communication research question' (sub question II.2); namely, that the following 19 different corporate bodies (CCUs) can be identified within the Dutch corporate governance code, which should each communicate with one another.

Supervisory board	Management board
Audit committee	Chairman of the management board
Remuneration committee	Company secretary
Appointment and selection committee	Internal audit department
Chairman of the supervisory board	Internal auditor
General meeting of shareholders	Chief financial officer
Institutional investors	Compliance officer
Depository receipt holders – management of the trust office	ICT
Employees	External auditor
Works council	Company

Figure 6.4: Tabaksblat Code – Corporate Communication Units

We saw in sub chapter 1.2 that this dissertation focuses on four selected corporate bodies. The description and explanation of the roles and tasks of the supervisory board (and its committees) (cf. 4.4.1), the GMS (cf. 4.4.2), the management board (cf. 4.4.3), and the external auditor (cf. 4.4.4) emphasize the significance of these corporate bodies. The selection of these four main bodies is based on their importance within the Dutch corporate governance system, within the Dutch Tabaksblat Code, and within the listed company. The four selected CCUs are considered to be representative for all remaining CCUs. The analysis of the constitutive communication rules included in the Tabaksblat Code and the influence of these rules on the annual report's generic integrity is based on the communication of the four selected CCUs.

Sarbanes-Oxley Act and AS2/3 – Corporate Communication Units

The analysis of the constitutive communication rules included in the SOX and AS2/3 resulted in the identification of the following 15 CCUs:

Public Company Accounting Oversight Board (PCAOB)	Issuer
Securities Exchange Committee (SEC)	CFO/CEO
Registered public accounting firm	Audit committee
Foreign registered public accounting firm	Securities analysts
Investors	Employees (plan participants, beneficiaries)
Principal stockholders	Attorneys
State regulatory authority	Registered and non-registered brokers/dealers
	Plan administrator

Figure 6.5: Sarbanes-Oxley Act/AS2 and 3 – Corporate Communication Units

Although the number of CCUs here is nearly the same as for the Tabaksblat Code, there are some interesting differences. The Tabaksblat Code requires communication action between many different stakeholders, including the works council, whereas the SOX only requires communication action between the financially oriented CCUs, which act on behalf of the investors. Further, some CCUs are involved which are federal institutions – the PCAOB and the SEC – or state institutions – the ‘state regulatory authority’. The federal organizations are CCUs, but at the same time the establishers and monitors of the SOX. Another important ‘outside’ CCU is the ‘attorneys’, who have become increasingly important because the US corporate governance system is an outsider system (cf. 3.4.2) in which not only the market process but also the public courts serve to solve problems. Federal and state legislation as well as the courts can be seen as safeguarding the investors’ interests. The SOX CCUs emphasize

on the one hand the legislation angel, and on the other hand the investor angel. Both of these aspects reflect the US corporate governance system (cf. 3.4).

This research focuses on four select corporate bodies, the CCUs for the Tabaksblat Code and the SOX respectively. The terms used differ per CCU and per corporate governance system (cf. 5.4). The US terms refer directly to US corporate governance which, as stated above, is an outsider system (3.4.2) in which the shareholder holds a central position. The first difference in terminology concerns the abovementioned US legislation angel, as legal terms have been used; for example, the term ‘issuer’ has been used instead of ‘company’ because the SOX is a securities law in which the ‘issuer of securities’ plays a central role.

The second difference relates to another aspect of the US corporate governance system, namely the one-tier board system in which the board consists of executive and non-executive directors. The non-executive directors are meant to be independent monitors. Although they are equally accountable for the company’s performance as the executives, the audit committee seems to have much more power, in particular monitoring power (cf. 5.4.3). The SOX provides little information with respect to the non-executive directors, which could suggest that the audit committee has taken over the monitoring role to a certain extent. These differences explain the following terms for the SOX CCUs, namely (1) the issuer, (2) the investors, (3) the registered public accounting firm, and (4) the audit committee.

Although the respective terms for the CCUs with respect to the Tabaksblat Code and the SOX differ, they are certainly comparable. Since this study concerns a Dutch cross-listed company, the CCUs can be compared as follows: the US CCU ‘issuer’ is the corporation, including the board of directors, and will be compared with the Dutch CCU ‘management board’; the US CCU ‘audit committee’ will be compared with the Dutch CCU ‘supervisory board’, given that the two-tier board system is a feature of the Dutch corporate governance system (cf. 3.5.1) and the supervisory board – at least in large corporations – usually includes three committees, one of them being the audit committee; and finally, although the US CCU ‘investors’ covers a larger and more differentiated group, it will be compared with the Dutch CCU ‘general meeting of shareholders’.

The foregoing has thus answered the first question of the preparation phase. The next sub chapter discusses the second question, regarding the content of the communication requirements that is the core of the communication actions.

6.4 Preparation phase 2. What should the CCU communicate about with the other CCU(s)?

We saw in sub chapter 2.2 that the rules of the corporate governance codes make explicit what it is that constitutes the underlying institution ‘good governance’, which until the codes were established was only implicit. These constitutive rules are of the form ‘*X counts as Y* (‘good governance’) in *C*’, whereby *C* is the context of the corporate governance system of the specific country. All rules included in a code together make up ‘good governance’ according to the relevant institution ‘corporate governance’. This means that the rules included in the Tabaksblat Code together construct the Dutch concept of ‘good governance’, and the rules included in the SOX together construct the US concept of ‘good governance’. Since ‘good governance’ consists mainly of communication, the majority of the constitutive rules are communication rules. The content of the constitutive communication rules identified therefore reflects the core elements of the relevant concept of ‘good governance’, or in other words, represents what is included in the status function ‘good governance’. The required communication between the CCUs of the Tabaksblat Code thus reflects the core elements of the Dutch concept of ‘good governance’, and the required communication between the CCUs

of the SOX likewise reflects the core elements of the US concept of ‘good governance’. Section 4.2.2 showed that Hopt (2002) identified the following common themes of the corporate governance codes:

- Board structure (one-tier and two-tier, committees);
- Role of non-executive directors;
- Executive remuneration;
- Responsibility for financial reporting;
- Role of institutional investors;
- Regulation of audit;
- Corporate governance disclosure;
- Codes as part of national law.

These common themes are related to the general concept of corporate governance (cf. 3.2). We saw in Chapter 3 that corporate governance is the system by which business corporations are directed and controlled (cf. 3.2), whereby the power distribution – between management, non-executive directors, and investors – is a key element. This power distribution is affected by internal and external control (or disciplinary) mechanisms. Important internal control mechanisms are independent directors who monitor management, adequate remuneration for management board members, and adequate and effective internal control systems. An example of an external control mechanism is the market for corporate control, which means that the shareholder may decide to make use of the ‘exit strategy’ (i.e. to sell his/her shares) in the case of a takeover (cf. 3.3).

As the common themes in the corporate governance codes mentioned above are expected to relate to the concept of corporate governance, the common theme ‘board structure’ could be related to the internal control mechanism of the independent directors within a one-tier board structure, for example in the US corporate governance system (cf. 3.4), and of the supervisory board members within a two-tier board structure, for instance in the Dutch system (cf. 3.5). The constitutive rules of the codes are thus expected to include content, for example, that determines issues related to the role and functioning of the independent directors and of the supervisory board members within the Act and the Code respectively. And this also means that, for instance, the management board remuneration might be expected to feature among the content themes of both codes.

The content themes of the constitutive communication rules included in the Dutch and US corporate governance codes are thus expected to relate to these ‘common themes’, whereby the relevant corporate governance system will have determined what and how control mechanisms are used (cf. 3.4 and 3.5).

6.5 Analysis stage 1 – CCU supervisory board

The analysis of the supervisory board will also include the analysis of its three committees (the audit committee, remuneration committee, and selection and appointment committee) as well as of the chairman of the supervisory board, as these are considered to be part of the supervisory board (cf. 1.3). The committees’ and the chairman’s communication relationships are first analyzed separately, followed by the results concerning the entire CCU supervisory board.

Communication lines

The answer to the first communication research question is that the supervisory board should communicate with the audit committee, the remuneration committee, the selection and appointment committee, the chairman of the supervisory board, the management board, the GMS, and the external auditor. Most communication requirements concern the

communication with the management board, which corresponds with the Dutch corporate governance system in which the supervisory board monitors the management board. This is a result of the Dutch two-tier board system, whereby the monitoring task of the supervisory board has been legally embedded (cf. 3.5). Further, the monitoring of the management corresponds with the Tabaksblat Committee's view of enhancing the role of the supervisory board as the supervision body.

The supervisory board's communication with the shareholders is important too. The communication requirements here deal mainly with the fact that the supervisory board has to provide the shareholders with relevant and adequate information – for example, about the remuneration policy, regulations with respect to existing or potential conflicts of interest, and the conclusions of the external auditor's assessment – in order to enable the shareholders to exercise their duties well. Other information provided by the supervisory board concerns the share price; this information should be limited and in line with the company's interests. The communication line between the supervisory board and the shareholders corresponds with the standpoint of the Tabaksblat Committee (cf. 4.4.2) that the shareholders should have more powers in order to effectively control the management board failing supervision by the supervisory board. The supervisory board has a further communication line with its chairman, in that the supervisory board members should notify the chairman of any existing or potential conflict of interest. The board should also communicate with its committees, with this communication being primarily characterized by the formal function of the supervisory board with regard to its committees and the committees' reporting requirement to the board. This communication line between the committees and the supervisory board demonstrates the importance of the latter having specific committees for specific tasks. The final communication line concerns communication with the external auditor, which involves the board itself being responsible for obtaining all necessary information from the external auditor. This means not only that the auditor is responsible for *providing* information, but also that the board's own responsibility for *obtaining* information from the auditor is significant, and enhances the importance of correct and adequate financial information within a company as well as the monitoring role of the board.

One communication requirement (III.6.3) calls for communication from the individual supervisory board members to the supervisory board as a whole, as it concerns the board's task to approve transactions by board members that may lead to conflicts of interest.

The rules concerning the supervisory board's communication lines are included in Appendix C.

Content themes

The analysis of the supervisory board's communication requirements shows that their contents relate to the main elements of the Dutch concept of 'good governance'. For example, V.2.3 ("the supervisory board shall, at least once every four years, conduct a thorough assessment of the functioning of the external auditor, and the main conclusions shall be communicated to the GMS for the purposes of assessing the nomination for the appointment of the external auditor") shows the communication process with regard to the external auditor's appointment between the supervisory board audit committee, the GMS and the external auditor. It also emphasizes the demand for an appropriate corporate governance structure. Further, examples have been identified of content relating to remuneration, supervising/monitoring, and disclosing conflicts of interest.

The disclosure-related content mainly concerns information that should be disclosed internally as part of the communication processes within the company. The appropriate corporate governance structure refers to the Tabaksblat Committee's appeal to establish the right 'checks' and 'balances' (cf. 4.4). Remuneration is important, as the 'right' remuneration

– consisting of a fixed part and a variable part – is a ‘hot item’ within the Code. Supervision refers to the enhanced monitoring role of the supervisory board – including the audit committee – and to the role of the external auditor, who monitors the financial information. Information disclosure with respect to existing or potential conflicts of interest is important too, as it refers mainly to the role of the management board, namely its accountability towards the stakeholders, and to the independence of the supervisory board members. All these themes are interrelated, which can be demonstrated through a few examples. Information disclosure, for example, can be the precondition for establishing the appropriate corporate governance structure. For that same reason, corporate governance structure and supervision/monitoring are strongly interconnected, because good supervision/monitoring is a precondition for an appropriate corporate governance structure. The information disclosure about conflicts of interest could be regarded to be part of general information disclosure, but the subject itself is one of the main corporate governance problems. Further, it can be stated that some principles and best practice provisions consist of two kinds of content, each of which may refer to a different corporate governance issue. The content of the communication requirements is thus quite diverse, varying from establishing the right corporate governance structure, information disclosure, remuneration, and supervision, to information disclosure about conflicts of interest. Most communication requirements for the supervisory board concern the principles III (about the role of the board), IV (about the powers of the shareholders and general meeting of shareholders), and V (about the internal and external auditor and the audit). Principle I states that the supervisory and management boards are responsible for the company’s corporate governance structure and compliance with the Tabaksblat Code, and accountable for this to the GMS. The appropriateness of all relevant content themes corresponds with the function of the supervisory board within the Dutch corporate governance system as a monitoring organ (cf. 3.5), which supervises and has a broad overview of the company’s ‘checks’ and ‘balances’.

The following overview (Figure 6.6) shows the content themes of the communication rules with respect to the supervisory board. A focus on the corporate governance structure may be observed.

CCU	Themes	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB		-----	-----	-----	-----	III.6.3
	CSB					III.6.1
	AC		III.5, III.5.1, III.5.2			
	RC		III.5, III.5.1, III.5.2			
	SAC		III.5, III.5.1, III.5.2			
MB			II.2.6, III.1.1, III.1.9	II.2.12, V.2	III.1, III.1.6, V.1, V.1.1, V.1.3	III.6 III.6.5
GMS	IV.3 IV.3.5 IV.3.7	I III.1.1 V.2.3	Determination and Disclosure of Remuneration principle			III.6 III.6.5
EA		III.1.9				

Figure 6.6: Content themes for the CCU supervisory board

Structure of communication actions

The communication actions included in the communication rules are not always part of communication lines; for example, regulations are part of the supervisory board's role and tasks but they are not part of a communication line with another CCU. This means that the required communication action can be distinguished in two different kinds of rules, namely (1) rules which are part of a communication line between two or more CCUs, called A-rules; and (2) rules which are not part of a communication relationship between CCUs, called B-rules.

Certain communication rules include a certain output requirement as a communication action. These rules often also include the way in which the output should be 'published': i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified. The written communications belonging to category (4) are expected to be published at least internally, and to support the corporate governance structure. By doing so, they are often part of the entire annual report process. The categories (1) and (2) are interrelated, because the separate CCU reports are also components of the annual report. Further, the annual report (1) should also be published on the company's website (3), indicating that (1) and (3) are also interrelated.

The means of structuring the communication actions required by the rules as introduced here will also be used for the communication rules of the other CCUs.

The overview starts with the B-rules concerning the annual report, as these call for the supervisory board to establish its own report as an essential component of the annual report.

Annual report – A. Communication requirements as part of the communication lines

Supervisory board's report – annual report (1) and (2)

Principle III.5 requires that the supervisory board's report should include how the duties of the supervisory board's committees have been carried out in the financial year. III.5.2 stipulates that the report shall also state the composition of the individual committees, the number of committee meetings, and the main items discussed. III.5.3²⁸ requires that each supervisory board committee should provide a report including its deliberations and findings, for the supervisory board to then include the significant findings in its own report. The committees' reports are thus part of the committees' communication requirements (cf. 6.5.2, 6.5.3, and 6.5.4).

One communication requirement is included in III.6.3 about publishing the transactions of supervisory board members that lead to conflicts of interest in the annual report. Since the supervisory board itself should approve these transactions, it is an A-rule.

Supervisory board's remuneration report (1) and (2)

The principle Determination and Disclosure of Remuneration stipulates that the supervisory board's report shall include the principal points of the report on the company's remuneration policy, as prepared by the supervisory board's remuneration committee. This remuneration report includes an explanation of the special remuneration for current and former management board members during a given financial year (II.2.12); this provision is part of the communication line with the management board.

The A-rules with respect to the annual report can be visualized as follows:

²⁸ III.5.3 deals with the reports of each of the committees. These reports are also considered to be the basis for the communicating the deliberations and findings of each committee in the supervisory board report.

Annual report				
SB report				Transactions by SB members
Duties of SB committees	Statements about <ul style="list-style-type: none"> • composition • number of meetings, and • main items discussed 	Significant findings from SB committees' reports	<ul style="list-style-type: none"> • Principal points of remuneration report • Determination and Disclosure of Remuneration principle 	

Figure 6.7: Supervisory Board A-rules for the annual report

Annual report – B. Communication requirements which are not part of a communication line Supervisory board's report – annual report (1) and (2)

The supervisory board should establish a report (III.1.2) to be included in the company's annual financial report. This supervisory board report should include the description of the board's activities in the relevant financial year, and the specific statements and information required by the provisions of the Tabaksblat Code. Further, it should also include detailed, obligatory information²⁹ about each supervisory board member (III.1.3).

Another content demand is included in III.1.5, which indicates that supervisory board members who are frequently absent from supervisory board meetings shall be called to account for this and identified in the supervisory board's report. This rule is related to the increased responsibility of the individual board members. Further, it includes specific content elements (III.1.7) of the supervisory board's report with respect to one rule which states that the supervisory board shall discuss its own functioning, its individual members, its desired profile, composition, and competence, and the management board's functioning. This corresponds with the increased responsibility of the supervisory board (cf. 4.4.1), which places importance on the competences, skills, and experience of its members. In addition, according to III.1.8, the supervisory board should also discuss the corporate strategy, the risks of the business, and the result of the management's assessment. The supervisory board is then obliged to refer to the conclusions of these discussions in its report. These requirements correspond with the legally embedded tasks of the supervisory board (cf. 3.5), namely monitoring the management board's policy and the general state of affairs within the corporation. Finally, III.2.3 indicates that the supervisory board's report shall state that, in the view of the supervisory board members, best practice provision III.2.1 has been fulfilled. It shall also state which supervisory board member is not considered to be independent, if any. (Prior to this, III.2.1 points out that each supervisory board member should be independent, and III.2.2³⁰ explains the term 'independence'.) The detailed independence rules also correspond with the increased responsibility of the supervisory board, since each member (cf. 4.4.1) must act critically and independently of one another, of the management board, and of any particular interests.

Supervisory board's remuneration report (1) and (2)

The supervisory board should establish (and in practice, the remuneration committee prepares) a remuneration report (II.2.9), which is part of the annual report. This best practice provision is not part of the communication lines of the supervisory board, but it is a direct

²⁹ (a) gender; (b) age; (c) profession; (d) principal position; (e) nationality; (f) other positions, if relevant to the performance of his/her duties; (g) date of initial appointment; (h) current term of office.

³⁰ III.2.2: Independence requirements for supervisory board members.

demand for communication output. The provision indicates that the report shall explain how the remuneration policy has been implemented in the past financial year, as well as an overview of the remuneration policy planned by the supervisory board for the next financial year and subsequent years. Provision II.2.10 adds to this the detailed, obligatory content elements³¹ of the remuneration report.

The B-rules concerning the annual report genre are visualized below:

Annual report III.1.2						
SB report III.1.2						Remuneration report
SB activities during year	Info on individual members	Absence of SB members	References to results of discussions about:	Statement of compliance	Statement on non-independent SB members	Content elements
			<ul style="list-style-type: none"> • SB's own functioning • MB's functioning • Desired SB profile • Composition • Competences <p>Corporate strategy and risks</p> <p>MB's assessment of internal risk management and control</p> <p>Functioning of individual SB members</p>			

Figure 6.8: Supervisory board B-rules for the annual report

Regulations (3) and (4)

A. Communication requirements as part of a communication line

Many communication requirements are concerned with establishing regulations, the majority of which³² should be posted on the company's website. Only one requirement (III.6.5) does not indicate the manner of publication (4). This rule concerns dealing with actual and potential conflicts of interest between management board members, supervisory board members, and the external auditor on the one hand, and the company on the other. It also stipulates which transactions require the approval of the supervisory board. The other regulations concern the ownership of and transactions in securities by management board members, other than securities issued by their 'own' company (II.2.6); and the supervisory board's relationship with the management board and the GMS (III.1.1). Further, the

³¹ Examples of the content elements: a) a statement on and explanation of the relative importance of the variable and non-variable remuneration components; c) the composition of the peer group whose remuneration policy determines in part the level and composition of the remuneration of the management board members; e) a description of the performance criteria and f) an explanation of these criteria; k) current pension schemes and the related financing costs; l) agreed arrangements for the early retirement of management board members.

³² II.2.6; III.1.1; III.5.1

supervisory board should establish regulations for its three committees (III.5.1) that set out the role and responsibility of each committee, its composition, the manner in which it discharges its duties, and a provision that a maximum of one member of each committee need not be independent.

Regulations (3)

B. Communication requirements which are not part of a communication line

The supervisory board should draw up a retirement schedule (III.3.6) for all supervisory board members, in order to avoid having many members retire at the same time. The supervisory board should also adopt a set of regulations (III.7.3) governing the ownership of and transactions in securities by supervisory board members, other than securities issued by their 'own' company. All supervisory board members shall give periodic notice, but in any event at least once a quarter, of any changes in their holding of securities in Dutch listed companies to the compliance officer or, if the company has not appointed a compliance officer, to the chairman of the supervisory board.

A-rules:

1. Disclosing conflicts of interest (4)

The supervisory board should notify its chairman of and provide all relevant information about existing and potential conflicts of interest (III.6.1).

2. Shareholders' circular (3)

With respect to the shareholders, the supervisory board should inform the GMS by means of a 'shareholders' circular' (IV.3.7) of all facts and circumstances relevant to the approval, delegation or authorisation to be granted. The circular should be posted on the company's website.

3. Accountability to shareholders (4)

The compliance with and enforcement of the Code (I) is generally expected to be included in the corporate governance chapter of the annual report, although this has not been explicitly indicated. There are no indications about the publication of a statement on compliance with and enforcement of the Code.

Communication rules that do not include output requirements

The communication rules concerning the CCU supervisory board, however, do not always aim at a certain output in the form of, for example, a report or regulations. These A-rules concern the following:

1. Supervision (4)

Some rules are specifically aimed at supervision, namely II.1 on the supervision of the management board's policies by the supervisory board, and III.1.6 on the general supervision of the management board. Rules V.1 and V.1.1 concern supervision with respect to whether management fulfills its responsibilities regarding the quality and completeness of financial information. Finally, rule V.1.3 concerns supervision of whether the management board ensures that financial information from subsidiaries etc. is reported directly.

2. Responsibilities (4)

Rule III.1.9 concerns the fact that the supervisory board and its individual members are responsible for obtaining information from the management board. Further, rule III.6 states that the supervisory board should approve decisions to enter into transactions that might lead

to conflicts of interest for supervisory board members. Rule V.2 relates to the responsibilities with respect to the nomination and remuneration of the external auditor, while V.2.3 concerns the assessment of the external auditor. Rule IV.3 concerns the board's responsibility to provide information to the GMS, on the proviso that this information is not contrary to the company's interests (IV.3.5).

6.5.1 Analysis stage 1 – Chairman of the supervisory board

Communication lines

The chairman of the supervisory board should communicate with the supervisory board, management board, and GMS. Although the chairman's communication lines correspond with the overall function of the supervisory board as explained in the previous sections, they focus on the function and role of the chairman, including the chairman's relationship with the supervisory board. Further, the chairman should see to it that the supervisory board's members obtain all relevant information. Finally, the chairman should monitor the relationship between the supervisory and management boards, and assess the management board's members. These last two communication requirements clearly demonstrate the general monitoring function of the supervisory board. The communication line with the shareholders focuses on the chairman's task of supervising their behavior during the GMS. Appendix C includes the specific rules and a short indication of their content and form.

Content themes

The content of the requirements for the supervisory board chairman and the chairman's communication partners focuses on the appropriate corporate governance structure. This is not surprising, given that the chairman is expected to monitor and promote the 'checks' and 'balances' within the company, which revolves around constructing and maintaining an appropriate corporate governance structure.

The following figure presents the content themes of the chairman's communication requirements:

CCU	Themes	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB			III.4, III.4.1			
	CSB	-----	-----	-----	-----	-----
	AC					
	RC					
	SAC					
MB			III.4, III.4.1			
GMS			III.4			
EA						

Figure 6.9: Content themes for the supervisory board chairman

Communication action structured

The communication action with respect to the chairman of the supervisory board consists of one A-rule, which is thus part of a communication line.

A. Communication requirement as part of a communication line

Relationship with the supervisory board, management board, and GMS (4)

The relevant communication requirements are important for the relationships with the supervisory board, the management board, and the GMS. These rules include regulations describing the relationship between the chairman and the supervisory board (III.4), and specifically that the necessary information arrives on time for the members of the supervisory board (III.4.1). These rules also stipulate that the chairman is the main contact for the management board (on behalf of the supervisory board), and at the same time assesses the functioning of that management board. Finally, as per III.4 the chairman ensures the proper conduct of the GMS. All requirements in this section are A-rules, but the means of ‘publishing’ these rules is unknown (4). The effects of the requirements, however, will be visible and even essential within the company, in particular concerning the supervisory and management boards.

6.5.2 Analysis stage 1 – Audit committee

Communication lines

The audit committee should communicate with the supervisory board, the management board, the GMS, and the external auditor; in other words, the three other selected CCUs, which is in accordance with the role of the audit committee as the main contact and monitor of the external auditor. In this role, the committee should make recommendations about the auditor’s remuneration of non-audit services to the supervisory board, as well as about the committee’s reporting on its dealings with the auditor to the supervisory board. The communication between the audit committee and the management board consists mainly of the committee’s supervision³³ of the management board. This focus on internal control, financial disclosure, and internal risk management is one of the core tasks of the audit committee, which it took on following the financial and accounting scandals (cf. 4.4.1). The communication line with the GMS consists mainly of providing the shareholders with the results of the committee’s assessment of the auditor. Appendix C provides a general overview of all communication requirements concerning the committee’s communication partners.

Content themes

The contents of the principles and best practice provisions support the establishing and/or maintaining of an appropriate corporate governance structure within the company, as the audit committee sees to it that the auditor performs his/her tasks well, and supports or even carries out the monitoring task of the supervisory board with respect to the management board (cf. 4.4.1). The overview below shows the relationship between the principles and best practice provisions, including the audit committee’s communication requirements and the relevant themes.

Themes CCU	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB	V.2.2	III.5.3	V.2		

³³ i.e. supervision of the operation of the risk management and control systems plus the Tabaksblat Code, enforcement of legislation and regulations, provision of financial information, relationship with external auditor.

	CSB					
	AC	-----	-----	-----	-----	-----
	RC					
	SAC					
MB					III.5.4	
GMS		V.2.3				
EA		III.5.5, III.5.8, V.1.2				

Figure 6.10: Content themes for the audit committee

Communication actions structured

The communication actions consist of A-rules, which are part of a communication line, and of B-rules, which are not part of a communication line. This section describes what these requirements include, and how the output should be ‘published’: i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified.

Annual report – A. Communication requirements as part of a communication line

Audit committee’s report (1) and (2)

The audit committee is required to establish a report (III.5.3) for the supervisory board containing its deliberations and findings from the past financial year. The significant findings should then be included in the annual report as part of the supervisory board’s report.

Relationship with the external auditor (4)

A. Communication requirements as part of a communication line

The audit committee is the principal contact (III.5.5) for the external auditor; the committee may invite the auditor to its meetings (III.5.8), and it determines how the auditor should be involved with respect to the publication of financial reports (V.1.2). Further, the audit committee shall assess the external auditor and provide the shareholders with the conclusions of that assessment (V.2.3). The committee also recommends the remuneration of the auditor, instructs the auditor regarding the provision of non-audit services (V.2), and reports to the supervisory board about its relationship with the auditor (V.2.2). Although the way in which these written communication ‘products’ should be published is not indicated, it is clear that they will at least be internally published, and that these calls for communication actions are part of the annual report process.

Relationship with the management board (4)

A. Communication requirement as part of a communication line

The committee has an important supervision task with respect to the management activities (III.5.4). How this A-rule is to be published has not been indicated, but like the previous rules it is very likely that it will be published internally. The supervision task is obviously part of the demand to establish and maintain an appropriate corporate governance structure.

6.5.3 Analysis stage 1 – Remuneration committee

Communication lines

The remuneration committee should communicate with the supervisory board, the management board, and the GMS. The communication line with the supervisory board focuses on the remuneration report, including the remuneration policy concerning the

management board members. The draft of the remuneration proposal is sent to the management board, and changes in the remuneration policy should be notified to the GMS.

We saw in sub chapter 4.3 that remuneration in general, and the management board's remuneration in particular, is one of the four main elements of the Tabaksblat Code. This remuneration includes both a variable part and a fixed part. The fixed remuneration will be determined by the supervisory board based on a proposal by the remuneration committee, within the scope of the remuneration policy adopted by the GMS. The variable remuneration is linked to previously determined, measurable and influencable targets, and to this end the remuneration report should include specific information, namely the relevant performance criteria, an explanation of these criteria, a summary of the methods to determine whether the performance criteria have been met, and an explanation for the choice of these methods.

Appendix C includes a complete overview of all communication lines as well as their main content and form.

Content themes

The contents of the principles and best practice provisions are, naturally, mainly focused on remuneration. The tasks and role of the remuneration committee, however, consist of supporting the supervisory board, and thus in turn supporting the establishment and/or maintenance of the appropriate corporate governance system. The only rule relating to the latter corporate governance issue (III.5.3) concerns the fact that the remuneration committee should provide the supervisory board with its report including the committee's deliberations and findings. The following overview shows the content themes involved:

CCU	Themes	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB			III.5.3	Determination and Disclosure of Remuneration principle		
	CSB					
	AC					
	RC	-----	-----	-----	-----	-----
	SAC					
MB				III.5.10		
GMS				Determination and Disclosure of Remuneration principle		
EA						

Figure 6.11: Content themes for the remuneration committee

Communication actions structured

The communication actions of the remuneration committee consist of A-rules, which are part of a communication line, and B-rules, which are not part of a communication line. This section describes what these requirements include, and how the output should be 'published': i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified.

Annual report – A. Communication requirement as part of a communication line

Remuneration committee's report – (1) and (2)

The committee should prepare a remuneration report³⁴ for the supervisory board, which then includes the remuneration report in its own report (itself a part of the annual report). The remuneration report should include a proposal for the remuneration of supervisory and management board members (Determination and Disclosure of Remuneration principle, III.5.3, III.5.10).

6.5.4 Analysis stage 1 – Selection and appointment committee

Communication lines

The selection and appointment committee should communicate with the supervisory and management boards. The communication with the supervisory board includes the committee's obligation to provide its report (III.5.3) to the supervisory board and to perform its specific tasks, namely:

1. Establishment of selection criteria and appointment procedures (III.5.13) with respect to the supervisory board's members;
2. Assessment of the size and composition of the supervisory board;
3. Proposal of a composition profile of the supervisory board;
4. Assessment of the functioning of individual supervisory members and a report on this to the supervisory board;
5. Proposals for appointments and reappointments.

The communication line (III.5.13) with the management board mainly concerns the establishment of selection criteria and appointment procedures for management board members, and the assessment of the functioning of those members.

Appendix C presents the overview of the committee's communication requirements as well as their main content and form.

Content themes

The contents of the communication rules for the selection and appointment committee revolve around the selection and appointment regulations. These regulations support the establishment and/or maintenance of the appropriate corporate governance structure, in that they should assure the selection and appointment of appropriately skilled³⁵ candidates for the management and supervisory boards, taking the size and composition of these boards into account. The committee also assesses the performance of the members of both boards. We saw in sub chapter 4.3 that, in particular, having the right people on the supervisory board is important given that the Tabaksblat Committee has placed greater responsibility with the board. The following overview shows the relevant content themes:

³⁴ Besides the relevant A-rules, two B-rules are also relevant for the annual report; content elements of the remuneration committee's report are included in II.2.10 and II.2.

³⁵ The skills of the (potential) supervisory and management board members have not been defined clearly. The supervisory board members should be capable of assessing the broad outline of the overall policy, and should have specific expertise (III.3). Further, at least one member should be a financial expert (III.3.2). And finally, the composition of the supervisory board shall be such that the members are able to act critically and independently of one another, of the management board and of any particular interests (III.2). The (potential) members of the management board may not be members of the supervisory board of more than two listed companies. Nor may a management board member be the chairman of the supervisory board of a listed company (II.1.7). No further qualification requirements are included.

Themes CCU		Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB			III.5.3, III.5.13			
CSB						
AC						
RC						
SAC		-----	-----	-----	-----	-----
MB			III.5.13			
GMS						
EA						

Figure 6.12: Content themes for the selection and appointment committee

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Communication actions structured

The communication actions consist of A-rules, which are part of a communication line, and B-rules, which are not. This section describes what these requirements include, and how the output should be ‘published’: i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified.

Annual report – A. Communication requirements as part of a communication line

Selection and appointment committee’s report (1) and (2)

The selection and appointment committee should establish its report like the other two committees, including its deliberations and findings from the past financial year (III.5.3). This report should then be included in the supervisory board’s report, which itself is part of the annual report.

Selection criteria and appointment procedures (4)

A. Communication requirements as part of a communication line

The committee should establish procedures for the selection criteria and appointment procedures for management and supervisory board members, propose a composition profile for the supervisory board, and assess the functioning of the management and supervisory board members (III.5.13). These regulations are expected to be published internally, although this is not explicitly indicated.

6.5.5 The communication requirements with respect to the entire CCU supervisory board

General remarks concerning the communication requirements of the CCU supervisory board

The communication requirements of the CCU supervisory board mainly relate to the powers and duties³⁶ of the supervisory board (cf. 3.5). According to these communication

³⁶ These duties consist of (1) establishing certain regulations, (2) supervising compliance with internal procedures with regard to financial information; (3) obtaining information from the management board and external auditor; (4) providing information to the GMS; making decisions about conflicts of interest; (5)

requirements, the board could be considered the pivot with regard to one of the main corporate governance solutions, namely to establish and maintain an appropriate corporate governance structure. The characteristics of such a structure can be observed in the communication actions with respect to supervision and obtaining and providing information; in the regulations concerning the connections between the supervisory board and its three committees, the management board, and the GMS; in the decisions about conflicts of interest; and finally in determining the remuneration for the management board and the external auditor. The communication requirements characterize the functioning of the supervisory board, which corresponds with the Dutch two-tier board system and the stakeholder system as the basis for the Tabaksblat Code (cf. 3.5.3). The supervisory board's communication requirements reflect the view of the Tabaksblat Committee that:

good corporate governance essentially revolves around efficient supervision of the management board (the “checks”) and a balanced distribution of influence and power between the management board, the supervisory board and the GMS (the “balances”). The external auditor plays an important role in the supervision and assists the supervisory board which, in turn, operates on behalf of the shareholders and other stakeholders³⁷.

In these ways, the requirements correspond with the increased responsibility which the Tabaksblat Committee has placed on the supervisory board, and with the fact that the supervisory board plays a key role within corporate governance in that corporate governance is about controlling power, which is the task of the supervisory board (cf. 6.3). This latter task can only be executed, according to Cools (cf. 5.5), if the board is able to obtain sufficient information. As shown in the footnote on the previous page, a core communication requirement of the board is to obtain sufficient information from the management board and the external auditor.

Content themes

The majority of the communication requirements of the CCU supervisory board (including the supervisory board, its chairman, the audit committee, the remuneration committee, and the selection and appointment committee) concern the issue ‘corporate governance structure’. Further, ‘remuneration’ and ‘information disclosure on conflicts of interest’ are also important corporate governance issues. So, too, is the ‘supervision/monitoring’ issue with respect to the communication with the management board, and the issue of ‘information disclosure’ concerning the communication with the GMS.

The following figure shows all communication requirements of the CCU supervisory board; it is therefore possible that rules referring specifically to the supervisory board itself will also be indicated.

Themes CCU	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB	V.2.2	III.4, III.4.1, III.5.3, III.5.13	Determination and Disclosure of Remuneration principle, V.2, III.5.10		III.6.3
CSB					III.6.1

determining the management board's remuneration, and the external auditor's nomination, remuneration, and assessment

³⁷ Tabaksblat Code, Account of the Committee's Work, 1, p. 39

	AC		III.5, III.5.1, III.5.2			
	RC		III.5, III.5.1, III.5.2			
	SAC		III.5, III.5.1, III.5.2			
MB			II.2.6, III.1.1, III.1.9, III.4, III.4.1, II.5.13	II.2.12, III.5.10(b), V.2	III.1, III.1.6, III.5.4, V.1, V.1.1, V.1.3	III.6 III.6.5
GMS	IV.3, IV.3.5 IV.3.7	I, III.1.1, III.4, V.2.3	Determination and Disclosure of Remuneration principle,			III.6 III.6.5
EA		III.1.9, III.5.5, III.5.8 V.1.2				

Figure 6.13: Content themes for the entire supervisory board

6.6 Analysis stage 1 – CCU management board

Communication lines

The communication partners of the management board are the supervisory board, the chairman of the supervisory board, the audit committee, and the GMS. In general, the communication between the management and supervisory boards expresses the core function of the management board within the governance structure, namely managing the company and taking account of the interests of the different stakeholders (cf. 4.4.3). The management board is responsible for achieving the company's aims, strategy, and policy, complying with all relevant legislation and regulations, and managing the risks inherent to the company's activities. The communication with the supervisory board mainly focuses on the management board's responsibility for the internal risk management and control systems, and its accountability for these systems to the supervisory board. This communication also stipulates that the management board should ask the supervisory board to approve the strategy and the parameters involved in the company's operational and financial objectives. Further, the management should assure the supervisory board that the external financial information is correct, complete, and up to date. The communication specifically with the chairman of the supervisory board concerns providing information about possible changes in securities holdings and existing or potential conflicts of interest. The communication with the audit committee mainly involves information about the internal risk management and control systems, the management statement (included in the annual report) on the effectiveness and adequacy of these systems, and the discussions on these systems with the audit committee. Finally, with respect to the communication with the GMS, the management board is accountable for the corporate governance structure, and for compliance with as well as enforcement of the Tabaksblat Code. An overview of all communication lines of the management board as well as their main content and the content themes concerned is included in Appendix C.

Content themes

The communication requirements with regard to the management board mainly relate to the corporate governance structure and information disclosure. We saw in sub chapter 3.5, on the Dutch corporate governance system, that the management board must keep the supervisory board very well informed in order to enable the supervisory board to monitor the management

board. This is also included in the first principle with respect to the management board: “The management board shall provide the supervisory board in good time with all information necessary for the exercise of the duties of the supervisory board.” This reflects the Tabaksblat Committee’s view that, together with the supervisory board, the management board holds a central position (‘checks’ and ‘balances’) whereby its role is to manage the company. This is also reflected in the board’s communication requirements with respect to the internal risk management and control system. These latter requirements are directly related to the corporate governance issue ‘financial disclosure’, and the overview of the corporate governance issues therefore includes this additional aspect of ‘financial disclosure’. The requirement regarding the internal risk management and control system in fact mirrors the content as the significant SOX404, which indicates that the management board’s statement about the effectiveness and adequacy of the internal risk management and control system should be included in the annual report. The overview below presents the results with regard to the content themes.

Themes CCU	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest	Financial disclosure
SB	V.2.2	II.1, II.1.2, II.1.7			II.3.4	II.1.4, V.1.3
CSB	II.2.6				II.3.2	
AC		II.1				II.1.4
RC						
SAC						
MB	-----	-----	-----	-----	-----	-----
GMS	IV.3, IV.3.5 IV.3.7	I IV.1				
EA						

Figure 6.14: Content themes for the management board

Communication actions structured

The communication actions consist of A-rules, which are part of a communication line, and B-rules, which are not. This section describes what these requirements include, and how the output should be ‘published’: i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified. This sub chapter shows that variations (1) and (2) are interrelated.

Annual report – A. Communication requirements as part of a communication line

Management’s statement (2)

The management board shall establish operational and financial objectives as well as the strategy to achieve these objectives (II.1.2), which will be included in the annual report. Provision II.1.4 concerns the management board’s statement that the internal risk management and control systems are adequate and effective. It also stipulates that the management board shall describe any significant changes and planned major improvements in the internal risk management and control systems, and confirm that these have been discussed with the audit committee and the supervisory board (cf. 4.4.3). II.3.4 states that transactions

leading to conflicts of interest with respect to the management board members should be published in the annual report.

Annual report – B. Communication requirements which are not part of a communication line

The B-rules include II.1.5, which implies that the management board shall set out in the annual report the sensitivity of the company's results to external factors and variables. Further, rule IV.3.9 specifies that the management board shall provide a survey of all existing or potential antitakeover measures in the annual report, and shall also identify the circumstances in which these measures are expected to be used. The antitakeover measures are common in the Dutch corporate governance system (cf. 3.5); the Tabaksblat Committee states that the legislator should regulate by law the use of antitakeover measures, and that while these measures can be useful when they are in the company's interest, certain conditions are needed with respect to their use. This latter point forms the core of IV.3.9.

Internal risk management and control systems (4)

A. Communication requirements as part of a communication line

The main task of the management board – managing the internal risk management and control systems – is reflected in rule V.1.3, on the establishment and maintenance of internal procedures to ensure that all financial information be known in order to guarantee the accuracy of external financial reporting. The management board is obliged to report on the internal risk management and control systems to the supervisory board, and should report any developments in these systems to the audit committee (II.1). It should be noted that these core communication actions relate to the core functions of the management board, but the 'medium' in which they should be published is not indicated.

Conflicts of interest (4)

A. Communication requirements as part of a communication line

If a management board member wishes to be member of a supervisory board of a listed company (II.1.7), this must be approved by the supervisory board. Likewise, other important positions held by management board members shall be notified to the supervisory board. Further, the management board is obliged to report to the supervisory board on the performance of the external auditor (V.2.2), though the means of disclosure is not explicitly indicated. The communication requirements involved are internally directed actions, meaning that the company decides for itself how to report such matters. The same applies for the next communication requirements, which stipulate that the management board must report to the chairman of the supervisory board any changes in securities holdings (II.2.6) in Dutch listed companies as well as any conflicts of interest that could be of material significance (II.3.2).

Accountability towards the general meeting of shareholders (3) and (4)

A. Communication requirements as part of a communication line

With respect to the GMS, the management board should:

1. Comply with and enforce the Code (I);
2. Decide on major changes in the company's identity or character (IV.1) (4);
3. Provide all shareholders with equal and simultaneous information about the share price (IV.3) (4); and
4. Provide a 'shareholders' circular' (IV.3.7) about any delegation of powers (3).

The shareholders' circular should be posted on the company's website. If the GMS were to ask for information which is not in the company's interests, the management board should give reasons for not providing this information (IV.3.5). Compliance with and enforcement of the Code could be expected to be included in the corporate governance chapter of the annual

report. As these actions are internally directed, it may be presumed that the Tabaksblat Committee saw no need to indicate the means of disclosure.

6.7 Analysis stage 1 – CCU general meeting of shareholders

Communication lines

The GMS's communication partners are the supervisory board, management board, and external auditor. The communication line with the supervisory board concerns the rules stipulating that the GMS:

1. Determines the remuneration of the supervisory board;
2. Should be able to have enough influence on the policy of the board, and the GMS of a one-tier board company has the power to cancel a binding nomination to appoint or dismiss a supervisory board member;
3. Approves the supervision by the supervisory board.

The communication with the management board includes the following:

1. The approval of management board's decisions on major changes with respect to the company;
2. The approval of the management board's policy; and
3. The GMS of a one-tier board company may cancel a binding nomination to appoint or dismiss a management board member.

The communication line with the external auditor involves the approval of the appointment of the external auditor by the GMS. Further, the shareholders may ask the auditor questions about the annual accounts during the GMS.

These communication requirements reflect the shareholders' increased powers, which is one of the four³⁸ main elements in the Tabaksblat Code (cf. 4.4). The most significant rules state that the supervisory board and management board are accountable for their performance to the GMS, and the boards must inform the GMS well in order to enable the latter to exert influence on the boards' policies.

Content themes

The communication requirements of the GMS are focused on the corporate governance structure. The core communication requirement is included in Principle IV.1, which states that the GMS must be able to exert influence on the policy of the supervisory board such that it plays a fully-fledged role in the company's system of 'checks' and 'balances'. The aim is clear, but there is no explanation of how this influence should be exerted or what the supervisory board should do to facilitate it. Further, the shareholders should approve the management's and supervisory board's policies by voting on these policies separately at the GMS. Both these rules³⁹ correspond with the principles of the Dutch corporate governance system (cf. 3.5), in which good corporate governance essentially revolves around efficient supervision of the management board (the 'checks') and the balanced distribution of influence and power between the management board, the supervisory board, and the GMS (the 'balances')⁴⁰. Another rule (IV.1.1) regarding the communication with the supervisory board and the management board indicates that the GMS of a company that does not have a statutory two-tier status may pass a resolution to cancel the binding nature of a nomination to appoint or dismiss a management or supervisory board member. This rule corresponds with the increased power bestowed upon the GMS by the Tabaksblat Committee, and is clearly

³⁸ 1. 'Comply or explain' rule; 2. remuneration; 3. role of supervisory board; 4. shareholders' power

³⁹ IV.1 and IV.1.6

⁴⁰ Tabaksblat Code, Account of the Committee's Work, 1, p. 39

related to the establishing or maintaining of an appropriate corporate governance structure. The same applies for the communication with the external auditor concerning the nomination of the auditor, which is to be submitted to the GMS.

The overview below shows the themes of the GMS communication requirements:

CCU	Themes	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest
SB			IV.1, IV.1.1, IV.1.6	III.7		
	CSB					
	AC					
	RC					
	SAC					
MB			IV.1, IV.1.1, IV.1.6			
GMS	-----	-----	-----	-----	-----	-----
EA			V.2, V.2.1, V.2.2			

Figure 6.15: Content themes for the general meeting of shareholders

Communication actions structured

This section includes an overview of the communication actions categorized as A-rules, which are part of a communication line, and B-rules, which are not part of a communication line. It describes what these requirements include, and how the output should be ‘published’: i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified.

Tasks and function of the general meeting of shareholders (4)

A. Communication rules as part of a communication line

The first requirement⁴¹ indicates that the GMS determines the remuneration of the supervisory board, and that the legislation concerning this remuneration will be included in the notes to the annual accounts. Another rule (IV.1) specifies that the GMS should be able to exert influence on the supervisory board’s policy. Neither rule includes an indication for the means of publishing; as these are internally directed communication actions, it can be presumed to be irrelevant. Further, the GMS should approve the management board’s policy (IV.1.6). This can on the one hand be seen an internally directed action, because the GMS will have obtained certain documents in order to be able to make its decision on approval; yet on the other hand, the shareholders will vote on this matter at the general meeting.

The external auditor will be appointed by the supervisory board, which will report on this appointment to the GMS (V.2). This communication requirement can again be presumed to be an internally directed action, and therefore the Code includes no indication of the means of disclosure. Finally, the GMS can question the external auditor about his/her statement in the annual report with regard to the fairness of the annual accounts (V.2.1), though again, this last rule is also an internally directed action and thus has no disclosure indication.

⁴¹ Principle III.7 also stipulates that the notes to the annual accounts shall, in any event, contain the information prescribed by law on the level and structure of the remuneration of individual supervisory board members.

B. Communication rule that is not part of a communication line (1)

IV.3.8 includes the stipulation that the report of the GMS shall be made available to shareholders on request, after which the shareholders shall have the opportunity to react to the report during the following three months. The report shall then be adopted in the manner provided for in the articles of association.

The communication requirements thus include communication actions with respect to the main functions of the GMS (remuneration; influencing the supervisory and management boards' policies; responsibilities towards external auditor) as part of the 'balances' as described in the Tabaksblat Code.

6.8 Analysis stage 1 – CCU external auditor

Communication lines

The external auditor's communication partners are the supervisory board, the management board, and the audit committee. The communication with the supervisory board concerns the rule that the auditor attends the board meeting in which the annual accounts are discussed, and reports his/her findings concerning the audit simultaneously to the supervisory and management boards. This communication line also provides for the auditor to receive all necessary financial information, and to respond to that information. With respect to the communication line with the audit committee, the main content element involves the auditor notifying the committee of any possible irregularities in the financial reports.

Content themes

The communication requirements of the external auditor mainly focus on financial disclosure. We have already seen that the supervisory board's obtaining of financial information from the management board and the external auditor is the core condition for the supervisory board to be able to fulfill its monitoring tasks. The external auditor not only reports information with respect to his/her audit directly and simultaneously to the supervisory board and the management board, as a result of the auditor's increased independence (cf. 4.4.4), but also supports the supervisory board with its monitoring task by auditing the company. The content of the auditor's communication requirements mainly relates to financial disclosure, which is directly related to the auditor's audit task. This means that the CCU external auditor's and the CCU management board's communication rules both include 'financial disclosure' as an extra content theme. Figure 6.16 presents the results:

Themes CCU	Info disclosure	Corporate governance structure	Remuneration	Supervision	Info on conflicts of interest	Financial disclosure
SB						V.4, V.4.1
CSB						
AC						III.5.5
RC						
SAC						
MB						V.4
GMS						

EA	-----	-----	-----	-----	-----	-----
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Figure 6.16: Content themes for the external auditor

Communication actions structured

The communication rules for the external auditor consist of A-rules, which are part of a communication line, and B-rules, which are not part of a communication line. This section describes what these requirements include, and how the output should be ‘published’: i.e. (1) in the form of a report, (2) as part of the annual report, or (3) posted on the website; or (4) not specified.

Annual report – B. Communication requirements that are not part of a communication line

External auditor’s report (1) and (2)

Rule V.4.3 stipulates that, pursuant to article 2:393, paragraph 4 of the Civil Code, the external auditor’s report shall contain those matters⁴² which the external auditor wishes to bring to the attention of the management board and the supervisory board in relation to his/her audit of the annual accounts and the related audits.

Tasks and responsibilities of the external auditor (4)

A. Communication requirements as part of a communication line

The external auditor reports his/her findings on the audit of the annual accounts to the management board and the supervisory board (V.4). The external auditor may also respond to the financial information he/she receives from the supervisory board (V.4.1). Both of these requirements could be seen as internally directed actions, which do not include a specific indication for ‘publication’. Further, the external auditor may contact the audit committee as in cases where he/she has detected financial or audit-related irregularities. This contact is assumed to be take place through written communication (III.5.5) and is therefore presumed to be an internally directed action with no indicated means of publication.

6.9 Analysis stage 2 – The ‘ought’ situation of the Dutch annual report genre according to the Tabaksblat Code

The previous sub chapters contained the results of the analysis of the communication rules included in the Tabaksblat Code. These results form the basis for answering the question how the Tabaksblat Code’s communication requirements influence the annual report’s generic integrity. We have seen that the analysis started with the answers to two questions, namely (1) ‘which CCU should communicate with which other CCU(s)?’ and (2) ‘what should the CCU communicate about with the other CCU(s)?’ The answers to these questions reveal the quality of the required communication between the CCUs supervisory board, management board, GMS, and external auditor. The answers to the first question revealed the communication lines between the CCUs, while the answers to the second question presented the content themes of the required communication.

This sub chapter reveals the connection between the results of the Tabaksblat Code analysis and the generic integrity of the annual report. To do so, it describes which text-internal and text-external factors – together constituting the generic integrity – have been

⁴² The auditor might want to draw attention to, for example, information about the course of events during the audit, comments on the quality of forecasts and budgets, or comments about threats and risks to the company.

influenced by the Tabaksblat Code. Section 6.9.1 starts with the text-external factors of the annual report genre as determined in the Code, followed by the text-internal factors in 6.9.2.

6.9.1 The text-external factors

The text-external factors consist of three major parts: (1) the discursive procedures, (2) the disciplinary culture, and (3) the discursive practices. The first of these is divided into (1a) the contributors to the annual report genre, and (1b) the structure of the annual report genre process. The second involves the generic norms or conventions, while the final part includes (3a) choice of genre and (3b) communication mode.

Discursive procedures

Contributors (1a)

According to the results of the analysis of the Tabaksblat Code, the contributors to the annual report are the CCU supervisory board (and its three committees), the CCU management board, and the CCU external auditor. The CCU GMS and the chairman of the supervisory board do not contribute to the annual report. The CCU supervisory board is responsible for the annual report's 'sub text', the 'supervisory board report', which in turn includes the sub texts 'remuneration report' and the 'supervisory board committee reports' (i.e. those of the audit committee, the remuneration committee, and the selection and appointment committee). The management board is responsible for its statement about the internal risk management and control systems. The management board and supervisory board are responsible for the publication of the transactions of management board or supervisory board members, respectively, that lead to conflicts of interest, although these requirements are not related to any concrete output or sub text.

Figure 6.18 shows that the CCU supervisory board is the main contributor and the main responsible CCU for the annual report sub texts 'supervisory board report' and 'remuneration report'. The separate committees' contributions to the annual report, specifically to the supervisory board report, are their own reports, and the committees are indeed responsible for their reports, but as they are part of the CCU supervisory board they are not mentioned as separate contributors and responsible CCUs.

The content requirements of the supervisory board's report in Figure 6.17 in particular focus on the committees of the board. The obligatory content elements of the B-rules (Figure 6.18), in contrast, concern issues with respect to the members of the supervisory board (i.e. their independence and functioning), the assessment of the management board by the supervisory board, and the discussions about the internal risk management and control systems. All of these requirements belong to the general tasks of the supervisory board (cf. 4.4.1). The B-rules concerning the remuneration report include the main points of the remuneration policy and specific content elements. These rules also reflect the responsibilities and tasks of the supervisory board.

The management board is the second contributor, and is responsible for describing and explaining issues concerning risk management and antitakeover mechanisms. The management board's main task is to manage the company, which means it is also responsible for managing the risks associated with the company's activities. In turn, this means that the management board needs and is responsible for ensuring that there is an adequate and effective internal risk management and control system (cf. 4.4.3).

The third contributor is the external auditor, who is responsible for his/her report of the audit. The conclusion can be drawn that the contributors in Figure 6.18 are also the responsible persons.

Structure of annual report genre process (1b)

The structure of the annual report process entails all preparations for the construction of the annual report genre. The analysis of the Tabaksblat Code shows that the genre process is determined in particular by the A-rules related to the annual report (cf. Figure 6.17). This is because these rules represent the relevant communication lines between the CCU supervisory board and its committees, the CCU management board, and the CCU external auditor, and thus indicate which CCU should communicate with which other CCU(s) in order to be able to construct the annual report. Besides these A-rules, however, the B-rules (cf. Figure 6.18) – which are not part of any communication line – with respect to the annual report should also be performed within the annual report process in order to establish the Dutch annual report genre.

Further, it could be stated that all A-rules support the annual report process, since compliance with the rules should lead – through the creation of information disclosure, an appropriate corporate governance structure and supervision/monitoring, proper remuneration, clarity about information concerning conflicts of interest, and clear and proper financial disclosure – to the establishment of the annual report genre according to the Tabaksblat Code in order to achieve formal transparency. If a company complies with all constitutive communication rules, the Dutch annual report genre has been established and formal transparency has been achieved, thus constituting the institution ‘good governance’.

The A-rules that are not annual report-related can be divided into two groups, namely the A-rules that influence the annual report process directly (the C-rules included in group C), and the A-rules that only indirectly influence but nevertheless support the annual report process (i.e. the non-annual report A-rules of group D).

Non-annual report A-rules – Group C

The most important non-annual report A-rules are almost all communication rules⁴³ concerning the supervisory board and its communication partner, the management board. These rules concern the supervision task of the supervisory board with respect to the management board in general and the management board’s policies in particular. They also include the management board’s responsibility for all publicly disclosed financial reports as well as compliance with and establishment and maintenance of internal procedures relating to financial information. Further, the rules concern the relationship between the supervisory and management boards, and the fact that the supervisory board and its members are responsible for obtaining information from the management board. Another set of rules concerns the relationship with, and nomination, appointment, and assessment of the external auditor, in which not only the supervisory board and management board, but also the audit committee and the GMS (which appoints the auditor) all play an important role. Other rules in this category include the supervisory board’s responsibility for the corporate governance structure and for compliance with the Tabaksblat Code to the GMS (I), which is a fundamental element of the annual report process, as well as the rule (III.1.9) that the supervisory board is responsible for obtaining information from the external auditor. The non-annual report A-rules for the supervisory board chairman which are specifically relevant for the structure of the annual report process concern the relationship (III.4) between the chairman and the supervisory board, including the chairman’s tasks of monitoring the functioning of the supervisory board and its committees, and assessing (III.4.1) the supervisory board.

⁴³ Group C rules concerning the CCU supervisory board and management board: III.1, III.1.1, III.1.6, III.1.9, V.1, V.1.1, V.1.3, V.2, V.2.2, V.2.3

The audit committee's non-annual report A-rules (III.5.5, III.5.8, V.1.2) that are significant for the annual report process concern the committee's relationship with the external auditor. In particular, these involve the fact that the audit committee is the main contact for the auditor with respect to irregularities in financial reports, decides when the auditor should attend its meetings, and determines how the auditor will be involved in the content and publication of financial reports other than the annual report. The audit committee is also involved in the process of the nomination and assessment of the external auditor (V.2; V.2.2), the conclusions of which are provided to the GMS (V.2.3). One of the most important tasks of the audit committee (III.5.4) is to supervise the management board's activities, including:

- the operation of the internal risk management and control systems, including supervision of the enforcement of the relevant legislation and regulations;
- the operation of the codes of conduct;
- the provision of financial information by the company;
- compliance with the recommendations and observations of internal and external auditors;
- the role and functioning of the internal audit department; and
- the relations with the external auditor.

Only one non-annual report A-rule (III.5.13) for the selection and appointment committee is important for the annual report process; namely, the assessment of the functioning of the individual members of the supervisory and management boards.

The management board's A-rules (II.1; V.1.3; V.2.2) involving the discussions with the supervisory board and audit committee about the internal risk management and control systems are needed for the annual report process, as is the rule stipulating that the management board is responsible for the correctness, timeliness, and completeness of the external financial reports. Further, the management board, like the supervisory board, is responsible (I) for the corporate governance structure and for compliance with the Tabaksblat Code.

The only significant non-annual report A-rules (V.4;V.4.1) with respect to the external auditor concerning the annual report process are about the auditor reporting his/her findings from the audit at the separate meetings of the supervisory board and the management board to discuss the audit. Further, it is obviously important for the annual report process that the auditor receives the adequate financial information and is able to respond to that information.

Although the GMS is not considered to be a direct contributor or responsible CCU for the annual report genre, the shareholders (V.2;V.2.2) do play an important role given that they appoint the external auditor after the supervisory board has submitted its nomination to the GMS.

Non-annual report-related A-rules – Group D

The D-rules⁴⁴ are all remaining A-rules that belong neither to the annual report-related A-rules nor to the non-annual report-related A-rules (group C).

All these rules are needed to establish the correct annual report process in order to comply with the Tabaksblat Code, and thus to construct a sound annual report.

Disciplinary culture (2)

The generic norms with respect to the annual report according to the Tabaksblat Code consist of all A- and B-rules relating to the annual report. The previous sections, on the contributors

⁴⁴ D-rules: II.1.7, II.2.6, II.3.2, III.5.1, III.6, III.6.1, III.6.5, III.7, IV.1, IV.1.1, IV.1.6, IV.3, IV.3.5, IV.3.7, and V.2.1

and the structure of the annual report process, have already provided specific information about the A- and B-rules. The following overview (Figure 6.17) shows the A-rules concerning the annual report:

CCU	Annual report input
Supervisory board	Supervisory board report: <ol style="list-style-type: none"> 1. Duties of the SB committees from past financial year (III.5) 2. Each SB committee: composition, number of meetings, main items discussed (III.5.2) 3. Most important points of the remuneration policy (III.5.10)
AC	Deliberations and findings of audit committee's report (III.5.3)
RC	Deliberations and findings of remuneration committee's report (III.5.3)
SAC	Deliberations and findings of selection and appointment committee's report (III.5.3)
	Remuneration report: <ol style="list-style-type: none"> 1. RC prepares remuneration report (Determination and Disclosure of Remuneration principle) 2. Explanation of special remuneration for current and former MB members (II.2.12)
	Description of transactions of SB members that might lead to conflicts of interest (III.6.3)
Management board	<ol style="list-style-type: none"> 1. Management's statement that the internal risk management and control systems are adequate and effective (II.1.4) 2. Description of operational and financial objectives and the strategy to achieve these objectives (II.1.2) 3. Description of transactions MB members that might lead to conflicts of interest (II.3.4) and declaration of compliance with II.3.2 to II.3.4.

Figure 6.17: Annual report-related A-rules

The overview below (6.18) presents the B-rules with respect to the annual report according to the Tabaksblat Code:

CCU	Annual report input
Supervisory board	SB should establish own report (III.1.2), including: <ol style="list-style-type: none"> 1. Obligatory information about SB members (III.1.3) 2. Frequent absence of SB members from SB meetings (III.1.5) 3. SB references to discussions on specific topics, and conclusions thereof (III.1.7) 4. References to discussions on corporate strategy and assessment of MB, and conclusions thereof (III.1.8) 5. Statement about SB members' independence/non-independence (III.2.1, III.2.2, III.2.3) 6. Main points of remuneration policy (cf. Figure 6.17)
	Remuneration report: <ol style="list-style-type: none"> 1. Implementation of remuneration policy of past financial year (II.2.9) 2. Obligatory content elements (II.2.10)
Management board	<ol style="list-style-type: none"> 1. Description of sensitivity of company's results to external factors and variables (II.1.5) 2. Survey of all existing potential antitakeover measures (IV.3.9)
External auditor	External auditor's report: Obligatory content elements (i.e. audit, financial figures, operation of internal risk management and control systems (V.4.3))

Figure 6.18: Annual report-related B-rules

Discursive practices (3)

Genre choice (3a)

The choice of the genre is determined by Dutch corporate law and the Tabaksblat Code, since all listed corporations are legally obliged to establish and publish an annual report, including their annual accounts⁴⁵.

The annual report, however, consists of certain text parts, in particular non-financial texts, which sub chapter 2.3 referred to as ‘sub genres’ (Garzone, 2004) or ‘narrative portions’ (Yuthas et al., 2002). The annual report can thus be considered a genre network (cf. 2.3). Bhatia distinguishes between text-internal and text-external factors of generic integrity, whereby intertextual aspects are regarded to be part of the text-internal factors. The annual report can be considered a genre network because different texts are included in and together construct the annual report genre. These texts are the different obligatory reports (supervisory board’s report, remuneration report, external auditor’s report, and the reports of each of the supervisory board’s committees). Further, the annual report genre is expected to include intertextual aspects, for example references made to laws or other legislative or regulatory documents (i.e. the Tabaksblat Code), in order to comply with the relevant legislative obligations⁴⁶.

Communication mode (3b)

The communication mode is the way in which the annual report A- and B-rules are described in the Tabaksblat Code. The rules have been set down in principles and best practice provisions and because the Code is an official and formal document, the rules are described in an official, formal, and neutral way. The language used, however, clearly also incites the companies to comply with the rules. The frequent use of the word ‘shall’ in almost all requirements emphasizes this. The language used is characterized by the need for clear and sufficient information provision. Further, the sentences are overall quite short. The following examples illustrate the use of language in the Tabaksblat Code:

A management board member may not be a member of the supervisory board of more than two listed companies. Nor may a management board member be the chairman of the supervisory board of a listed company. Membership of the supervisory board of other companies within the group to which the company belongs does not count for this purpose. The acceptance by a management board member of membership of the supervisory board of a listed company requires the approval of the supervisory board. Other important positions held by a management board member shall be notified to the supervisory board. (II.1.7, p. 10)

This demonstrates not only that the sentences are short, but also that they are in fact a demand/call for action or an injunction. The first two sentences concern prohibitions and limitations. The next sentence contains the exclusion of a certain group, whereas the fourth includes a call for approval. The last sentence includes a demand for information disclosure. The next quote, below, presents a ‘shall’ sentence including a demand:

The supervisory board shall receive from each of the committees a report of its deliberations and findings. (II.5.3, p. 20)

The next section describes the text-internal factors of the annual report according to the Tabaksblat Code’s communication rules.

⁴⁵ Civil Code, article 2:362, paragraph 1 and Civil Code, article 2:391, paragraph 1.

⁴⁶ Idem, and IFRS accounting standards.

6.9.2 The text-internal factors

The generic integrity's text-internal factors consist of (1) the communicative purpose, (2) the situational context, (3) move structures, (4) themes, and (5) intertextual aspects.

Communicative purpose (1)

The analysis of the Tabaksblat Code has shown that the overall or general communicative purpose is transparency. In the Tabaksblat Code, transparency is regarded to directly relate to 'good governance' because it is linked with transparent managerial decision-making. The Code emphasizes the importance of transparency as follows:

Good entrepreneurship, including integrity and **transparency** of decision-making by the management board, and proper supervision thereof, including accountability for such supervision, are essential if the stakeholders are to have confidence in the management board and the supervision. These are the two pillars on which good corporate governance rests and on which this code is based. (Tabaksblat Code 2003, p. 3)

And

The code is one step towards restoring the public's trust and confidence in the honesty, integrity and **transparency** of the management and operation of Dutch listed companies. (Tabaksblat Code 2003, p. 39)

The Tabaksblat Code emphasizes not only the importance of transparent decision-making by management, but also the transparency of the entire system of 'checks' and 'balances':

A sound and **transparent** system of checks and balances in companies would be an important means of boosting confidence in companies that operate in the capital markets. (Tabaksblat Code 2003, p. 67)

The Tabaksblat Committee relates the checks and balances to good corporate governance, and defines the roles, tasks, and responsibilities of the main corporate bodies that play the key roles within these checks and balances:

Good corporate governance essentially revolves around efficient supervision of the management board (the "checks") and a balanced distribution of influence and power between the management board, the supervisory board and the general meeting of shareholders (the "balances"). The external auditor plays an important role in the supervision and assists the supervisory board which, in turn, operates on behalf of the shareholders and other stakeholders. (Tabaksblat Code 2003, p. 39⁴⁷)

The above quotes from the Tabaksblat Code show that the general goal is transparency, and that the general communicative purpose of the rules included in the Code – and thus also the communication requirements concerning the annual report's generic integrity – is transparency. Since the annual report is to be seen as a genre network, the separate texts included are expected to also have the overall communicative purpose of transparency⁴⁸. If corporations comply with all constitutive rules, formal transparency has been achieved, which consequently brings the institution 'good governance' into existence.

Situational or immediate context (2)

The CCU contributors and the CCUs responsible for the annual report or parts of the genre (cf. 6.9.1) play an important role within the situational context, as they are expected to influence the annual report genre.

⁴⁷ The need for 'checks' and 'balances' was among other things related to "The bankruptcies of several large corporations, a series of high-profile accounting scandals and significant increases in the remuneration packages of some management board members have created widespread public doubts concerning the accountability and supervision of corporate policy-makers." (Tabaksblat Code 2003, p. 39)

⁴⁸ The separate texts could also have their own communicative purpose, but investigating these separate communicative purposes does not fit into the scope of this study.

The influence of the ‘wider’ context concerns the company’s obligation to comply with the Tabaksblat Code and other regulations (i.e. accounting standards) and legislation (i.e. corporate law) (cf. 6.9.1).

Move structures (3)

Few indications for move structures can be found in the Code’s communication rules. The annual report-related A-rules (Figure 6.17) include rule II.2.10, which clearly contains content elements with respect to the remuneration policy that are to be seen as move structures⁴⁹. The moves consist of:

- | | |
|---------------------------------|------------------------------------------|
| (1) <i>A statement;</i> | (9) <i>An explanation;</i> |
| (2) <i>An explanation;</i> | (10) <i>A third summary;</i> |
| (3) <i>The composition;</i> | (11) <i>A description;</i> |
| (4) <i>A summary;</i> | (12) <i>An explanation;</i> |
| (5) <i>Another explanation;</i> | (13) <i>Another explanation;</i> |
| (6) <i>A description;</i> | (14) <i>Pension schemes;</i> |
| (7) <i>An explanation;</i> | (15) <i>Financing costs; and finally</i> |
| (8) <i>A second summary;</i> | (16) <i>Agreed arrangements.</i> |

These moves have been visualized as follows:

Move	Content
<i>A statement</i> <i>An explanation</i>	relative importance of variable and non-variable remuneration components of this ratio
<i>An explanation</i>	of any absolute change in the non-variable remuneration component
<i>The composition</i>	of the group of companies (peer group) whose remuneration policy determines in part the level and composition of the remuneration of the MB members
<i>A summary</i>	of the company’s policy with regard to the term of the contracts with MB members, the applicable periods of notice and redundancy schemes, and an explanation of the extent to which best practice provision II.2.7 is endorsed
<i>An explanation</i>	of the performance criteria on which any right of the MB members to options, shares or other variable remuneration components depends
<i>A summary</i>	of the chosen performance criteria
<i>An explanation</i>	of the methods that will be applied in order to determine whether the performance criteria have been fulfilled
<i>A summary</i>	of the choice of these methods
<i>A summary</i>	of the factors that will be used to make the comparison (if performance criteria are based on a comparison with external factors; etc.)
<i>A description</i> <i>An explanation</i>	of each proposed change to the conditions on which a MB member can acquire rights to options, shares or other variable remuneration components
<i>An explanation</i>	if any right of an MB member to options, shares, or other variable components is not performance-related, an explanation of why this is the case
<i>Current pension</i>	schemes and the related financing costs
<i>Agreed arrangements</i>	for the early retirement of MB members

Figure 6.19: Move structure 1 – II.2.10

⁴⁹ II.2.10: The overview referred to in II.2.9 shall contain certain obligatory information, such as a statement of the relative importance of the variable and non-variable remuneration components; and if applicable, the composition of the group of companies (peer group) whose remuneration policy determines in part the level and composition of the remuneration of the management board members.

Communication requirement II.1.4⁵⁰ also contains moves which should be included in the annual report, namely:

- (1) A *declaration* by the management board that the internal risk management and control systems are adequate and effective;
- (2) Clear *substantiation* of this declaration;
- (3) A *report* by the management board on the operation of the internal risk management and control system;
- (4) A *description* of significant changes and major improvements;
- (5) *Confirmation* that the changes and/or improvements have been *discussed* with the audit committee and the supervisory board.

These moves are presented in the following figure:

Move	Content
<i>Declaration</i>	the MB shall declare in the AR that the internal risk management and control systems are adequate and effective
<i>Substantiation</i>	the MB shall provide clear substantiation of this
<i>Report</i>	in the AR, the MB shall report on the operation of the internal risk management and control system during the year under review
<i>Description</i>	in doing so, it shall describe any significant changes that have been made and any major improvements that are planned
<i>Confirmation of discussions</i>	and shall confirm that they have been discussed with the AC and the SB

Figure 6.20: Move structure 2 – II.1.4

A-rule II.3.4⁵¹ includes certain phrases that should be included in the annual report, and could be seen as moves as well; namely:

- (a) *Transactions* in which there are conflicts of interest with the management board;
- (b) *Transactions* in which there are conflicts of interest with the supervisory board;
- (c) A *statement* of the conflict of interest;
- (d) A *declaration* that best practice provisions II.3.2 to II.3.4 inclusive have been complied with.

The moves are presented in the following figure:

Move	Content
<i>Transactions agreed on</i>	all transactions in which there are conflicts of interest with MB members shall be agreed on terms that are customary in the sector concerned
<i>Decisions require approval</i>	decisions to enter into transactions in which there are conflicts of interest with MB members that are of material significance to the company and/or to the relevant MB members require the approval of the SB
<i>Transactions published</i>	such transactions shall be published in the AR
<i>A statement</i>	together with a statement of the conflict of interest

⁵⁰ II.1.4: The management board shall declare in the annual report that the internal risk management and control systems are adequate and effective and shall provide clear substantiation of this. In the annual report, the management board shall report on the operation of the internal risk management and control system during the year under review. In doing so, it shall describe any significant changes that have been made and any major improvements that are planned, and shall confirm that they have been discussed with the audit committee and the supervisory board.

⁵¹ II.3.4: All transactions in which there are conflicts of interest with management board members shall be agreed on terms that are customary in the sector concerned. Decisions to enter into transactions in which there are conflicts of interest with management board members that are of material significance to the company and/or to the relevant board members require the approval of the supervisory board. Such transactions shall be published in the annual report, together with a statement of the conflict of interest and a declaration that best practice provisions II.3.2 to II.3.4 inclusive have been complied with.

<i>A declaration</i>	and together with a declaration that best practice provisions II.3.2 to II.3.4 inclusive have been complied with.
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Figure 6.21: Move structure 3 – II.3.4

Rule III.6.3 concerns the publication of supervisory board transactions that might lead to conflicts of interest. This rule includes the following moves, which also appear in the figure below:

- (a) *Publication of transactions*;
- (b) *A statement* of the conflict of interest; and
- (c) *A declaration* that best practice provisions III.6.1 to III.6.3 inclusive have been complied with.

Move	Content
<i>Publication of transactions</i>	All transactions in which there are conflicts of interest with supervisory board members shall be agreed on terms that are customary in the sector concerned. Decisions to enter into transactions in which there are conflicts of interest with supervisory board members that are of material significance to the company and/or to the relevant supervisory board members require the approval of the supervisory board. Such transactions shall be published in the annual report.
<i>A statement</i>	on conflicts of interest
<i>A declaration</i>	that best practice provisions III.6.1 to III.6.3 inclusive have been complied with.

Figure 6.22: Move structure 4 – III.6.3: annual report-related A-rule

Some of the annual report-related B-rules include moves as well. For example, communication requirement III.1.3 contains the following specific moves:

- | | |
|---------------------------------|------------------------------------------|
| (a) <i>Gender</i> ; | (e) <i>Nationality</i> ; |
| (b) <i>Age</i> ; | (f) <i>Other positions</i> ; |
| (c) <i>Profession</i> ; | (g) <i>Date of initial appointment</i> ; |
| (d) <i>Principal position</i> ; | (h) <i>Current term of office</i> . |

In addition, two other rules (III.1.7; III.1.8) stipulate that references should be made to conclusions drawn from certain supervisory board discussions on *its own functioning* and *that of its individual members*, the *desired profile, composition and competence* of the supervisory board, and *the functioning of the management board* as an organ of the company as well as *the performance of its individual members*. These discussion elements can also be regarded as moves. Further, some phrases or moves are included in III.2.3 concerning the supervisory board's report, which should include a *statement* that best practice provision III.2.1 has been fulfilled and another *statement* concerning which supervisory board member is not independent, if any.

Themes (4)

The general themes of the annual report are ‘information disclosure’, ‘corporate governance structure’, ‘remuneration’, ‘supervising/monitoring’, ‘information disclosure on conflicts of interest’, and ‘financial disclosure’.

The theme ‘corporate governance structure’ occurs most frequently. This theme is reserved almost exclusively for the supervisory board, since only one communication requirement for the management board has the ‘corporate governance structure’ theme. The A- and B-rules concerning this theme with respect to the supervisory board include the quality of the supervisory board members (e.g. age, gender, independence), facts about the supervisory board's committees (e.g. duties and composition), references to specific topics discussed (e.g. its own functioning and that of its individual members, the corporate strategy, the assessment of the management board, etc.), and its supervision tasks. The other rules with the ‘corporate governance structure’ theme are the A-rules of the supervisory board's committees concerning their report on their performance in the past financial year.

The themes ‘remuneration’, ‘financial disclosure’, and ‘information disclosure on conflicts of interest’ arise equally often. The supervisory board’s and remuneration committee’s A- and B-rules with respect to the remuneration report naturally reflect the ‘remuneration’ theme. The management board’s A-rule about its statement, the management board’s B-rules, and the auditor’s report (B-rule) all have the ‘financial disclosure’ theme. Finally, the supervisory board’s and management board’s A-rules on publication of their transactions which lead to conflicts of interest reflect, obviously, the ‘information disclosure on conflicts of interest’ theme.

The following overview (Figure 6.23) presents the A-rules with respect to the annual report genre of each CCU and the content themes:

CCU	Annual report input	Content themes
Supervisory board	Supervisory board report: 1. Duties of the SB committees from past financial year (III.5) 2. Each SB committee: composition, number of meetings, main items discussed (III.5.2) 3. Most important points of the remuneration policy (III.5.10)	1. CG structure 2. CG structure 3. Remuneration
AC	Deliberations and findings of audit committee’s report (III.5.3)	CG structure
RC	Deliberations and findings of remuneration committee’s report (III.5.3)	CG structure
SAC	Deliberations and findings of selection and appointment committee’s report (III.5.3)	CG structure
	Remuneration report: 1. RC prepares remuneration report (Determination and Disclosure of Remuneration principle) 2. Explanation of special remuneration for current and former MB members (II.2.12)	1. Remuneration 2. Remuneration
	Description of transactions of SB members that might lead to conflicts of interest (III.6.3)	Information disclosure on conflicts of interest
Management board	1. Management’s statement that the internal risk management and control systems are adequate and effective (II.1.4) 2. Description of operational and financial objectives and the strategy to achieve these objectives (II.1.2) 3. Description of transactions of MB members that might lead to conflicts of interest (II.3.4) and declaration of compliance with II.3.2 to II.3.4.	1. Financial disclosure 2. CG structure 3. Information disclosure on conflicts of interest

Figure 6.23: Annual report-related A-rules – Content themes

The next overview (Figure 6.24) presents the B-rules with respect to the annual report genre of each CCU, including the relevant themes:

CCU	Annual report input	Content themes
Supervisory board	SB should establish its own report (III.1.2), including: 1. Obligatory information about SB members (III.1.3) 2. Frequent absence of SB members from SB meetings (III.1.5) 3. SB references discussions on specific topics, and conclusions thereof (III.1.7) 4. References to discussions on corporate strategy and assessment of MB, and conclusions thereof (III.1.8) 5. Statement about SB members independence/non-independence (III.2.1, III.2.2, III.2.3) 6. Main points of remuneration policy (cf. Figure 6.17)	1. CG structure 2. CG structure 3. CG structure 4. Supervision 5. CG structure 6. Remuneration

	Remuneration report: 1. Implementation of remuneration policy of past financial year (II.2.9) 2. Obligatory content elements (II.2.10)	1. Remuneration 2. Remuneration
Management board	1. Description of sensitivity of company's results to external factors and variables (II.1.5) 2. Survey of all existing potential antitakeover measures (IV.3.9)	1. Financial disclosure 2. Financial disclosure
External auditor	External auditor's report: Obligatory content elements (i.e. audit, financial figures, operation of internal risk management and control systems) (V.4.3)	Financial disclosure

Figure 6.24: Annual report-related B-rules – Content themes

The fact that the theme ‘corporate governance structure’ is most relevant for the annual report, and that the second overview (Figure 6.24) demonstrates that the CCU supervisory board should provide the most input to the annual report compared with the other CCUs, could be explained through the abovementioned transparency goal of the Tabaksblat Code (“transparency of decision-making by the management board, and proper supervision thereof, including accountability for such supervision”). The Code’s striving for the right ‘checks’ and ‘balances’ in Dutch companies is reflected in the preferred themes.

Intertextual aspects (5)

Bhatia (2004) (cf. 2.3) describes intertextual aspects as:

a number of relationships that the text in question may have with those which in some way have been used, referred to or exploited either directly or indirectly in the construction of the text in question, and may include some of the following:

- 1) Texts providing a context (e.g. a letter to which the one in question is a reply);
- 2) Texts within and around the text (e.g. a chapter in the context of a book);
- 3) Texts explicitly referred to in the text (e.g. references in academic journals);
- 4) Texts referred to implicitly in the text;
- 5) Texts embedded within the text (e.g. a conversation within a story);
- 6) Texts mixed with the text (i.e. quotations) (Bhatia 2004, pp. 126-127)

The Tabaksblat Code has determined that the annual report should include certain elements (cf. 6.17 and 6.18) that could all be regarded as intertextual aspects. The main sub texts to be included in the annual report are the supervisory board’s report, the management board’s report, and the external auditor’s report. The following figures show how the annual report A- and B-rules per sub text can be classified into Bhatia’s categories of intertextual aspects.

The report of the supervisory board belongs to category 2, since it is a text “within and around the text”. The separate reports – the remuneration report and the reports of the committees – included in the supervisory board’s report belong to category 5, since they are texts embedded within the text of the board’s report. The remuneration report includes two move structures which belong to category 4, as they are texts referred to implicitly in the text of the report. The main points of the remuneration policy are included in the remuneration report and are therefore category 6 elements, since they are mixed with the report’s text. The remaining elements of the supervisory board’s report belong to different categories: the moves III.1.7 and III.1.8 belong to category 3 as they are explicit references; III.1.3 and III.2.3 belong to category 4 because they are texts referred to implicitly in the text; III.1.5 belongs to category 6 because it is a text mixed with the report’s text; the transactions with conflicts of interest in III.6.3 belong to category 3, while the latter part of the rule – namely the statement and the declaration – belongs to 5 as they are texts embedded within the text. The last rule, III.5.10, is included in category 1 since it provides the context for the remuneration report. The results are shown in the figure below:

		Category
	Supervisory board's report:	2
III.1.2	The annual financial report of the company shall include a report of the supervisory board in which the supervisory board describes its activities in the financial year and which includes the specific statements and information required by the provisions of this code.	(2)
III.1.5	Supervisory board members who are frequently absent shall be called to account for this. The report of the supervisory board shall state which supervisory board members have been frequently absent from meetings of the supervisory board.	6
III.1.7 Move	References concerning SB discussions (SB and MB functioning; SB issues)	3
III.1.8 Move	References concerning SB discussions (corporate strategy, business risks, MB's assessment internal control and risk management systems, changes to these systems)	3
III.1.3 Move	Individual SB members (specific individual aspects)	4
III.2.3 Move	Statement that III.2.1 has been fulfilled + if needed, non-independence declaration of specific SB member	4
III.5	In its report, the supervisory board shall report on how the duties of the committees have been carried out in the financial year.	5
III.5.2	The report of the supervisory board shall state the composition of the individual committees, the number of committee meetings and the main items discussed	5
III.6.3	All transactions in which there are conflicts of interest with supervisory board members shall be agreed on terms that are customary in the sector concerned. Decisions to enter into transactions in which there are conflicts of interest with supervisory board members that are of material significance to the company and/or to the relevant supervisory board members require the approval of the supervisory board. Such transactions shall be published in the annual report, together with a statement of the conflict of interest and a declaration that best practice provisions III.6.1 to III.6.3 inclusive have been complied with.	3 (transaction s) 5 (statement and declaration)
III.5.1	Remuneration committee: a) drafting a proposal [...] for the remuneration policy to be pursued; b) drafting a proposal for the remuneration of the individual members of the MB [...]: (i) the remuneration structure and (ii) the amount of the fixed remuneration, the shares and/or options to be granted and/or other variable remuneration components, etc. [and] the performance criteria and their application; c) preparing the remuneration report [...]	1
II.2.9	Remuneration report (including): The remuneration report of the supervisory board shall contain an account of the manner in which the remuneration policy has been implemented in the past financial year, as well as an overview of the remuneration policy planned by the supervisory board for the next financial year and subsequent years. [II.2.10 The overview referred to in II.2.9 cf. move structures: many content elements]	5
II.2.10 Move	[cf. move structures]	4
II.2.12 Move	explanation of special remuneration	4
Determination and Disclosure of Remuneration principle	principal points of remuneration policy as included in remuneration report will be included in SB report	6
III.5.3	Reports of the SB committees	5

Figure 6.25: Intertextual aspects 1 – Report of the supervisory board

The report of the management board is a category 2 aspect, since it is a text within and around the annual report text. The most significant elements of the management board's report are the 'move structures' (1) management's statement about internal risk management and control systems (II.1.4) and (2) the operational and financial objectives of the company together with the strategy and its parameters (II.1.2), which are both category 6 aspects since they are mixed with the text. Move structure II.3.4, including the publication of the transactions which lead to conflicts of interest, is a category 4 aspect, whereas the latter part of the move structure, namely the explicit reference, is a category 3 aspect. The remaining rules (II.1.5 and IV.3.9) both belong to category 5 since they are texts embedded within the management board's report. All this is shown in the figure below:

		category
	Report of the management board	2
II.1.4 Move	Management's statement about internal risk management and control systems being adequate and effective	6
II.1.2	The management board shall submit to the supervisory board for approval: a) the operational and financial objectives of the company; b) the strategy designed to achieve the objectives; c) the parameters to be applied in relation to the strategy, for example in respect of the financial ratios. The main elements shall be mentioned in the annual report.	6
II.3.4 Move	All transactions in which there are conflicts of interest with management board members shall be agreed on terms that are customary in the sector concerned. Decisions to enter into transactions in which there are conflicts of interest with management board members that are of material significance to the company and/or to the relevant board members require the approval of the supervisory board. Such transactions shall be published in the annual report, together with a statement of the conflict of interest and a declaration that best practice provisions II.3.2 to II.3.4 inclusive have been complied with.	4 3
II.1.5	The management board shall, in the annual report, set out the sensitivity of the results of the company to external factors and variables.	5
IV.3.9	The management board shall provide a survey of all existing or potential antitakeover measures in the annual report and shall also indicate in what circumstances it is expected that these measures may be used.	5

Figure 6.26: Intertextual aspects 2 – Report of the management board

The external auditor's report is itself a category 2 aspect, as it is a text within and around the annual report text. The reference to article 2:393, par. 4 of the Civil Code, however, is an explicit reference and thus a category 3 aspect. Since the content elements included in rule V.4.3 are examples only, they have not been categorized and are thus not included in the following overview of the results.

		Category
V.4.3	The report of the external auditor pursuant to article 2:393, paragraph 4, Civil Code shall contain the matters which the external auditor wishes to bring to the attention of the management board and the supervisory board in relation to his audit of the annual accounts and the related audits.	2 (report) 3 (reference to CC)

CC = Civil Code

Figure 6.27: Intertextual aspects 3 – Report of the external auditor

To sum up, the annual report A- and B-rules are all considered to be intertextual aspects. The main separate reports of the annual report – namely, the reports of the supervisory board, the management board, and the external auditor – are all category 2 aspects as they are texts within and around the annual report text. The reports included in the supervisory board's report – the remuneration report and the reports of the audit committee, the remuneration committee, and the selection and appointment committee – are category 5 aspects. Six of the annual report A- and B-rules concerning the supervisory board report are specific intertextual aspects because they also represent move structures. The report of the management board includes two move structures. These mainly belong to category 4, though one move structure belongs to category 6 and two belong to category 3. The overviews show that the intertextual aspects included in the annual report genre are highly diverse, which confirms the view that the annual report is a genre network.

6.10 Summary

This chapter consisted of two important parts. The first described the preparation phase for analysis step 1 (i.e. the analyses of the communication rules included in the Tabaksblat Code and the SOX), while the second examined the constitutive communication rules of the Code.

The preparation phase provided the answer to sub question II.1, namely ‘how can the rules included in the Tabaksblat Code and the SOX be identified and analyzed as communication requirements?’ This phase consisted of several steps, the first of which showed that the constitutive communication rules could be identified with the help of certain key words⁵². The second step involved the question ‘which CCU should communicate with which other CCU(s)?’ This showed that while there are many CCUs, yet this dissertation focuses on four selected CCUs per code (cf. 1.3). This means that, with respect to the Tabaksblat Code, this investigation focuses on (1) the CCU supervisory board⁵³; (2) the CCU management board; (3) the CCU general meeting of shareholders; and (4) the external auditor. These corporate bodies play an important role in the Tabaksblat Code (cf. 4.4.1–4.4.4) and in the Dutch corporate governance system (cf. 3.5), since establishing the right ‘checks’ and ‘balances’ is a very important element of the Dutch system (cf. 6.4). The four selected CCUs with respect to the SOX (cf. 1.3) are (1) the CCU issuer; (2) the CCU registered public accounting firm; (3) the CCU audit committee; and (4) the CCU investors. All these CCUs are considered to be financially oriented corporate bodies that (should) act on behalf of the investors. The third step of the preparation phase examined the question ‘what should the CCU communicate about with the other CCU(s)?’ This showed that because the communication rules constitute ‘good governance’, the content of the rules is expected to relate to issues that concern ‘good governance’. The required communication between the CCUs of the Tabaksblat Code thus reflects the core elements of the Dutch concept of ‘good governance’, and that between the CCUs of the SOX likewise reflects the core elements of US ‘good governance’. Hopt (2002) observed certain common themes⁵⁴ in the corporate governance codes which are related to the concept of corporate governance (cf. Chapter 3), whereby internal and external control mechanisms play a key role with respect to the power distribution between the management board, independent directors (supervisory board members), and investors. Each corporate governance system shows what internal and/or external control (or disciplinary) mechanisms are preferred (cf. 3.4 and 3.5).

The answers to the two questions are expected to show how the communication lines, processes and structure should be established. From these answers, we can deduce how the text-internal and text-external factors⁵⁵ of the Dutch annual report genre have been determined.

Analysis step 1 provided the answers to sub question II.2, ‘how do the communication requirements included in the Tabaksblat Code determine corporate communication (communication structure including communication lines, and communication processes); and how do the communication rules determine the annual report genre?’ The results of this step

⁵² Examples of key words are ‘report’, ‘discuss’, ‘notify’, ‘state’, etc.

⁵³ The CCU supervisory board includes its chairman and the audit committee, the remuneration committee, and the selection and appointment committee.

⁵⁴ Common themes within the codes: (1) Board structure (one-tier and two-tier); (2) Role of non-executive directors; (3) Executive remuneration; (4) Responsibility for financial reporting; (5) Role of institutional investors; (6) Regulation of audit; (7) Corporate governance disclosure; (7) Codes as part of national law.

⁵⁵ The text-internal factors include situational context, communicative purpose, move structures, themes, and intertextual aspects. The text-external factors include (1) discursive procedures, namely (a) annual report contributors and (b) the structure of the annual report process; (2) disciplinary culture consisting of generic norms; and finally (3) the discursive practices, namely (a) the choice of genres and (b) communication mode.

lead to the ‘should’ situation of the Dutch annual report genre. Analysis step 1 consisted of two stages. The first included the analysis of the communication requirements of the Tabaksblat Code, which involved the answers per CCU to the two questions elaborated in the preparation phase, namely ‘which CCU should communicate with which other CCU(s)?’ and ‘what should the CCU communicate about with the other CCU(s)?’

The answers to the first question revealed that the CCU supervisory board plays the major communication role, which corresponds with its tasks and function, and with its pivotal role within the company through maintaining overall supervision. This communication role thus corresponds with the view of the supervisory board in the Dutch corporate governance system (cf. 3.5.1). The second important communication entity is the CCU management board. The management board’s communication requirements focus on the internal risk management and control systems as the core of the board’s general task (i.e. managing the company). The CCU general meeting of shareholders holds the third position in terms of communication roles, with the focus of its communication requirements being on the approval of the supervision by the supervisory board, of the decisions on major company changes by the management board, and of the appointment of the external auditor. These tasks enhance the powers of the shareholders, which was one of the core objectives of the Code (cf. 3.5.3 and 4.4). Another significant communication requirement related to the above requirements concerns the fact that the shareholders should be able to exert influence on the supervisory board’s policy. Finally, the external auditor holds the last position with respect to the corporate communication rules. The focus of the external auditor’s communication is on performing the audit of the company. One of the most important communication requirements concerns the auditor’s communicating of any audit-related irregularities to the audit committee.

The answers to the second question identified the content themes of the communication rules as ‘information disclosure’, ‘corporate governance structure’, ‘remuneration’, ‘supervision/monitoring’, and ‘information disclosure on conflicts of interest’. With respect to the management board’s and external auditor’s communication rules, the theme ‘financial disclosure’ was also identified. The content themes per CCU emphasized and confirmed the tasks and responsibilities of the relevant CCU according to the Dutch corporate governance system and the Tabaksblat Code. This is reflected in the separate rules, but in particular in the fact that the content theme of the majority of the communication rules is ‘corporate governance structure’, which corresponds with the Tabaksblat Committee’s effort to emphasize the importance of establishing and maintaining an adequate corporate governance structure within a company (the ‘checks’ and ‘balances’) (cf. 6.4).

The communication actions included in the constitutive communication rules consist of two different kinds of rules, namely A-rules, which are part of a communication line between two or more CCUs, and B-rules, which are not part of a communication line.

The findings of the first stage of analysis step 1 formed the basis for the second stage, which focused on how the communication rules per CCU determine the integrity of the Dutch annual report genre.

Text-external factors

The contributors to the annual report genre are the CCU supervisory board and its committees and the CCU management board with respect to the A-rules; and the CCUs supervisory and management boards and the CCU external auditor with respect to the B-rules. The CCU general meeting of shareholders is not a direct contributor, since the GMS is the main annual report addressee but could be considered as having an indirect contribution on account of its powers concerning approvals. The majority of the contributions to the annual report genre consist of reports, namely (1) the supervisory board report, which includes the remuneration

report and the reports of the board's committees, (2) the report of the management board, and (3) the external auditor's report.

The structure of the annual report process is mainly determined by the annual report-related A- and B-rules, but also (although less importantly) by certain non-annual report A-rules that have a direct or indirect influence on the annual report process. These latter rules form the basis for the annual report process, since without them there would not be a sound annual report in accordance with the Tabaksblat Code.

The norms (part of the discursive culture) are all A- and B-rules concerning the annual report (cf. figures 6.17 and 6.18).

The choice of genre is the annual report, although the separate reports could be regarded as sub texts or even 'sub genres'. The fact that the annual report consists of these separate texts, which are considered to be intertextual aspects, gives rise to the view that the annual report is a genre network.

The communication mode is formal, official, and neutral, with the requirements inciting the company to comply with the rules as indicated by the word 'shall'. The sentences are short and most frequently include a demand, a call for a certain action, or a prohibition.

Text-internal factors

The general communicative purpose is transparency, focused on the right 'checks' and 'balances' within the company. To this end, the supervisory board – together with the audit committee and external auditor – supervises the management board ('checks') and the powers between the management board, supervisory board, and the GMS are well distributed ('balances'). The separate reports included in the annual report, however, might have their own specific communicative purpose⁵⁶.

The situational or immediate context relates mainly to the legal obligation of listed companies to establish an annual report in general, and to do so in accordance with the Tabaksblat Code requirements in particular.

The 'move structures' could be identified, but not frequently. The moves are included in both annual report-related A- and B- rules, and concern specific content elements or phrases that should be included in the annual report. The relevant moves in the A-rules (cf. figures 6.19–6.22) concern the remuneration report's content elements, management's statement, and transactions leading to conflicts of interest with respect to management and supervisory board members. The relevant annual report-related B-rules include move structures with respect to the supervisory board's report. These moves concern certain content elements related to the individual supervisory board members, and references to certain discussions in the supervisory board. The moves are also intertextual aspects, which are included in the separate reports which themselves should be included in the annual report. The reports and the move structures confirm the view of the annual report as a genre network.

The communication rules with respect to the annual report have all been categorized according to the content themes mentioned previously. The tasks and responsibilities of the contributors according to the Dutch 'checks' and 'balances' view are reflected in the content of the relevant communication requirements as well as in the content themes.

The next chapter presents analysis step 1 (cf. 1.1) of the communication rules included in the SOX and related Auditing Standards 2 and 3, which will give rise to the description of the 'should' situation of the US Form 20-F genre network according to the SOX and AS2 and 3.

⁵⁶ This could only be detected after a genre-based analysis of the relevant reports, which does not fit into the scope of this dissertation.

Analysis Step 1: Analysis of Constitutive Communication Rules included in Sarbanes-Oxley Act and Auditing Standards 2 and 3

7.1 Introduction

This chapter presents analysis step 1 (cf. 1.1) of the communication requirements according to the Sarbanes-Oxley Act (SOX) and Auditing Standards 2 and 3 (AS2 and AS3). The preparation phase for this step was described in sub chapters 6.2–6.4. The analysis framework used here is the same as that used in the previous chapter, about the Tabaksblat Code. This means that analysis step 1 consists of two stages. The first is the structuring of the identified constitutive communication rules according to each of the four selected Corporate Communication Units (CCUs), namely the registered public accounting firm, the issuer (including the CEO/CFO), the audit committee, and the investors, based on the answers to the questions introduced in Chapter 6, namely:

1. Which CCU should communicate with which other CCU(s)? and
2. What should the CCU communicate about with the other CCU(s)?

The analysis per CCU starts by answering question 1, in order to determine the communication partners per CCU and thus to identify the communication lines per CCU⁵⁷. The answer to the second question then highlights the relevant content theme (cf. 6.4) of each communication line. Sub chapter 6.4 showed that Hopt (2002) identified the following common themes within the corporate governance codes:

- (1) Board structure;
- (2) Role of non-executive directors;
- (3) Executive remuneration;
- (4) Responsibility for financial reporting;
- (5) Role of institutional investors;
- (6) Regulation of audit;
- (7) Corporate governance disclosure; and
- (8) Codes as part of national law.

These common themes are related to the general concept of corporate governance (cf. 3.2), which has been described as the system by which business corporations are directed and controlled, whereby the power distribution between management, supervisory board/non-executive directors, and investors is a key element. This power distribution is affected by internal and external control (or disciplinary) mechanisms. Important internal control mechanisms are the independent directors/supervisory board members who monitor management, adequate remuneration for management board members, and adequate and effective internal control systems. An example of an external control mechanism is the market for corporate control, which means investors may decide to make use of the ‘exit strategy’ (cf. 3.2) in the case of a takeover. The common themes as identified by Hopt might be expected to be found in the constitutive communication rules of the SOX too.

As not only the SOX but also AS2 and AS3 are analyzed here, each CCU section – where relevant – is divided into three parts, namely SOX, AS2 and AS3. The first stage of the analysis forms the basis for the second stage, which shows how the identified and

⁵⁷ The entire overview of all communication lines per CCU and a short indication of their communication content is included in Appendix D.

structured communication rules determine the integrity of the US Form 20-F genre network, and thus how the constitutive communication rules can be structured according to the factors that determine genre integrity. Bhatia (2004) (cf. 2.3) stated that the generic integrity consists of text-external and text-internal factors, which can be categorized as follows:

Text-external factors:

1. Discursive procedures, consisting of the annual report contributors and the structure of the annual report process;
2. Disciplinary culture, consisting of generic norms;
3. Discursive practices, consisting of the choice of genre and the communication mode.

Text-internal factors:

1. Situational context;
2. Communicative purpose;
3. Move structures;
4. Themes;
5. Intertextual elements which concern the interrelationship between genres.

The constitutive communication rules are investigated to determine which are considered to be text-external factors and which are to be seen as text-internal factors of the integrity of the US Form 20-F genre network according to the SOX and the AS2 and AS3. The results will show the ‘ought’ situation with respect to the Form 20-F genre. In other words, this chapter provides the answer to sub question II.3 (cf. 1.2), namely:

How do the communication requirements included in the Sarbanes-Oxley Act determine corporate communication (communication structure including communication lines, and communication processes), and how do the communication rules determine the annual report genre?

This chapter starts with the first stage of analysis step 1, organized per CCU: sub chapter 7.2 presents the analysis of the communication rules for the CCU registered public accounting firm, followed by the CCU issuer (including the CEO/CFO) in 7.3, the CCU audit committee in 7.4, and the CCU investors in 7.5. Subsequently, sub chapter 7.6 covers the second stage, describing the text-external (7.6.1) and text-internal (7.6.2) factors of the integrity of the Form 20-F genre network. The final sub chapter (7.7) provides a summary of the chapter.

7.2 CCU registered public accounting firm⁵⁸

Communication lines

The CCU registered public accounting firm (RPAF) should communicate with the CCUs issuer, audit committee, and investors. However, the auditor’s communication lines include only three SOX rules; all other relevant rules are included in AS2 and AS3. Appendix D presents a complete overview of all communication rules and a short indication of their content as well as the relevant content themes.

Content themes

The analysis of the RPAF’s communication lines shows that most content themes concern the ‘financial disclosure’ theme. We saw in section 3.4.2 that federal and state legislation as well as courts are to be seen as safeguards for investors’ interests, since investors play a core role within an outsider system such as the US corporate governance system. The SOX, which is officially called the Accounting Industry Reform Act 2002, is a securities legislation aimed specifically at protecting investors (cf. 5.4) by setting out the auditor’s task of ensuring that the financial disclosures are correct (cf. SOX404(b)).

⁵⁸ The Registered Public Accounting Firm, or RPAF, has also been referred to as the auditor.

The communication rule concerning the auditor and the issuer (AS2-134⁵⁹) revolves around the ‘corporate governance structure’ theme, and stipulates that when the auditor evaluates the likelihood that a deficiency or combination of deficiencies could result in a misstatement, he/she should evaluate how the controls interact with other controls.

The next three rules with the ‘corporate governance structure’ theme are part of the communication with the audit committee. The first concerns SOX204(k), about the auditor’s obligation to report on the audit to the audit committee, and the second involves SOX301(m)(2), which highlights the fact that the auditor should report directly to the audit committee. Section 5.4.1 pointed out that the auditor’s independence is of the utmost importance, given that one of the causes of the scandals around 2000 was that the auditors were providing non-audit as well as audit services, thus compromising their independence. The fact that the auditor should report to the audit committee rather than the management board reflects the new emphasis on auditor independence. The third rule (AS2-56) underpins the strong relationship between auditor and the audit committee, including that the auditor should evaluate and assess the effectiveness of the audit committee.

The content theme ‘information disclosure’ could be detected in only one SOX communication rule (SOX204(k)(3))⁶⁰, as part of the communication with the issuer. This rule indicates that the auditor should report all material written communications between the auditor and the management to the audit committee.

All remaining communication rules have the ‘financial disclosure’ theme, as is clear from the headings of the Auditing Standards. AS2 is titled “Auditing Standard No. 2 – An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements”. AS2 is an extension of SOX103(a)(2)(A)(iii) and 404 (cf. 5.5.1), which demands a level of assurance of the reliability of financial reporting. For this reason, the auditor must evaluate both the management’s assessment process and the effectiveness of internal control over financial reporting, meaning that he/she must express two opinions in all reports on internal control over financial reporting. It is clear that the rules of AS2 are focused on the auditor’s report, including the auditor’s assessment. The communication actions correspond with this focus.

The main rule for the auditor (AS2-4) includes the auditor’s task, namely:

The registered public accounting firm must plan and perform the audit to obtain reasonable assurance about whether the company maintained [...], effective internal control over financial reporting [...].
The registered public accounting firm must audit the company’s financial statements [...].

All remaining AS2 communication requirements are related to the rule quoted above, and with respect to the communication with the issuer they indicate, for example, that the auditor:

- must obtain sufficient evidence to provide a reasonable basis for his/her opinion (AS2-19); or
- must obtain an understanding of and evaluate management’s process for assessing the effectiveness of the internal control over financial reporting (AS2-40); or
- should evaluate management’s documentation whether it includes particular information (AS2-42); or
- should evaluate all evidence obtained from all sources (AS2-127); or

⁵⁹ When evaluating the likelihood that a deficiency or combination of deficiencies could result in a misstatement, the auditor should evaluate how the controls interact with other controls. There are controls, such as information technology general controls, on which other controls depend. Some controls function together as a group of controls. Other controls overlap, in the sense that these other controls achieve the same objective (AS2-134).

⁶⁰ Sec. 204. Auditor reports to audit committees. Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following: “(k) Reports to audit committees.—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer— [...] “(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.”

- should obtain written representations from management to perform his/her task (AS2-142); and
- should communicate all deficiencies in the internal control over financial reporting to the management (AS2-209).

The AS2 rules concerning the communication with the audit committee include, for example, that the auditor should notify any material misstatements (AS2-192) and significant deficiencies (AS2-207) to the audit committee. The communication with the investors includes rule AS2-6, which states that the auditor should be aware of the fact that “persons who rely on the information concerning internal control over financial reporting include investors, creditors, the board of directors and audit committee, and regulators in specialized industries, such as banking or insurance”, which implies once more that the auditor should check carefully whether the financial information is sound.

AS3 is called “Additions to the Sarbanes-Oxley Act (section 103a): Auditing Standard No. 3 – Audit Documentation”. The rules included in this Standard (cf. 5.5.1) also focus on the auditor’s task, as the audit documentation must contain sufficient information to enable an experienced auditor to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and to determine who performed the work, that the work was indeed completed, and who reviewed the work on what date⁶¹. Another important component of AS3 concerns changes to audit documentation. Audit documentation has been defined as a “written record of the basis for the auditor’s conclusions that provides the support for the auditor’s representations”⁶². Also called ‘work papers’ or ‘working papers’, this includes records of the planning and performance of the audit work, procedures performed, evidence obtained, and conclusions drawn. AS3 rules occur only in the communication between the RPAF and the issuer. These rules include the auditor’s representations (AS3-2), and further that the auditor must identify in the engagement completion document any significant findings detected during the review of interim financial information (AS3-13).

The following overview shows the content themes of the RPAF’s communication rules. Only three themes could be identified, namely ‘information disclosure’, ‘corporate governance structure’, and ‘financial disclosure’. It is clear from the overview that there is a strong emphasis on the latter:

Theme CCU	Information disclosure	Corporate governance structure	Remuneration	Financial disclosure
RPAF	-----	-----	-----	-----
Issuer (CEO/CFO)	SOX204(k)(3)	AS2-134		SOX404(b) AS2-4, 6, 19, 21, 40, 42, 47, 49, 79, 127, 128, 130, 133, 138, 142, 143, 148, 160, 186, 187, 192, 197, 201, 202, 203, 204, 206, 207, 208, 209, 210, 211, 213, 214 AS3-2, 13
Audit committee		SOX204(k) SOX301(m)(2)		AS2-6, 56, 192, 205, 206, 207, 210, 214
Investors				AS2-6

Figure 7.1: Content themes of the registered public accounting firm’s communication rules

⁶¹ PCAOB, Bylaws – Rules – Audit Documentation, AS3-6

⁶² AS3-2, p. 2

Communication actions structured

The communication actions included in the RPAF's communication rules are not always part of one or more communication lines. Rather, we can distinguish between A-rules that are part of a communication line, and B-rules that are not. The latter rules often include a communication action in the form of output (e.g. a report).

This section structures the constitutive communication rules into A- and B-rules, and describes how the output should be 'published': i.e. (1) in the form of a report; (2) as part of the annual report; (3) posted on the website; or (4) not specified (though it could be stated that this kind of written communication will be disclosed at least internally, within the company). The variations (1) and (2) are interrelated, because most separate reports should be included in the annual report as well. The analysis shows that the number of A- and B-rules is fairly equally divided.

Annual report: auditor's report (1) and (2)

A. Communication rules that are part of a communication line

SOX404(b) indicates that the annual report should contain the audit report, in which the auditor attests to and reports on the assessment made by the management. AS2-4 requires the auditor to audit the issuer's financial statements as specified in the management's assessment.

Annual report: auditor's report (1) and (2)

B. Communication rules that are not part of a communication line

Although only one SOX rule is involved here, it is one of the most important of all the SOX rules, namely SOX103(a)(2)(A)(iii): Auditing, Quality Control, and Independence Standards and Rules, which states that each RPAF shall:

describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b), and present (in such report or in a separate report) certain content elements⁶³.

This rule contains the core content elements of the auditor's report.

The remaining rules are included in AS2 and AS3. AS2 is an addition to SOX103(a)(2)(A)(iii) and 404(b), concentrating on the audit report, and AS3 concerns audit documentation. The RPAF's most important contribution to the annual report is the auditor's report. This may be a combined report or separate reports (AS2-169). The auditor's report on management's assessment of the effectiveness of internal control over financial reporting must include many obligatory content elements⁶⁴ (AS2-167). Further, AS2-171 and 172 include rules concerning the date of the auditor's report(s).

Annual report modifications due to specific circumstances (1) and (2)

A. Communication rules that are part of a communication line

Some A-rules could be considered to be only relevant for the annual report in particular situations. If the auditor assesses the control risk as other than low for certain assertions or significant accounts, he/she should document the reasons for that conclusion (AS2-160).

⁶³ The main content elements are: I. the findings; II. an evaluation of [certain aspects of the] internal control structure and procedures; and III. a description, at a minimum, of material weaknesses in such internal controls, and of any material non-compliance found on the basis of such testing.

⁶⁴ These content elements include the items a–p, some examples being: a. A title that includes the word *independent*; b. An identification of management's conclusion about the effectiveness of the company's internal control over financial reporting as of a specified date based on the control criteria; c. An identification of the title of the management report that includes management's assessment (the auditor should use the same description of the company's internal control over financial reporting as management uses in its report); d. A statement that the assessment is the responsibility of management.

Finally, the last rule includes that it is the auditor's task to include significant findings in an engagement completion document (AS3-13).

Annual report modifications due to specific circumstances (1) and (2)

B. Communication rules that are not part of a communication line

These rules include the content elements of the auditor's report if the auditor has found a deficiency or material weakness (AS2-176). In that situation, the auditor should add specific information⁶⁵ to his or her report.

Further, the auditor should document the effect of a conclusion that the control risk is other than low, and modify the standard report as a consequence of that control risk (AS2-161). The auditor should also add certain content elements⁶⁶ to his/her report if the management has provided inadequate information (AS2-180).

If the auditor detects a material effect on the issuer after the assessment date, this will have important consequences for the content of his/her report. The relevant content elements are included in several rules, as follows:

- An explanatory paragraph describing the event and its effects or directing the reader's attention to the event and its effects as disclosed in the management's report (AS2-189);
- AS2-190 contains additional information for the management's report;
- AS 2-191 provides the following language to use as the last paragraph of the report to disclaim an opinion on management's cost-benefit statement:
We do not express an opinion or any other form of assurance on management's statement referring to the costs and related benefits of implementing new controls; or
- AS2-194 and 195: When the auditor's opinion on the financial statements is unaffected by the adverse opinion on the effectiveness of internal control [...], the report on internal control [...] should include:
This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements, and this report does not affect our report dated [date of report] on those financial statements. [Revise this wording appropriately for use in a combined report.].
- AS2-196: The following text should be included:
This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements.

Clearly, the PCAOB did not want to leave room for interpretation.

AS2 also contains rules (AS2-173 and 174) with respect to conditions⁶⁷ that cause the need to modify the auditor's report, including an obligatory paragraph describing the reasons for modification.

AS3

AS3 includes the following B-rules relevant for the auditor:

- If the auditor has identified information relating to significant findings/issues that is inconsistent with/contradicts the auditor's final conclusions, this information must be included in the audit documentation (AS3-8);

⁶⁵ Examples of this specific information: (1) The definition of a material weakness; (2) A statement that a material weakness has been identified and included in management's assessment; (3) A description of any material weaknesses

⁶⁶ Cf. footnote 9

⁶⁷ a. Management's assessment is inadequate or management's report is inappropriate (174); b. There is a material weakness in the company's internal control over financial reporting (175–177); c. There is a restriction on the scope of the engagement (178–181); d. The auditor decides to refer to the report of other auditors as the basis, in part, for the auditor's own report (182–185); e. A significant subsequent event has occurred since the date being reported on (186–189); f. There is other information contained in management's report on internal control over financial reporting (190–192).

- If the auditor becomes aware after the documentation completion date that audit procedures may not have been performed [...] the auditor must have persuasive other evidence (AS3-9);
- If the auditor must document significant findings, actions taken to address them and the basis for the conclusions reached in connection with each engagement (AS3-12).

Relationship between RPAF the issuer (4)

A. Communication rules as part of a communication line

The majority of the rules⁶⁸ with respect to the relationship between the RPAF and issuer do not provide indications of the means of ‘publication’, and are thus considered to be communication for internal use. The AS2 A-rules concerning the relationship between the auditor and the issuer include explicit information on how to establish the management’s assessment of the internal control over financial reporting. The auditor should obtain reasonable assurance (cf. 5.5.1) about whether the issuer maintained effective internal control over financial reporting. Therefore, it is important for the auditor to obtain sufficient evidence and an understanding of:

- (1) Management’s assessment;
- (2) The results of procedures;
- (3) The design of controls;
- (4) The relevant documents; and
- (5) The reports.

The auditor should also communicate any deficiencies and material weaknesses to the issuer. Finally, another rule indicates how the auditor should deal with changes and additional information about the internal control over financial reporting, and what to do if he/she identifies a material weakness or deficiency within them.

Relationship between RPAF and audit committee (4)

A. Communication rules as part of a communication line

With respect to the audit committee as communication partner, it can be concluded that the auditor should assess the committee and keep it informed about the audit and relevant audit issues⁶⁹. Although there are no indications for publishing the output of these rules, it is clear that they underpin and support the annual report, and are thus very important for the annual report process.

Relationship between RPAF and investors (4)

A. Communication rules as part of a communication line

The communication with the investors (AS2-6) focuses only on the fact that the auditor should take the investors as addressees into account while providing information about the internal control over financial reporting.

7.3 CCU issuer

This sub chapter presents the analysis of the communication requirements with respect to the CCU issuer, which also includes the requirements for the CEO/CFO.

⁶⁸ SOX204(k)(3); AS2-6, 19/21, 40, 42, 47, 49 79, 127, 128, 130, 133, 134, 138, 142, 143, 148, 197, 201, 202, 203, 204, 206, 207, 208, 209, 210, 211.

⁶⁹ SOX204(k)(3), 301(m)(2); AS2-6, 56, 192, 205, 206, 207, 210.

Issuer

Communication lines

The CCU issuer's communication partners are the CCU RPAF, the CEO/CFO, and the CCU audit committee. The complete overview of all communication lines for the CCU issuer can be found in Appendix D.

Content themes

The issuer's communication rules with respect to the communication partner RPAF are all included in AS2, and therefore relate in general to financial disclosure. Within the communication with the RPAF, they are in effect conditions for the establishment of an appropriate corporate governance structure. The first rule states that the issuer should file the auditor's report as part of the annual report (AS2-2). The subsequent focus is on what management must do to enable the auditor to audit the internal control over financial reporting adequately⁷⁰, as well as the fact that the management should establish a report that includes its conclusion about the effectiveness of the internal control over financial reporting. These rules reflect the management's tasks according to the US corporate governance system (cf. 3.4.2), namely that the management's principal internal responsibility is the company's shareholders. Adequate and effective internal control over financial reporting is the means to ensure correct financial disclosures, and this is to be confirmed by the auditor as well, in order that the shareholders can decide in an informed manner whether to keep or sell their shares. The consequence is that there should be a close relationship between the issuer and the RPAF (cf. 5.4.2).

The communication with the CEO/CFO is determined by only one SOX rule (SOX306/1), indicating that the issuer should notify any black-out period to the CEO/CFO. This belongs to the 'information disclosure' theme. The communication with the audit committee is very important, as it refers to the assessment of the audit committee's monitoring function by the board of directors (management/executives), since they remain responsible for maintaining effective internal control over financial reporting (AS2-55/56). The note to AS2-55 states clearly that "This standard does not suggest that this responsibility has been transferred to the audit committee". This rule has the 'corporate governance structure' theme.

CEO/CFO

Communication lines

The communication lines of the CEO/CFO concern the CCUs issuer and audit committee.

Content themes

The role of the CEO/CFO has become increasingly important as they are the signing officers, which makes them personally accountable for the correctness of the information on Form 20-F (cf. 5.4.2). As shown in SOX302(a) and (b)(5), the communication with the RPAF and the audit committee is based on this key role, as they are required to disclose all significant deficiencies, material weaknesses, and any instances of fraud to the RPAF. The rules that determine the communication with the RPAF and audit committee include the 'corporate governance structure' theme. The communication with the issuer concerns SOX304(a), including that if the issuer has to make a restatement as a consequence of non-compliance with the reporting requirements (cf. 5.4.2), the officers will have to return their bonuses and

⁷⁰ AS2-20/163

other equity-based remuneration (as well as any profits thereof) to the issuer. The relevant content theme is therefore ‘remuneration’.

The following overview shows the content themes included in the communication rules of the CCU RPAF:

Theme CCU	Information disclosure	Corporate governance structure	Remuneration	Financial disclosure
RPAF		SOX302(a)/(b)(5)		AS2-2, 20, 163
Issuer (CEO/CFO)	SOX306/1 (issuer > CEO + CFO)	-----	SOX304(a) (issuer > CEO + CFO)	-----
Audit committee		AS2-55/56		
Investors				

Figure 7.2: Content themes of the issuer’s (incl. CEO and CFO) communication rules

Communication actions structured

The majority of the obligatory communication actions are A-rules, and thus part of a communication line. This section describes the rules, their content elements, and how the output should be ‘published’: i.e. (1) in the form of a report; (2) as part of the annual report; (3) posted on the website; or (4) not specified (though it could be stated that this kind of written communication will be disclosed at least internally, within the company). The variations (1) and (2) are interrelated, because most separate reports should be included in the annual report as well.

Annual report: auditor’s report and management’s report (1) and (2)

A. Communication rules that are part of a communication line

The first rule (AS2- 2) stipulates that the issuer must file the auditor’s attestation report in the annual report, and the signing officers must report any significant deficiencies and material weaknesses (SOX302(a) and (b)(5)). Further, the rules set out the management’s role (AS2-20 and 163) with respect to the auditor’s and management’s reports being part of the annual report, as well as rules (AS2-55/56) concerning the management’s responsibility to maintain effective internal control over financial reporting.

Annual report: management’s report (1) (2)

B. Communication rules that are not part of a communication line

In the annual report, the issuer is required to include an internal control report (SOX404(a)) and the management’s report (AS2-162). The latter should include the following elements:

- (1) A statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- (2) A statement identifying the framework used by management;
- (3) An assessment of and a statement about the effectiveness of the company’s internal control over financial reporting; and
- (4) A statement of the auditor’s attestation report on management’s assessment.

Annual report A-rules:

1. CEO/CFO to certify annual report

The CEO/CFO are required to certify each annual report (SOX906; also 302(a)/(b)(5)).

2. CEO/CFO's Code of Ethics

The issuer should disclose its Code of Ethics (SOX406(a)) with respect to the CEO/CFO in the annual report.

3. Audit committee's financial expert

The issuer should disclose whether the audit committee does or does not have a financial expert (SOX407(a)) in the annual report.

Remaining A-rules (not part of the annual report):

1. Black-out period (4)

SOX306/1 includes that if a director or executive officer is subject to the requirements of SOX306, the issuer of certain equity securities should notify the CEO/CFO of any black-out period.

2. Signing officers' task in case of restatement (4)

SOX304(a) states that the officers must return their bonuses to the issuer in the case of a restatement.

3. Assessment of audit committee (4)

The issuer's board of directors/executive management remains responsible for assessing the performance of the audit committee (AS2-55/56).

Remaining B-rule (not part of the annual report)

General rule about documentation of design of controls over relevant assertions

Rule AS2-44 indicates that the:

documentation of the design of controls over relevant assertions related to significant accounts and disclosures is evidence that controls related to management's assessment of the effectiveness of internal control over financial reporting [...] have been identified.

Such documentation also provides the foundation for appropriate communication concerning responsibilities for performing controls, and for the company's evaluation and monitoring of the effective operation of these controls.

7.4 CCU audit committee

Communication lines

The audit committee's communication partners are the CCUs RPAF, issuer, audit committee (its members being the independent directors of the issuer's board of directors), and investors. Appendix D presents an overview of all communication lines of the CCU audit committee.

Content themes

The SOX rules with respect to audit committee's communication partners (the RPAF, the issuer, and the members of the audit committee) relate to the 'corporate governance structure' theme.

The auditors' independence is a very important issue in the SOX and related Auditing Standards (cf. 5.4.1), as their non-independence (a consequence of the provision of non-audit services) was one of the causes of the 2000 financial scandals. It is therefore an important task of the audit committee to determine which non-audit services do not restrict the auditor's

independence, and are thus permissible⁷¹. The communication with the RPAF, further, includes that the audit committee is responsible for the appointment, compensation, and supervision of the RPAF's work⁷².

The communication with the issuer involves the establishment of a whistleblowers procedure⁷³ by the audit committee for any accounting, internal auditing control, or other auditing issue. This, too, can be seen as a consequence of the Enron scandal; an additional 'safeguard' for correct financial disclosure.

Only one AS2 rule⁷⁴ is relevant, but this rule is of the utmost importance. It relates to financial disclosure, specifically the audit committee's general role in the control environment and its monitoring role with respect to components of internal control over financial reporting.

The only rule⁷⁵ included in the communication with the investors concerns the disclosure of the approval of non-audit services to the investors.

The overview below shows the content themes of the audit committee's communication rules. Most rules are from the SOX, and all of these except two have the appropriate 'corporate governance structure' theme.

Theme CCU	Info disclosure	Corporate governance structure	Remuneration	Financial disclosure
RPAF		SOX201(h), 202, 301(m)(1)(B)(2)		
Issuer (CEO/CFO)		SOX202(1)(A), 301(m)(A)(4)		AS2-55
Audit committee	-----	SOX202/3 (audit committee > AC members)	-----	----- ---
Investors	SOX202/2			

Figure 7.3: Content themes of the audit committee's communication rules

Communication actions structured

The audit committee's communication rules are all A-rules, as they are part of a communication line, and all are SOX rules except for one AS2 rule.

This section describes the rules, their content elements, and how the output should be 'published': i.e. (1) in the form of a report; (2) as part of the annual report; (3) posted on the website; or (4) not specified (though it could be stated that this kind of written communication will be disclosed at least internally).

Audit committee's monitoring role (4)

The audit committee plays a significant role with respect to the control environment, and monitors components of internal control over financial reporting (AS2-55).

⁷¹ SOX201(h), SOX202(i)(1)(A), SOX202/1A), and SOX202/3

⁷² SOX301(m)(B)(2)

⁷³ SOX301(m)(A)(4)

⁷⁴ AS2-55

⁷⁵ SOX202/2

(Pre)approval of audit and non-audit services (1)

SOX201(h), 202/1A, 202/2, 202(i)(1)(A) and 202/3 indicate that all audit and non-audit services of the RPAF should be preapproved by the audit committee. These approvals will be disclosed to the investors in periodic reports.

Relationship with the RPAF (4)

The audit committee is directly responsible for the appointment, remuneration, and supervision of the RPAF's work (SOX301(m)(1)(B)(2)).

Whistleblowers regulation (4)

SOX301(m)(A)(4) stipulates that the audit committee should establish complaint procedures with respect to accounting.

7.5 CCU investors

Communication lines

The CCU investors has only one communication partner, namely the CCU issuer.

Content themes

SOX403(a)(a) concerns those investors who own more than 10 percent of any class of any security; they should file statements with respect to the amount of all equity securities of the given issuer, the date of filing, changes in ownership, and purchases and sales. The content of this rule is clearly about financial disclosure, as is enhanced by the fact that the rule is part of AS2, which includes additional rules to SOX103(a)(2)(A)(iii) and 404(b).

Communication actions structured

Statements concerning equity securities (SEC website)

A. Communication rule that is part of a communication line

The SEC will make the abovementioned statements concerning equity securities publicly available on its website.

Theme CCU	Info disclosure	Corporate governance structure	Remuneration	Financial disclosure
RPAF				
Issuer (CEO/CFO)				SOX403(a)(a)
Audit committee				
Investors	-----	-----	-----	-----

Figure 7.4: Content themes of the investors' communication rules

7.6 How do the communication rules determine the integrity of the US Form 20-F genre?

Sub chapters 7.2–7.5 addressed the first stage of analysis step 1, as each included the analysis of the communication rules with respect to one of the four selected CCUs. The previous sub chapters, therefore, revealed the communication partners of each CCU, and the content and

content themes involved in that communication. Besides the communication as part of a communication relationship – the A-rules – communication rules have also been analyzed that are not part of a communication line, but that are relevant for the CCU concerned – the B-rules.

This sub chapter shows how the results of stage 1 influence the integrity of the US Form 20-F genre network. This means that the following sections show which of the identified and structured constitutive communication rules are to be seen as text-external (7.6.1) and text-internal (7.6.2) factors of the US Form 20-F genre network.

7.6.1 Text-external factors

The text-external factors consist of (1) the discursive procedures, including (a) the contributors and (b) the structure of the annual report process; (2) the disciplinary culture, consisting of the norms; and (3) the discursive practices, including (a) the choice of genre and (b) the communication mode.

Discursive procedures (1)

Contributors (a)

The contributors to the US annual report genre, namely the Form 20-F, are the CCU RPAF and the CCU issuer (CEO and CFO included). The other CCUs (the audit committee and the investors) do not directly contribute to the annual report.

Structure of the annual report process (b)

The structure of the annual report process is influenced by four groups of constitutive communication rules. The first two groups (groups A and B) cover the annual report-related A- and B-rules of the annual report contributors. The third group (A+ rules) covers the rules that only become annual report-related rules in specific circumstances, which is elaborated below. Group C consists of A-rules that are not included in the first group, but that have a direct influence on the annual report process. Finally, group D consists of A-rules that belong in neither group A nor C and that have an indirect influence on the annual report process, thus supporting the process and being essential to the construction of a sound annual report process.

Group A

The first group consists of the most significant constitutive communication rules, all of which are annual report-related A-rules for the annual report contributors. Concretely, these entail that the RPAF has to establish the auditor's report as part of the annual report (SOX404(b)), and that the management's report – also obligatory part of the annual report – should include the management's assessment of the effectiveness of the company's internal control over financial reporting. Further, the RPAF must plan and perform the audit as set down in the management's assessment (AS2-4). The issuer's contribution consists of annual report-related A-rules concerning the obligation that the auditor's report be included in the annual report (AS2-2). Other contributions are the rules AS2-20 and 163, which describe the management's role with respect to the auditor and indicate that the management's report should be part of the annual report. The management's report should include the statement about its responsibility for maintaining effective internal control over financial reporting (AS2-55/56). Finally, the CEO and CFO are obliged to report any significant deficiencies and material weaknesses (SOX302(a) and (b)(5)).

Group B

The second group of constitutive communication rules relevant for the annual report process consists of all annual report-related B-rules for the contributors RPAF and issuer. The relevant B-rules concerning the CCU RPAF include:

- Specific obligatory content elements of the audit report (SOX103(a)(2)(A)(iii));
- SOX404(b), including the auditor's attestation on management's assessment of the effectiveness of internal control over financial reporting;
- Other content elements (AS2-167);
- Most importantly, the auditor's report, including the auditor's statement about the internal control over financial reporting (AS2-169);
- Rules determining the date of the auditor's report (AS2-171; 172);
- AS3-4, on audit documentation;
- AS3-5, including specific content elements of audit documentation; and
- Identification of items inspected with respect to audit documentation (AS3-10).

The relevant annual report B-rules with respect to the CCU issuer concern:

- The highly significant rule SOX404(a), which requires the issuer to include the internal control report in Form 20-F;
- Obligatory content elements with respect to the management's report (AS2-162);
- Certification of Form 20-F by the CEO and CFO (SOX906; also 302(a) and (b)(5) are of utmost importance);
- Code of Ethics (SOX406(a)) with respect to the CEO/CFO to be included in Form 20-F; and
- Obligatory statement on whether the audit committee has a financial expert member (SOX 407(a)) to be included in Form 20-F.

Group A+

The third group of constitutive communication rules concerning the annual report process consists of A- and B-rules that do not belong to groups 1 or 2, and that are only relevant for and applicable to Form 20-F in specific circumstances. These rules exclusively concern the RPAF, and four separate sub groups can be distinguished. The first sub group⁷⁶ concerns changes/adjustments in the auditor's report after the auditor has detected significant deficiencies or material weaknesses. The second⁷⁷ relates to the issuer; if the management has added information to its report after its assessment and the auditor finds a material misstatement in the added information, the auditor should adjust his/her report accordingly. The third sub group⁷⁸ contains content elements that the auditor should include in his/her report if the information provided to the auditor is inadequate. Finally, the last group⁷⁹ includes additions to the auditor's report for various reasons; for example, if the management's report is inappropriate, or the management's process for assessing internal control over financial reporting is inadequate. Figures 7.7–7.10 briefly present these rules and their content.

Group C

This group of communication rules contains A-rules⁸⁰ that are not part of group A, but that influence the annual report process directly and form the basis for a sound annual report

⁷⁶ AS3-12, 176.

⁷⁷ AS2-190, 191, 194, 195, 196.

⁷⁸ AS2-159, 180.

⁷⁹ AS2-161, 173, 174, 189; AS3-8, 9.

⁸⁰ C-rules: SOX204(k)(3), 301(m)(2), 301(m)(1)(B)(2) and 301(m)(1)(4)(A), 201(h), SOX202(i)(1)(A) and (B), 202/2 and 202/3; AS2-6, 19, 21, 40, 42, 47, 49, 56 (2nd sentence), 79, 127, 128, 148, 142, 143, 202, 203, 204, 206, and AS3-2.

process in order to constitute the US Form 20-F genre network, and thus the US institution ‘good governance’. The rules concerned are not only part of the communication lines of the contributors to the US annual report (the CCUs RPAF and issuer, including the CEO and CFO), but also concern the CCU audit committee. Sub chapter 7.2 identified the relevant rules and briefly explained their content.

The communication rules (SOX201(h), 202/1A, 202/2, 202(i)(1)(A), 202/3) concerning the relationship between the RPAF and the audit committee also support the annual report process, since they are about the auditor’s obligation to assess the audit committee and keep it informed of the audit and relevant audit issues. If the RPAF does not comply with these rules, the established annual report will not be correct; the Form 20-F genre, the US annual report, will not have been established, and thus the institution ‘good governance’ will not have been constituted. In addition, communication rule AS2-6, which stipulates that the RPAF should take the investors into account when providing information about the internal control over financial reporting – which in turn refers to the core US transparency goal, namely financial disclosure – is needed to constitute the US Form 20-F genre and thus also ‘good governance’.

Group D

The A-rules⁸¹ that do not belong to groups A and C only apply if the A+ rules apply. These D-rules support the A+ rules, and thus the annual report process.

Disciplinary culture (2)

Norms

The norms that determine the integrity of the Form 20-F genre network according to the SOX and AS2 and 3 include all annual report-related A- and B-rules (cf. figures 7.5 and 7.6). We saw in the previous sections that the RPAF and the issuer (including the CEO and CFO) are the contributors to the annual report, and consequently their A- and B-rules with respect to the annual report are the norms that determine the Form 20-F’s integrity.

Annual report-related A-rules

The A-rules as presented in Figure 7.5 demonstrate clearly that in fact only one input rule is involved, namely that the auditor should establish the auditor’s report on behalf of the Form 20-F contributor ‘RPAF’. The obligation to include this report in the annual report, however, concerns the issuer. The management of the contributor ‘issuer’ is responsible for establishing the management’s report as part of the annual report, but also for presenting its written assessment to the auditor about the effectiveness of the internal control over financial reporting in order to enable the auditor to do his/her work. The auditor’s responsibility to the issuer is, in turn, to plan and perform the audit as mentioned in the management’s assessment. Thus, both the RPAF and the issuer are presumed to be responsible for the audit and the assessment of the effectiveness of the internal control over financial reporting, since both ‘activities’ are linked. The issuer’s annual report obligations mainly concern the management’s report, including the management’s assessment. The certification requirements for the CEO and CFO are of the utmost importance (cf. 7.3), and the fact that the CEO and CFO have responsibilities towards the RPAF and audit committee emphasizes the major role (and independence) of the auditor as well as the role of the audit committee (cf. 7.4).

⁸¹ Group D: AS2-41, 130, 133, 134, 138, 160, 186, 187, 192, 197, 201(RPAF-issuer), 55, 205, 207, 208, 209, 210, 211, 213, 214; AS3-13; SOX306/1, 304(a), 403(a)(a).

CCU	Annual report input	partner-CCU
RPAF	Auditor's report as obligatory part of annual report (SOX404(b))	Issuer
	RPAF must plan and perform audit as mentioned in management's assessment (AS2-4)	
Issuer CEO CFO	Auditor's attestation report should be filed in annual report (AS2-2)	RPAF
	Management's statement about effectiveness of internal control over financial reporting as part of annual report (AS2-20)	
	Management's conclusion about effectiveness of internal control over financial reporting included in annual report and in management's representation letter to auditor (AS2-163)	
	Management's report should include statement about management's responsibility for maintaining effective internal control over financial reporting (AS2-55-56)	Audit committee
	CEO and CFO certification including that they have reviewed annual report and to their knowledge it includes no untrue statements of material fact (SOX302(a)/(b))	

Figure 7.5: Annual report-related A-rules

Annual report-related B-rules

Figure 7.6 shows that all the RPAF's B-rules concern the auditor's report, whereas the issuer's B-rules vary between obligatory content elements for the management's report, the CEO's and CFO's certification, and the statements about whether the issuer has included a Code of Ethics and whether the audit committee has a financial expert.

CCU	Annual report input
RPAF	Auditor's report (SOX103(a)(2)(A)(iii))
	Auditor's report (AS2-167, 169)
	Auditor's report – date (AS2-171, 172)
Issuer CEO CFO	Management's report (SOX404(a))
	Management's report – obligatory content elements (AS2-162)
	Certification of annual report (SOX906; cf. SOX302(a)/(b) annual report-related A-rules)
	Code of Ethics (SOX406(a))
	Statement whether audit committee does/does not have financial expert member (SOX407(a))

Figure 7.6: Annual report-related B-rules

The Form 20-F contributors, the RPAF and issuer (including the CEO and CFO), should provide contributions to the annual report that are mostly in form of a specific report. The management is responsible for the internal control report and management's report on internal control over financial reporting, which must include its assessment of the effectiveness of the company's internal control over financial reporting. Further, the report should contain the management's representation letter to the auditor, including a written conclusion about the effectiveness of the company's internal control over financial reporting.

The auditor's contribution consists mainly of the auditor's report⁸² or attestation report, including his/her opinion about the effectiveness of the internal control over financial reporting, and his/her attestation and report on the management's assessment. The disclosure in Form 20-F of whether the audit committee has a financial expert member can be attributed to the 'audit oversight role' of the audit committee. Further, the auditor should report to the audit committee on his/her audit activities and any significant deficiencies and material weaknesses. The relationships between the auditor and audit committee, and between the management and audit committee, reflect the central role of the audit committee's supporting and monitoring tasks. In addition, the committee plays a mediating role with respect to the signing officers, since the latter should disclose any deficiencies or fraud to the audit committee (302(a)(5)). The CEO's and CFO's certification is of major importance for the annual report (cf. 7.3).

The last CCU is that of the investors. The investors do not play a role by contributing documents to the annual report, but are the main addressees of the annual report, and in the US corporate governance system (cf. 3.4) – an outsider system – the investors ideally hold a 'pivot' position within legislation and within society. Further, the company's actions should be in the interest of the investors (cf. 7.4.4), since the SOX is meant to protect investors by improving the accuracy and reliability of corporate disclosures, which should lead to transparency.

The norms that determine the Form 20-F genre network not only include the annual report-related A- and B-rules, but also particular obligatory content elements that should only be included in Form 20-F in particular situations. For example, if the management decides to add information to its report on internal control over financial reporting, the auditor must disclaim an opinion on that added information. These rules can be referred to as the *annual report modification norms*, and they fall into four sub groups (cf. 'Structure of the annual report process'):

- (1) Additions related to any significant deficiencies or material weaknesses identified;
- (2) Additions in the case of material misstatement in the additional management information;
- (3) Additions related to inadequate information provision; and
- (4) Modifications in the standard report based on certain conditions.

Sub group 1

If the auditor has found significant deficiencies or material weaknesses, the following extra content requirements should be included in Form 20-F:

AS3-12	<p>The auditor must document significant findings [...] and the basis for the conclusions reached in connection with each engagement. <i>Significant findings</i> [...] are substantive matters that are important to the procedures performed, evidence obtained, or conclusions reached, and include:</p> <ul style="list-style-type: none"> a. Selection, application, and consistency of accounting principles and related disclosures; b. Results of auditing procedures that indicate a need for significant modification of those procedures, etc.; c. Audit adjustments [...] that could [...] have a material effect on the company's financial statements; d. Disagreements among members of the engagement team [...] about the conclusions of significant accounting or auditing matters; e. Circumstances; f. Significant changes in assessed level of audit risk, etc.
AS2-176	<p>When expressing an adverse opinion on the effectiveness of internal control because of material weakness, the auditor's report must include [...].</p>

Figure 7.7: Significant deficiencies and/or material weaknesses

⁸² The obligatory content elements of the auditor's report can be found in sub chapter 7.2.

Sub group 2

The management might also add information to its report after its assessment, whereupon the auditor may detect a material misstatement in the added information. In this case, the figure below shows what information should be included in the auditor's report:

AS2-190	<p><i>Management's Report Containing Additional Information.</i> Such information might include:</p> <ul style="list-style-type: none"> • Disclosures about corrective actions taken by the company after the date of management's assessment; • The company's plans to implement new controls; and <p>If management's assessment includes such additional information, the auditor should disclaim an opinion on the information, using the following language for example:</p> <p style="padding-left: 2em;"><i>We do not express an opinion or any other form of assurance on management's statement referring to the costs and related benefits of implementing new controls.</i></p>
AS2-191	<p>When the auditor's opinion on the financial statements is unaffected by the adverse opinion, the report on internal control over financial reporting should include the following or similar language in the paragraph that describes the material weakness:</p> <p style="padding-left: 2em;"><i>This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements, and this report does not affect our report dated [date of report] on those financial statements. [Revise this wording appropriately for use in a combined report.]</i></p>
AS2-194	<p>Such disclosure is important to ensure that users of the auditor's report on the financial statements understand why the auditor issued an unqualified opinion on those statements.</p>
AS2-195	<p>Disclosure is also important when the auditor's opinion on the financial statements is affected by the adverse opinion on the effectiveness of internal control over financial reporting. In that circumstance, the report should include the following or similar language in the paragraph that describes the material weakness:</p> <p style="padding-left: 2em;"><i>This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements.</i></p>
AS2-196	

Figure 7.8: Material misstatement in additional management information

Sub group 3

The auditor should also add specific information if the documentation that the management has provided to the auditor is inadequate. The following figure presents the rules concerning such additions:

AS2-159	<p>In addition to the documentation requirements in AU sec. 339, <i>Audit Documentation</i>, the auditor should document, for example:</p> <ul style="list-style-type: none"> • The process used to determine significant accounts and disclosures and major classes of transactions, including the determination of the locations or business units at which to perform testing; • Other findings that could result in a modification to the auditor's report.
AS2-180	<p>When the auditor plans to disclaim an opinion and the limited procedures performed by the auditor caused the auditor to conclude that a material weakness exists, the auditor's report should include [...].</p>

Figure 7.9: Inadequate information provision

Sub group 4

The auditor should, further, include certain content elements in specific situations. The rules concerned are the following:

AS2-161	The auditor should document the effect of a conclusion that control risk is other than low.
AS2-173	The auditor should modify the standard report if any of the following conditions exists: <ol style="list-style-type: none"> Management's assessment is inadequate or management's report is inappropriate; There is a material weakness in the company's internal control over financial reporting; There is a restriction on the scope of the engagement; The auditor decides to refer to the report of other auditors as the basis [...] for the auditor's own report; A significant subsequent event has occurred since the date being reported on; There is other information contained in management's report.
AS2-174	If the auditor determines management's process for assessing internal control over financial reporting is inadequate, the auditor should modify his/her opinion for a scope limitation.
AS2-189	The auditor may obtain knowledge about subsequent events [and] the auditor should include in the report an explanatory paragraph describing the event and its effects.
AS3-8	In addition to the documentation necessary to support the auditor's final conclusions, audit documentation must include information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions.
AS3-9	If, after the documentation completion date [...], the auditor becomes aware [...] that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must [...] demonstrate, that sufficient procedures were performed [...]. To accomplish this, the auditor must have persuasive other evidence.

Figure 7.10: Modifications in standard report

The additional information as shown in figures 7.7–7.10 is included in AS2 and AS3, which describe in detail what the auditor's tasks are and how the audit documentation should be established. The Standards themselves are extensive, whereas only those rules that could affect the integrity of the Form 20-F genre have been presented here. Figures 7.7 – 7.10 further show that the norms concerned reflect the mutual relationship between the RPAF and the issuer.

Discursive practices (3)

Choice of genre (a)

The choice of the genre is the annual report genre, namely the US Form 20-F. However, the Form 20-F genre includes several separate reports, namely:

- (1) The auditor's report;
- (2) The management's report, including:
 - (3) The internal control report.

Other obligatory texts concern the certification by the CEO and CFO, the statement whether the issuer has or has not included a Code of Ethics concerning the CFO and CEO, and the statement about the audit committee's financial expert . Given all these separate texts, the Form 20-F genre can clearly be considered a genre network.

Communication mode (b)

The SOX is a law, and therefore the language used is of a legal nature: formal, official, and neutral. The rules mainly include a demand, a call for a certain action, or a prohibition, for example the following rule:

SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS.

(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

- (1) State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

- (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.
- (b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement. (Sarbanes-Oxley Act 2002, p. 45)

While the language used should ideally enhance the comprehensibility of the text, some requirements are not overly clear. However, it seems to be very important to the SEC (and PCAOB) that the CCUs concerned do understand the rules well. This can be seen in that fact that the SEC has posted some helpful documents on its website, such as (1) a handbook on ‘plain English’; (2) FAQs and answers with respect to the SOX rules; and (3) a separate section on how to interpret and deal with SOX404.

AS2 and AS3 are also legal documents, and the language used is comparable to that in the SOX. Since the Standards are extensions to the main SOX rules (cf. 5.5), the requirements included in the Standards are very detailed and specific. For example:

163. Management should provide, both in its report on internal control over financial reporting and in its representation letter to the auditor, a written conclusion about the effectiveness of the company's internal control over financial reporting. The conclusion about the effectiveness of a company's internal control over financial reporting can take many forms; however, management is required to state a direct conclusion about whether the company's internal control over financial reporting is effective. This standard, for example, includes the phrase "management's assessment that W Company maintained effective internal control over financial reporting as of [date]" to illustrate such a conclusion. Other phrases, such as "management's assessment that W Company's internal control over financial reporting as of [date] is sufficient to meet the stated objectives," also might be used. However, the conclusion should not be so subjective (for example, "very effective internal control") that people having competence in and using the same or similar criteria would not ordinarily be able to arrive at similar conclusions. (Auditing Standard 2, p. 59)

This example shows that the PCAOB has not only made an effort to describe the main content in a clear, formal, official, and neutral way, but also that it determines exactly what kinds of phrasing is appropriate and is not appropriate. The Board's effort to achieve clarity, however, might sometimes lead to the reverse effect, for example in the following rule:

194. When the auditor's opinion on the financial statements is unaffected by the adverse opinion on the effectiveness of internal control over financial reporting, the report on internal control over financial reporting (or the combined report, if a combined report is issued) should include the following or similar language in the paragraph that describes the material weakness: This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements, and this report does not affect our report dated [date of report] on those financial statements. [Revise this wording appropriately for use in a combined report.] (Auditing Standard 2, p. 69)

This rule includes the specific phrase or language to be used (i.e. from “This material weakness ...”) in the auditor’s report in the specific circumstances as described in the relevant rule (AS2-194). Moreover, if the auditor used a combined report for his/her statements, this phrase should be modified (i.e. “Revise this wording appropriately for use in a combined report”). Although the rule determines – at least to a certain extent – the sentences/words to be used, the auditor might use “similar language”, which in fact undermines the apparently fixed nature of the quoted phrase.

In the AS2 appendices, the PCAOB has included examples of texts to be used in certain specific circumstances.

The PCAOB (cf. 5.2) emphasizes that in particular the auditor’s tasks and obligations as required in the SOX and Auditing Standard rules will be fulfilled correctly. To foster the correct performance, the PCAOB has formulated three degrees of responsibility (cf. 5.5.1). The distinction between rules requiring the most and the least responsibility is based on

linguistic determinants, which vary from “*must*”, “*shall*”, and “*is required*”, indicating the highest degree of responsibility, to “*should*”, and then finally to “*may*”, “*might*”, and “*could*”, indicating the middle and lowest degrees of responsibility respectively. This communication mode, using certain verbs to indicate the auditor’s degree of responsibility, could be useful as practical tool for the auditor to prioritize the tasks, and as a monitoring tool for the PCAOB.

7.6.2 Text-internal factors

The text-internal factors concern the (1) communicative purpose, (2) situational context, (3) move structures, (4) themes, and (5) intertextual aspects.

Communicative purpose (1)

The communicative purpose of the US Form 20-F genre network according to the SOX is transparency, with the emphasis on financial disclosure as the core of the US view on transparency (cf. 5.4). A brief overview of the use of the terms “transparency” or “transparent” shows that the SOX uses these only in section 401, and exclusively with regard to financial disclosure:

- (B) Whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors **in a transparent fashion**. (Sarbanes-Oxley Act, p. 42)
- (C) Whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors **in a transparent fashion**. (Sarbanes-Oxley Act, p. 43)
- (E) Any recommendations of the Commission for improving **the transparency** and quality of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission. (Sarbanes-Oxley Act, p. 43)

Transparency is clearly only used with respect to how off-balance sheet transactions should be reported in order to clarify them for the investors. The better and clearer the transactions are communicated, the more transparent they are, and the better informed investors will be with respect to making investment decisions (cf. 3.4). This means that transparency is in fact the most important aim of the SOX, pointed out in the introduction to the SOX as follows:

To protect investors by improving the accuracy and reliability of corporate **disclosures** made pursuant to the securities laws, and for other purposes. (Sarbanes-Oxley Act, p.1)

Thus, according to the SOX, the accuracy and reliability of the disclosures (which are mainly financial disclosures) should be improved, and as stated previously, transparency is the quality determinant with regard to that improvement. In other words, transparency of the (financial) disclosures⁸³ is the ultimate goal of the SOX. This view is also apparent with regard to the composition of the PCAOB, each member of which should have:

⁸³ Other examples of financial disclosure in the SOX: Section 202: Preapproval Requirements, including paragraph (2) Disclosure to Investors (p. 29) about the disclosure of audit committee approval of a non-audit service to investors in periodic reports. In the headings of the corresponding Title (IV) Enhanced Financial Disclosures, the financial connection is obvious: disclosures in periodic reports (section 401); disclosures of transactions involving management and principal stockholders (section 403); disclosure of audit committee financial expert (section 407); and enhanced review of periodic disclosures by issuers (section 408). Another form of disclosure appears in section 406: Code of Ethics for Senior Financial Officers, which concerns disclosure of the Code of Ethics and any changes to it, whereby the definition of the Code of Ethics includes the “full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer” (p. 46). The Act also includes the audit committee financial expert disclosure, which is based on the ‘comply or explain’ rule (section 407, p. 46). Another form of disclosure is the ‘real time issuer disclosures’

[...] an understanding of the responsibilities for and nature of the **financial disclosures** required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to **such disclosures**. (Title 1, section 101, p.7)

Thus, according to the content of the SOX, the main corporate bodies are those which are directly related to financial disclosures: the issuer, the accounting firm, the audit committee, and the investors – namely, the four selected CCUs.

The separate reports included in Form 20-F might have their own specific communicative purposes, but an investigation of this falls outside the scope of this study.

Situational context (2)

The context consists of the influence of the Form 20-F contributors and responsible CCUs. The wider context, however, mainly concerns other legislation (i.e. securities legislation and corporate law) and regulation (i.e. US GAAP). Dutch companies listed at US stock exchanges are obliged to establish an annual report in line with the SOX and AS2 and AS3.

Move structures (3)

As we saw in section 6.7.1, many of the constitutive communication rules in the SOX, and in particular in the Auditing Standards, include not just the extended and detailed content elements to be included in the Form 20-F, but also predetermined phrases. Such details can be seen as move structures, since they determine the structure of a report, for example. SOX302 includes content elements that are in fact obligatory moves relating to the certification text, namely (1) a review, (2) three different kinds of declaration, and (3) a disclosure. This is shown in the following figure:

Moves	Content
1. Review	of the report
2. Declaration	(2) Based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
3. Declaration	(3) Based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report.
4. Declaration	The signing officers: (A) are responsible for establishing and maintaining internal controls; (B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared; (C) have evaluated the effectiveness of the issuer's internal controls as of the date within 90 days prior to the report; (D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date.
5. Disclosure to issuer's auditor and AC	(A) All significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and [...] any material weaknesses in internal controls; and (B) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls.
6. Indication	Whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Figure 7.11: Move structure 1 – SOX302 certification by CEO and CFO

(section 409), which concern disclosures to the public “on a rapid and current basis” about material changes in the financial condition or operations of the issuer”. Further, the SOX refers to disclosures on conflicts of interest by securities analysts and registered brokers or dealers (section 501, p. 48), which are connected with undesirable disclosure of financial information by the analysts and brokers/dealers to the public.

Another rule, AS2-167, includes such detailed content elements that they could be considered to be obligatory moves of the auditor's report on the management's assessment of internal control over financial reporting. The move structures included here are:

- | | |
|-------------------------------------------------------------|--------------------------------------|
| (1) The title; | (6) Two kinds of auditor's opinions; |
| (2) The identification of management's conclusion; | (7) The signature; |
| (3) The identification of the title of management's report; | (8) The city and state; and |
| (4) Seven different statements; | (9) The date of the report. |
| (5) A definition; | |

These move structures and their specific content are presented in the following figure:

Move	Content
1. Title	including the word <i>independent</i> ;
2. Identification of management's conclusion	about the effectiveness of the company's internal control over financial reporting as of a specified date based on the control criteria [for example, criteria established in Internal Control—Integrated Framework issued by the COSO];
3. Identification of title of management report	that includes management's assessment (the auditor should use the same description of the company's internal control over financial reporting as management uses in its report);
4. Statement	that the assessment is the responsibility of management;
5. Statement	that the auditor's responsibility is to express an opinion on the assessment and an opinion on the company's internal control over financial reporting based on his or her audit;
6. Definition	of internal control over financial reporting as stated in paragraph 7;
7. Statement	that the audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board;
8. Statement	that the standards of the Public Company Accounting Oversight Board require that the auditor plans and performs the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects;
9. Statement	that an audit includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as the auditor considered necessary in the circumstances;
10. Statement	that the auditor believes the audit provides a reasonable basis for his or her opinions;
11. Statement	that, because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements and that projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate;
12. Auditor's opinion	on whether management's assessment of the effectiveness of the company's internal control over financial reporting as of the specified date is fairly stated, in all material respects, based on the control criteria (See discussion beginning at paragraph 162);
13. Auditor's opinion	on whether the company maintained, in all material respects, effective internal control over financial reporting as of the specified date, based on the control criteria;
14. Signature	The manual or printed signature of the auditor's firm;
15. City and state	or city and country, in the case of non-U.S. auditors from which the auditor's report has been issued;
16. Date	of the audit report.

Figure 7.12: Move structure 2 – AS2-167: Auditor's Report on Management's Assessment of Internal Control Over Financial Reporting

Less detailed requirements, but ones that still include content elements that could be considered to be moves, are included in AS2-162 (e.g. three different statements and one assessment) and in AS2-159 (concerning documentation requirements), including the moves:

- (1) Understanding and evaluation;

- (2) Process used;
- (3) Identification;
- (4) Auditor's reliance;
- (5) Evaluation; and
- (6) Findings.

The move structures included in the last two rules are presented in the following two figures:

Move	Content
1. Statement	of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
2. Statement	identifying the framework used by management to conduct the required assessment of the effectiveness of the company's internal control over financial reporting;
3. Assessment	of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year, including an explicit statement as to whether that internal control over financial reporting is effective; and
4. Statement	that the registered public accounting firm that audited the financial statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting.

Figure 7.13: Move structure 3 – AS2-162: Reporting on Internal Control Over Financial Reporting – Management's Report

Move	Content
1. Understanding and evaluation	The understanding obtained and the evaluation of the design of each of the five components of the company's internal control over financial reporting;
2. Process used	The process used to determine significant accounts and disclosures and major classes of transactions, including the determination of the locations or business units at which to perform testing;
3. Identification	of the points at which misstatements related to relevant financial statement assertions could occur within significant accounts and disclosures and major classes of transactions;
4. Auditor's reliance	The extent to which the auditor relied upon work performed by others as well as the auditor's assessment of their competence and objectivity;
5. Evaluation	of any deficiencies noted as a result of the auditor's testing; and
6. Findings	Other findings that could result in a modification to the auditor's report.

Figure 7.14: Move structure 4 – AS2-159

AS2-176, concerning the material weakness part of the auditor's report, consists of:

- (1) A definition;
- (2) A statement; and
- (3) A description.

AS2-190, on the additional information to the management's report, includes the following move structures:

- (1) Disclosures;
- (2) An implementation; and
- (3) A statement,

The move structures mentioned above are presented in the following two figures:

Move	Content
1. Definition	of a material weakness, as provided in paragraph 10.
2. Statement	that a material weakness has been identified and included in management's assessment. (If the material weakness has not been included in management's assessment, this sentence should be modified to state that the material weakness has been identified but not included in management's assessment. In this case, the auditor also is required to communicate in writing to the audit committee that the material weakness was not disclosed or identified as a material weakness in management's report.)

3. Description	of any material weaknesses identified in a company's internal control over financial reporting. This description should provide the users of the audit report with specific information about the nature of any material weakness, and its actual and potential effect on the presentation of the company's financial statements issued during the existence of the weakness. This description also should address requirements described in paragraph 194.
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Figure 7.15: Move structure 5 – AS2-176

Move	Content
1. Disclosures	about corrective actions taken by the company after the date of management's assessment;
2. Implementation	The company's plans to implement new controls; and
3. Statement	that management believes the costs of correcting a material weakness would exceed the benefits to be derived from implementing new controls.

Figure 7.16: Move structure 6 – AS2-190

The predetermined moves described as “phrases” can be found in the annual report-related A-rule AS2-163⁸⁴, including the following:

Management's assessment that W Company maintained effective internal control over financial reporting as of [date], and

Management's assessment that W Company's internal control over financial reporting as of [date] is sufficient to meet the stated objectives.

This rule also includes the following warning against a subjective conclusion:

However, the conclusion should not be so subjective (*for example, "very effective internal control"*) that people having competence in and using the same or similar criteria would not ordinarily be able to arrive at similar conclusions.

Other predetermined moves or phrases can be found in the rules AS2-191, 194, and 196 included in Figure 7.8 concerning material misstatements in additional management information. The first rule includes the following phrase:

We do not express an opinion or any other form of assurance on management's statement referring to the costs and related benefits of implementing new controls.

The second rule includes the following:

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements, and this report does not affect our report dated [date of report] on those financial statements. *[Revise this wording appropriately for use in a combined report.]*

And the third:

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20X3 financial statements.

⁸⁴ AS2-163. Management should provide, both in its report on internal control over financial reporting and in its representation letter to the auditor, a written conclusion about the effectiveness of the company's internal control over financial reporting. The conclusion about the effectiveness of a company's internal control over financial reporting can take many forms; however, management is required to state a direct conclusion about whether the company's internal control over financial reporting is effective. This standard, for example, includes the phrase "management's assessment that W Company maintained effective internal control over financial reporting as of [date]" to illustrate such a conclusion. Other phrases, such as "management's assessment that W Company's internal control over financial reporting as of [date] is sufficient to meet the stated objectives," might also be used. However, the conclusion should not be so subjective (*for example, "very effective internal control"*) that people having competence in and using the same or similar criteria would not ordinarily be able to arrive at similar conclusions.

Themes (4)

The themes in the annual report genre are influenced by the way in which the annual report-related A- and B-rules relate to the content themes as explained in the first stage of analysis step 1, in the sub chapters 7.2–7.5. The following figure shows the themes of the annual report-related A-rules:

CCU	Annual report input	Content theme
RPAF	Auditor's report as obligatory part of annual report (SOX404(b))	Financial disclosure
	RPAF must plan and perform audit as mentioned in management's assessment (AS2-4)	Financial disclosure
Issuer	Auditor's attestation report should be filed in annual report (AS2-2)	Financial disclosure
	Management's statement about effectiveness of internal control over financial reporting as part of annual report (AS2-20)	Financial disclosure
	Management's conclusion about effectiveness of internal control over financial reporting included in annual report and in management's representation letter to auditor. (AS2-163)	Financial disclosure
	Management's report should include statement about management's responsibility for maintaining effective internal control over financial reporting. (AS2-55-56)	Corporate governance structure
	CEO and CFO certification including that they have reviewed annual report and to their knowledge it includes no untrue statements of material fact (SOX302(a)/(b))	Corporate governance structure

Figure 7.17: Content themes of annual report-related A-rules

Figure 7.17 shows that the majority of the themes concern 'financial disclosure', with only the last two requirements relating to the appropriate 'corporate governance structure' theme. The 'financial disclosure' theme in Figure 7.17 is related to the auditor's and management's reports, including the management's written assessment or conclusion on the effectiveness of the internal control over financial reporting. Meanwhile, the 'corporate governance structure' theme also relates to the management's report, but focuses on the management's responsibility concerning effective internal control over financial reporting. This theme additionally relates to the CEO's and CFO's certification, which is in fact a statement that they – as representatives of the company – hold all responsibility for the company's performance and in particular for the correctness of its financial statements.

The themes of the B-rules presented in Figure 7.18 are more or less equally divided between 'financial disclosure' and 'corporate governance structure'. The latter solely concerns SOX rules, whereas the former mainly relates to the AS2 rules. The 'financial disclosure' theme in the following figure is related to the auditor's report and the management's report (comparable to Figure 7.17), whereas the 'corporate governance structure' theme concerns the following rules:

1. The certification by the CEO and CFO (comparable to Figure 7.17);
2. The Code of Ethics, which represents a statement about the trustworthiness and honesty of the CEO and CFO as representatives of the company, and could be considered a 'confidence-establishing' or 'confidence-restoring' element;
3. The issuer's statement that the audit committee includes a financial expert, which could be seen as another 'confidence-establishing' or 'confidence-restoring' factor.

The following overview shows all annual report-related B-rules and their content themes.

CCU	Annual report input	Content theme
RPAF	Auditor's report (SOX103(a)(2)(A)(iii))	Financial disclosure
	Auditor's report (AS2-167, 169)	Financial disclosure
	Auditor's report – date (AS2-171, 172)	Financial disclosure
Issuer CEO CFO	Management's report SOX404(a))	Financial disclosure
	Management's report – obligatory content elements (AS2-162)	Financial disclosure
	Certification of annual report (SOX906; cf. SOX302(a)/(b) annual report-related A-rules)	Corporate governance structure
	Code of Ethics (SOX406(a))	Corporate governance structure
	Statement whether audit committee does/does not have financial expert member (SOX407(a))	Corporate governance structure

Figure 7.18: Content themes of annual report-related B-rules

The norms including modifications of the annual report genre (figures 7.7–7.10) in specific circumstances can all be related to the ‘financial disclosure’ theme. The heading of Figure 7.7 indicates that the ‘financial disclosure’ theme concerns significant deficiencies and material weaknesses. Figure 7.8’s heading demonstrates how this theme relates to material misstatements in additional management information. Figure 7.9’s heading reveals the relationship between the theme and inadequate information provision. And finally, the heading of Figure 7.10 shows that the theme concerns modifications in the standard auditor’s report as consequences of certain circumstances, for example, that the management process or information was inadequate.

Intertextual aspects (5)

Bhatia (2004) (cf. 2.3) describes intertextual aspects as:

A number of relationships that the text in question may have with those which in some way have been used, referred to or exploited either directly or indirectly in the construction of the text in question, and may include some of the following:

- 1) Texts providing a context (e.g. a letter to which the one in question is a reply);
- 2) Texts within and around the text (e.g. a chapter in the context of a book);
- 3) Texts explicitly referred to in the text (e.g. references in academic journals);
- 4) Texts referred to implicitly in the text;
- 5) Texts embedded within the text (e.g. conversation within a story);
- 6) Texts mixed with the text (e.g. quotations) (Bhatia 2004, pp. 126-127).

The Form 20-F genre consists of two main reports, namely the auditor’s report and management’s report, which can be subdivided into specific content aspects. The two main reports and the separate content elements can be structured according to Bhatia’s intertextual aspects. The reports themselves belong to category 2, given that they are separate reports within the annual report. The certification by the CEO and CFO and their Code of Ethics belong to category 5, because they are texts embedded within a text. The specific content elements vary between categories 3, 4, 5, and 6. Except for one rule, the annual report modification norms (figures 7.7–7.10) all belong to category 5, since they are considered to be texts within the text. The exception concerns the engagement completion document (AS3-13), which is a category 2 aspect because it is a text within and around the text.

Rule AS2-167, regarding the auditor's report, should include a certain title, and this rule can therefore be seen as a category 6 aspect. Four content elements included in this rule belong to category 3, since they include explicit references to:

- (1) The COSO framework;
- (2) The PCAOB and its standards; and
- (3) The control criteria.

One element, (c), is a category 4 aspect because it refers implicitly to the management's internal control report. The remaining aspects (e), (f), (i), (j), (k), (m), (n), (o), and (p) are category 5 aspects since they are texts embedded within the report text. AS2-171 and 172 concern the fact that if there are two separate auditor's reports, these should be dated the same; therefore, they could be seen as category 4 aspects in the sense of referring implicitly to the first report.

The management's report includes only category 5 aspects, since these content elements are considered to be texts embedded within the report's text. The certification by the CEO and CFO include content elements that are also all category 5 aspects, as they are texts embedded within the certification text. The Code of Ethics disclosure is a category 5 aspect as well.

The content elements are partially composed of moves that have been described in the previous section, and can thus be seen as intertextual aspects. The intertextual aspects confirm the fact that the annual report is a genre network.

7.7 Summary

This chapter included the two stages of analysis step 1 (cf.1.1), which led to the answers to sub question II.3: 'How do the communication requirements included in the Sarbanes-Oxley Act determine corporate communication (communication structure including communication lines, and communication processes), and how do the communication rules determine the annual report genre?'

The first stage consisted of structuring the identified constitutive communication rules per CCU by answering two questions, namely (1) Which CCU should communicate with which other CCU(s)? and (2) What should the CCU communicate about with the other CCU(s)? The results of the first stage were used for the second stage, categorized according to the text-external and text-internal factors that determine the US Form 20-F genre, in order to establish the 'ought' situation of the Form 20-F genre network according to the SOX and AS2 and AS3.

The answers to the first question demonstrated that the major communication role of the CCU RPAF corresponds with auditor's role in the SOX (cf. 5.4.1). The second important CCU is the issuer, including the CEO and CFO. Since the accounting firm is in the service of the issuer, the communication relationship between the RPAF and the issuer holds a core position within the communication rules of the SOX and AS2 and 3. The significance of the audit committee's role with respect to the communication requirements is clear due to its overall 'audit oversight' role within the SOX; specifically, the auditor has to report directly to the committee, and the committee is directly responsible for supervising the auditor's work. The investors' communication is focused on one financial disclosure rule, but it mainly reflects a passive communication role, since the entire SOX includes rules to protect investors.

The answers to the second question demonstrated that a significant majority of the rules are related to the 'financial disclosure' theme, while the 'corporate governance structure' theme relates only to the SOX rules and not to AS2 and 3. The audit committee's

communication rules mostly concern the ‘corporate governance structure’ theme, since the committee fulfills a pivotal role within a company. The issuer is responsible for presenting its written assessment about the effectiveness of the internal control over financial reporting to the auditor, in order to enable the auditor to do his/her work. The auditor’s responsibility to the issuer is, in turn, to plan and perform the audit. Together with the issuer, the audit committee is responsible for the audit and management assessment, since both ‘activities’ are linked. Further, the audit committee has a direct relationship with the auditor since the committee appoints the auditor and determines his/her remuneration, while the auditor should directly report to the audit committee. The audit committee’s tasks and responsibilities, although aimed at financial disclosure, are merely focused on an appropriate corporate governance structure. The ‘information disclosure’ and ‘remuneration’ themes emerge only rarely, whereby the CCU issuer’s communication can be considered the most varied, since all four content themes are represented.

Finally, the answers revealed that one can identify A-rules, which are part of the communication between CCUs and are mostly SOX-related, and B-rules, which are not related to any communication line and are mostly related to the Auditing Standards. The latter is, in turn, logically related to the fact that these Standards are elaborations or extended rules with respect to SOX404 and 103(a)(2)(A)(iii), about the internal control over financial reporting.

The second stage of the analysis consisted of determining the text-external and text-internal factors, as set out below.

Text-external factors

The contributors to the annual report are the CCU RPAF and the CCU issuer (including the CEO and CFO). The structure of the annual report process is clearly quite complex, given that four groups of communication requirements could be identified. Group A consists of constitutive communication rules that are called the annual report-related A-rules⁸⁵; group B includes the annual report-related B-rules⁸⁶; and group A+ consists of rules⁸⁷ that are only relevant for the annual report in specific circumstances, which mainly concern the audit process. For example, if the auditor has detected significant deficiencies or material weaknesses, both the auditor’s report and management’s report have to be adjusted. Group C⁸⁸ concerns communication rules (A-rules) that do not belong to group A but are directly related to the annual report process; they also contribute to the construction of a sound annual report process. The remaining A-rules⁸⁹ that do not belong to groups A or C together form group D. These rules only apply if the A+ rules apply, playing a supporting role for the A+ rules and thus the annual report process.

The norms include the annual report-related A- and B-rules, the A+ rules if the issuer’s management or the auditor are involved in or aware of specific circumstances concerning the audit, and the C- and D-rules in direct or indirect support of the annual report process.

The choice of genre is the Form 20-F genre. The separate reports and texts (auditor’s report, management’s report, CEO’s and CFO’s certification and Code of Ethics, and

⁸⁵ Group A: SOX404(b), 302(a) and (b); AS2-2, 4, 20, 55, 56, 163

⁸⁶ Group B: SOX404(a), 103(a)(2)(A)(iii), 406(a), 407(a); AS2-162, 167, 169, 171, 172

⁸⁷ Group A+: AS3-12; AS2, 176, 190, 191, 194, 195, 196, 159, 180, 161, 173, 174, 189; AS3-8, 9

⁸⁸ Group C: SOX204(k)(3), 301(m)(2), 301(m)(1)(B)(2), 301(m)(1)(4)(A), 201(h), 202(i)(1)(A) and (B), 202/2, 202/3; AS2-6, 19, 21, 40, 42, 47, 49, 56 (2nd sentence), 79, 127, 128, 148, 142, 143, 202, 203, 204, 206; and AS3-2

⁸⁹ Group D: AS2-41, 130, 133, 134, 138, 160, 186, 187, 192, 197, 201(RPAF-issuer), 55, 205, 207, 208, 209, 210, 211, 213, 214; AS3-13; SOX306/1, 304(a), 403(a)(a).

management's statement on the audit committee's financial expert) demonstrate that this is in fact a genre network.

The communication mode can be defined as formal, official, and neutral, since it is essentially legal language. The rules mainly include a demand, a call for a certain action, or a prohibition. Further, linguistic distinctions are made with respect to the auditor's and other CCUs' degrees of responsibility: the verb forms "must", "shall", and "is required" indicate the highest degree of responsibility, followed by "should", then finally "may", "might", and "could" (indicating the lowest degree).

Text-internal factors

The communicative purpose is transparency, with an emphasis on financial disclosure. The separate reports might have their own specific communicative purposes, but a genre-based investigation of this falls outside the scope of this dissertation.

The situational/immediate context consists of the influence of the annual report contributors and responsible CCUs on the annual report.

The move structures concern the CEO's and CFO's certification texts, and the auditor's report on management's assessment of internal control over financial reporting. Further, the management's report includes three statements and an assessment, which can be seen as moves. The other moves are included in three annual report modification rules. Besides the obvious moves, certain predetermined phrases – which have to be integrated in their entirety into the relevant texts – are also considered to be moves, and the rules concerned are related to the auditor's report and management's report.

The most significant themes included in the constitutive communication rules are that of 'financial disclosure' and 'corporate governance structure'. The 'information disclosure' and 'remuneration' themes arise only rarely in the annual report-related A- and B-rules.

The intertextual aspects concern the separate reports, namely the auditor's report and management's report, which should both be included in the annual report. Both are intertextual category 2 aspects, in that they are texts within and around a text. The CEO's and CFO's certification is a category 5 aspect, since it is a text embedded within a text. The Code of Ethics, too, is a category 5 aspect for the same reason. The A+ rules concern one category 2 aspect, namely the engagement completion document, which is a text within and around a text. The other modification rules again belong to category 5, being texts embedded within a text. The management's report and the Code of Ethics for the CEO and CFO include only category 5 aspects. The auditor's report, however, includes one category 6 aspect; four category 3 aspects; three category 4 aspects; and nine category 5 aspects. Some of the obligatory annual report elements have been not only described as intertextual aspects, but also determined to be move structures⁹⁰.

⁹⁰ Move structures AS2-159/162/167/176; SOX302(a); move structure and phrases: AS2-163/191/194/196

Introduction to Case-study Investigation and Case-study Company

8.1 Introduction

8.1.1 Chapter introduction

Searle's (2005) theory of institutions emphasizes the role of language with respect to institutions; he states that language not only describes a pre-existing institutional reality but in fact *constitutes* institutions (cf. 1.1). Searle defines an institution as a system of constitutive rules with the form '*X counts as Y in C*'. *X* concerns the characteristics of an object, person, or state of affairs, *Y* is *X* with an added status function, and *C* is the context or collective acceptance. The status function can only be represented by the use of language. Since corporate governance is an institution, its constitutive rules have the form '*X counts as 'good governance' in C*'; the status function 'good governance', therefore, can only be represented by the use of language. This means that the corporate governance codes include rules that constitute 'good governance', which makes clear which principles a company should comply with and which communication practices it should hold. The annual report genre represents the entire corporate communication (cf. 1.1) and the rules included in the codes are mainly communication rules, which determine the integrity of the annual report genre and the US Form 20-F genre. The analysis of the communication rules in the Tabaksblat Code (cf. Chapter 6) and the Sarbanes-Oxley Act (SOX) as well as Auditing Standards 2 and 3 (cf. Chapter 7) ultimately showed how these rules have been categorized as text-external and text-internal factors that determine the integrity of the Dutch annual report genre network and the US Form 20-F genre network, respectively. In other words, both chapters shed light on the 'ought' situations of the Dutch and US annual report genres.

The results of analysis step 1 (chapters 6 and 7) form the starting point for analysis step 2 (cf. 1.1). This second step focuses on whether the text-internal and text-external factors that determine the integrity of the Dutch annual report genre according to the Tabaksblat Code and of the US Form 20-F genre according to the SOX (as described in chapters 6 and 7, respectively) can be detected in the case-study company's actual 2006 Dutch annual report and Form 20-F, depicted in sub chapter 1.1 as follows:

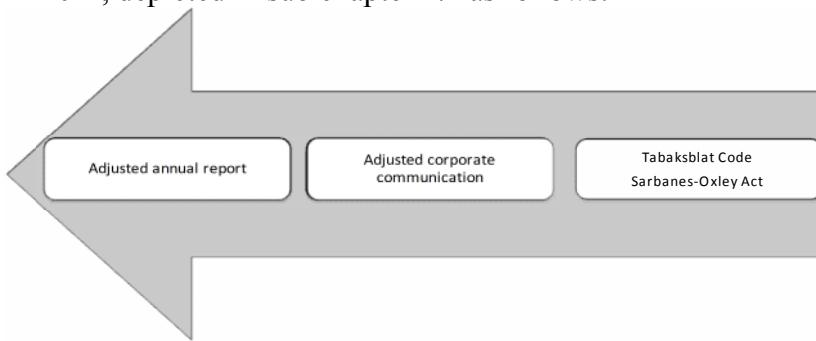


Figure 1.4: Focus of analysis step 2

We saw in Chapter 2 that the single-case study in this dissertation shows, from the communication perspective and using genre theory as an instrument, how the constitutive rules are put into practice. Section 2.4.2 typified the case study as an 'illuminative' case, as it sheds light on how the game 'good governance' is played in a corporation. The case in this study has two goals, which will be elaborated further in 8.2 (case-study goals).

Chapter 9 (2006 Dutch annual report) and Chapter 10 (2006 Annual Report on Form 20-F) show how the constitutive communication rules have been put into practice, analyzing the case-study company's 2005 annual report and 2006 Form 20-F to determine whether the former displays the integrity of the Dutch annual report genre according to the Tabaksblat Code, and whether the latter demonstrates the integrity of the US Form 20-F genre according to the SOX (and AS2 and 3).

Integrity is, in Searle's view, the primary feature constituting the institution 'good governance' (cf. 1.1). Chapter 2 pointed out that generic integrity is determined by legislation and regulation (cf. 2.3). The SOX is itself federal securities legislation (cf. 7.3), supported by the Auditing Standards. The Tabaksblat Code, however, is a regulation, of which only the 'comply or explain' rule has been legally embedded (cf. 4.3). The integrity of the Dutch annual report genre network is determined not only by the constitutive communication rules included in the Tabaksblat Code, but also by Dutch legislation and other regulations. Although this dissertation focuses on the Tabaksblat Code, the following section elaborates on the legal and other regulatory requirements that determine the integrity of the Dutch annual report genre, in order to provide a complete overview and to determine whether these requirements also stipulate a fixed structure for the separate chapters and required sub texts within the annual report genre network.

8.1.2 The Dutch annual report genre

As stated above, the integrity of the Dutch annual report genre has been determined not only by the Tabaksblat Code but also by Dutch legislation and other regulations. The main legal requirements with respect to the Dutch annual report genre can be found in Civil Code 2.

Legal obligations

Civil Code 2 distinguishes between the annual report and the annual accounts. Both are legal obligations for corporations. The annual accounts cover the financial requirements, including (as a minimum) the balance and the profit and loss accounts with accompanying explanation. Corporations are obliged to add an auditor's attestation to the annual accounts, and large corporations should add also a cash-flow overview. The annual report includes a description of the state of affairs concerning the financial year under review. The term 'annual report' usually covers both the annual report and the annual accounts.

The following sections describe the most important sections of the Civil Code with respect to the annual report.

Section 361, paragraph 2:361. This section starts with a definition of the annual accounts:

The simple annual accounts consist of the balance and the profit and loss account with an explanation, and the consolidated annual accounts if the legal entity establishes these. (Author's translation)

Section 2:362, paragraph 1. This section refers to the annual accounts, including the following:

The annual accounts provide, in line with the norms that are regarded to be acceptable within society, such insight that a well-considered opinion can be formed about the capital and the result, and as far as the nature of the annual accounts allow, about the solvability and liquidity of the legal entity. (Author's translation)

The above quote implies that the annual accounts should be correct, which is emphasized again in section 2:362, paragraph 4. The latter section includes obligatory provisions with respect to the structure of the annual accounts.

Sections 362 and 363 include further requirements that determine how the annual accounts should be structured.

Section 2:391, paragraph 1 concerns the annual report, specifying the following obligatory general content:

The annual report reflects a reliable picture of the situation as at the balance date, the development during the financial year, and the results of the legal entity and the group societies whose financial data have been included in the annual accounts. The annual report includes, in accordance with the size and complexity of the legal entity and group societies, a balanced and complete analysis of the situation as at the balance date, the development during the financial year, and the results. If necessary for a good understanding of the development and the results of the position of the legal entity and group societies, the analysis contains financial as well as non-financial performance indicators, including environmental and personnel issues. The annual report also provides a description of the main risks and uncertainties confronting the legal entity. The annual report will be established in the Dutch language, unless the GMS decides to use another language. (Author's translation)

Further, the annual report should include certain announcements and mention the aims and policy of the legal entity with respect to risk management.

Section 391 indicates that the annual report may not conflict with the annual accounts.

Section 392 sets down requirements with respect to information that the management board should include in the annual accounts and/or annual report.

Section 393 includes specific requirements with respect to the accountant for the annual accounts.

Annual report (2:391)					
Annual accounts (2:361) Including:	Auditor's report (2:362) Including:	1. A reliable overview of the situation as at the balance date (2:391) Including:	Announcements (2:392) Including:	MB should include:	IFRS rules
1.Balance sheet	Auditor's statement (2:393) incl:	A. Results	1. The expected state of affairs*	1. Auditor's attestation report	
2. Profit and loss account and explanation	a. Which annual accounts and which legal provisions applied to these annual accounts;	B. Description of development during financial year	2. Research and development activities	2. A reflection on the Articles of Association concerning the profit destination;	
3. Consolidated balance sheet	b. A description of the scope of the investigation (at least the guidelines used for the accountants' investigation);	C. If necessary to understand development, the analysis includes:	3. Special events that influenced expectations	3. Description of the destination of the profit or processing of the loss	
4. Certain structure requirements (2:362, 363, 364-372)	c. An opinion on whether annual accounts provide required insight + comply with legal requirements;	1. Financial and non-financial performance indicators	4. Remuneration policy for MB and SB + how it was implemented over past year.	4. Description of the Articles of Association	
	d. A reference to certain issues without providing a statement as mentioned in paragraph 6, b;	2. The results of the position of the legal entity and subsidiaries	5. Risk management aims and policy	5. Description of the situations after the balance date with important financial consequences for the legal entity	

	e. An announcement of the proven deficiencies;	2. Development during the past financial year		6. Description of the existence of subsidiaries, countries, and trade name if this deviates from the legal entity's name.	
	f. An opinion about the annual report's consistency with the annual accounts	3. Results of the legal entity			
	g. Auditor's signature and date	4. Description of main risks and uncertainties			

Figure 8.1: Dutch legal requirements concerning the annual report

* The focus of the future state of affairs is on investments, financing, workforce, and circumstances that have influenced the development of the turnover and returns.

The overview of the Dutch annual report's obligatory legal and regulatory requirements – excluding the Tabaksblat Code – shows that the Dutch annual report genre should contain several content requirements. These correspond to a certain extent with the content elements of the German annual report genre (cf. 2.3; Hundt 2000), namely:

1. The elements 7–10 of the German annual report structure cover the analysis of the company's state of affairs as at the balance date;
2. The elements 12 and 15–19 cover the obligatory content elements concerning the annual accounts with respect to the Dutch annual report genre;
3. Element 22 covers the auditor's report including auditor's statement/attestation;
4. Element 24 could be considered to cover – at least partially – the Dutch legal requirement that the management board should include point 6 about the subsidiaries in the annual report genre;
5. Element 25 might be considered to cover 'announcement' 1 of the Dutch annual report genre.

The order of the structure of the Dutch annual report, however, is not as standardized as the German annual report genre, although certain sections (2:362 and 363) of the Civil Book determine to a certain extent the order of the structure of the annual accounts.

IFRS

Civil Code 2, section 362 states that a "legal entity may establish the annual accounts in accordance with the IFRS". Since January 1, 2005, European listed corporations have been obliged to comply with the IFRS norms. For Dutch companies the IFRS follows on from GAAP, better known as NL-GAAP.

8.1.3 Chapter outline

Sub chapter 8.2 introduces the case-study investigation and process. The remainder of the chapter then describes the case-study company's general 2006 annual report process (for both the Dutch annual report and the Form 20-F), consisting of three main steps:

1. Examination of the general influence of the Tabaksblat Code and the SOX on the case-study company, including:
 - a. The implementation method;
 - b. The application of the relevant code;
 - c. The general compliance-monitoring process.
2. Description of:
 - a. The participants;
 - b. The coordinators;
 - c. The time schedule.
3. Description of the general tasks and responsibilities of the four selected Corporate Communication Units (CCUs) within the process.

Sub chapter 8.3 covers points 1a, 1b, and 1c relating to the Tabaksblat Code, while 8.4 does the same for the SOX. Sub chapter 8.5 examines the case-study company's general 2006 annual report process with respect to both the Dutch annual report and the US Form 20-F. Sub chapter 8.6 sets out the general tasks and responsibilities of the four selected CCUs, followed by a summary of the chapter in 8.7.

8.2 The case-study investigation process

The introduction to the case-study investigation consists of analysis step 2 with respect to the case-study company's 2006 Dutch annual report and 2006 Annual Report on Form 20-F. The following sections describe the separate parts of the case-study investigation process, namely:

- The selection of the case-study company;
- The interviewees;
- The goal of the case-study investigation;
- Data collection;
- The in-depth interviews.

Selection of case-study company

The selection of the case-study company was based on two aspects. First, the company should be listed in both the Netherlands and the US. Second, its website should give indications of (1) well-structured corporate communication, (2) mainly transparent and clear texts, and (3) clear references to corporate governance, suggesting that the company is considered a good example of a cross-listed company complying with the Tabaksblat Code and the SOX. Desk research led to a few possible candidates, one of which was immediately willing to participate in the investigation. The case-study company is a very large Dutch cross-listed company.

Interviewees

Interviewee1

The interviewee from the first case-study company was the secretary to the Board of Management of a corporation that includes ten Business Units and – as the interviewee called it – a ‘functional column’, which included the Communication Department and the Legal Department. The interviewee’s position was not actually called ‘company secretary’, according to the interviewee, because that title belongs to the Anglo-Saxon model, in which the role of general counsel is combined with the role of company secretary. Instead, his job title was ‘secretary to the Board of Management’, and his ‘core business’ – together with the Legal Department – concerned corporate governance. The interviewee was not only a jurist but also a lawyer, and had previously worked for the Legal Department. The fact that the interviewee, with this juridical background, was the secretary to the Board of Management was a consequence of the fact that, given the importance of legislation, listed companies need jurists with practical experience. The interviewee also considered it a consequence of the zeitgeist, which he saw as becoming more and more “juristified”.

The secretary to the Board of Management was responsible for information provision from the organization to the management board and supervisory board, and vice versa. Because of this pivotal role, this individual was a very useful and eligible interviewee. His knowledge and experience mainly revolved around the corporate communication structure in general and the communication with respect to the Tabaksblat Code in particular. The interviewee had up-to-date knowledge of the role and tasks of the supervisory board (as well as its chair and its three committees), the management board, the external auditor, and the general meeting of shareholders. He was particularly well-informed about and played a

certain role within the communication of and between the four selected Corporate Communication Units as well as with regard to the Tabaksblat Code and the Dutch annual report. Further, he also had general knowledge of the communication structure with respect to the SOX and Form 20-F.

Interviewee 2

The second interviewee managed the Department of Professional Practice (DPP), the ‘technical’ department of a Dutch public accounting firm that had been registered with the PCAOB from the outset in 2005. The interviewee held the view that the partner accounting firm in the US would have been registered earlier than that in the Netherlands. He had the following, interrelated tasks:

- (1) Corporate governance;
- (2) Internal control;
- (3) SOX; and
- (4) The integrated audit.

Further, the interviewee was a part-time lecturer at Nyenrode Business University. Together with colleagues, he trained all employees with respect to the integrated audit (SOX). He (and his colleagues) also played an advisory role for employees confronted with questions or problems while performing their integrated audit duties.

The accounting firm’s representative was the most eligible interviewee with respect to the general auditing process in which the external auditor is involved, but was also particularly eligible with regard to the integrated audit, which is the consequence of SOX404 (the most significant SOX rule; cf. 5.4.1). This rule not only requires an audit of the effectiveness of the internal control and management systems (which the Tabaksblat Code requires as well, as a Dutch legal obligation), but the external auditor should also report on management’s assessment of the effectiveness of internal control over financial reporting.

Both interviewees and companies will remain anonymous.

Case-study goals

We saw in section 2.4.2 that the case in this study has two goals. The first is to show how codified rules of ‘good governance’ are used to clarify ‘good governance’ within a company, as the case study allows for comparison of the ‘ideal’ annual report genre the ‘practical’ annual report (i.e. comparison of the ‘ought’ situation with the ‘is’ situation). To this end, the case study actually includes two comparisons: (1) the ‘ought’ situation of the communication actions required by the Dutch and US corporate governance codes will be compared with the ‘is’ situation of the 2006 Dutch annual report and the 2006 US Form 20-F; but also (2) both ‘ought’ and both ‘is’ situations will be compared. The results of the two comparisons will show whether and how formal transparency has been achieved, and thus also whether and how ‘good governance’ has been constituted.

The second goal is to demonstrate the relevance of the constitutive rules of an institution (‘good governance’). In other words, this study sheds light on the implications of Searle’s theory for a specific corporation, in that it investigates how the game of ‘good governance’ has been played in this particular case.

Data collection

The case study’s starting point is the analysis of the case-study company’s Dutch 2006 annual report (English version) and US Form 20-F. This analysis will show whether the text-internal and text-external factors as described in chapters 6 (which determine the Dutch annual report genre according to the Tabaksblat Code) and 7 (which determine the US Form 20-F genre

according to the SOX) can be identified. We saw in sub chapter 2.3 that the text-external factors consist of:

- (1) Discursive procedures consisting of:
 - (a) annual report contributors; and
 - (b) structure of the annual report process
- (2) Disciplinary culture, consisting of generic norms/conventions
- (3) Discursive practices, consisting of:
 - (a) the choice of genres; and
 - (b) communication modes.

The text-internal factors can be divided into:

- a) Communicative purpose;
- b) Situational/immediate context;
- c) Move structures;
- d) Themes; and
- e) Intertextual aspects.

The results of both analyses will show whether the case-study company's annual reports demonstrate the integrity of the Dutch and the US annual report genre. If so, the Dutch institution 'good governance' and the US institution 'good governance' will have been constituted and transparency achieved.

The initial data were gathered from the analyses of the case-study company's 2006 Dutch annual report (English version) and Form 20-F, as well as from four in-depth interviews with the case-study company interviewee and two in-depth interviews with the accounting firm representative.

Data from case-study company interviewee

The case-study company interviewee provided the following relevant documents:

- 2006 Annual Report (and included Corporate Social Responsibility Report);
- 2006 Form 20-F;
- 2006 Annual Report for Corporate Governance Code Monitoring Committee;
- Email exchange between the company and a University of Groningen project leader concerning the evaluation of listed companies' compliance with the Tabaksblat Code rules;
- Time Schedule for Annual Report 2006;
- Two juridical articles, one on risk management (Schoordijk 2005) and one on CSR (Eijsbouts 2005);
- Copy of a newspaper text announcing the case-study company's 2006 GMS;
- Correspondence between the company and a bank with respect to the GMS;
- Overview of actions with respect to the GMS;
- 2007 GMS Agenda;
- 2007 letter to shareholders including all voting options concerning the 2006 GMS;
- A document including the overview of the company's compliance topics and definition of 'compliance';
- An email including answers to certain SOX questions;
- A document/template called 'Supervisory board evaluation'.

Further, the interviewee referred to the Articles of Association and the minutes of the 2007 GMS on the corporate website, as well as to the website of the Authority Financial Markets (AFM), which lists the stock options and shares of management board members in listed companies.

Data from accounting firm representative

The accounting firm representative provided a document called 'Shaping the audit committee agenda', which included guidance for implementation of the Dutch corporate governance code, and a CD called 'Audit Committee Toolkit' both provided by the Audit Committee Institute.

This interviewee also referred to the PCAOB's website with respect to inspection reviews and the 4010 report with respect to 'understanding the business/the client'. In addition, he referred to the NIVRA's⁹¹ website, which includes the standards (COS⁹²) established in accordance with Dutch legislation and derived from the International Standards on Auditing (ISA). Further, the interviewee referred to the website of the Audit Committee Institute with respect to rule 56 (Auditing Standard 2) on the relationship between the audit committee and the external auditor. Finally, he mentioned the website of the American Institute of Certified Public Accountants (AICPA), which is comparable to the Dutch NIVRA, with regard to the accountant's statements.

Both interviewees agreed to the interviews being recorded. These records will be destroyed after the dissertation has been approved.

In-depth interview structure

Case-study company

Four interviews were conducted with the case-study company interviewee. The overall content of the interviews can be captured in a few groups of questions.

Interview 1

The first interview consisted of three groups of questions. The first group included general questions about the role and tasks of the interviewee, while the second involved questions about the implementation of the Tabaksblat Code and the SOX. The third group concerned the general annual report process (for both the 2006 Dutch and US annual reports) and the questions that arose from the findings of the analysis of the 2006 Dutch annual report. In turn, these findings led to further questions which can themselves be divided into seven sub groups, concerning:

1. Unclear formulation of the obligatory rules;
2. Ambiguous formulations, whereby only the interviewee could clarify the correct interpretation;
3. Unclear explanations of deviations;
4. The underlying corporate communication structure with respect to the annual report and the annual report process, mostly relating to the communication lines between the main CCUs. In order to identify the communication structure, the following questions were asked:
 - a. What role does the supervisory board/management board/general meeting of shareholders/external auditor play with respect to the issue concerned?
 - b. What are the communication steps with regard to this issue; i.e.
 - i. Which CCU communicates with which other CCU(s)?
 - ii. What does the CCU communicate about with the other CCU(s)?
 - iii. Is there any documentation available on this issue?
5. Noteworthy or unclear issues included in the separate chapters of the 2006 Dutch annual report and Form 20-F;
6. The 2006 CSR report, which had been published simultaneously with the 2006 Dutch annual report;
7. The corporate governance items described on the company's corporate website.

The questions under point 4 above helped to unravel the complete annual report process and underlying communication structure (including the communication lines) of the four CCUs together and of each CCU separately with respect to the annual report and annual report process.

⁹¹ NIVRA: Koninklijk Nederlands Instituut van Registeraccountants (Netherlands Institute of Registered Accountants), comparable to the US AYECA

⁹² COS: Controle- en overige standaarden (Control and Other Standards), comparable to Accounting Standards

Interviews 2–4

The second, third, and fourth interviews started with questions that arose while processing the answers from the previous interview. The last interview ended with a general question about the most significant communication-related change within the company as a consequence of the company's compliance with the Tabaksblat Code and the SOX.

Although the interviews were based on the interview questions included in the Case Study Protocol (Appendix C), the interviewee and interviewer had some very interesting discussions. These discussions are integrated into the case-study analysis as well.

The accounting firm

Interviews 1–2

The interviews with the accounting firm representative started with general questions about the interviewee's role and function, as well as about the firm's registration with the PCAOB and the consequences of this registration for the accounting firm. However, the majority of the questions (included in Appendix C), focused on the general audit process and the specific CCU Registered Public Accounting Firm rules with respect to Form 20-F and the integrated audit process.

8.3 The influence of the Tabaksblat Code on the case-study company – general

The first sections of this sub chapter describe general topics regarding the influence of the Tabaksblat Code on the case-study company as referred to by the relevant interviewee. These topics are as follows: (1) the implementation of the Tabaksblat Code, (2) the application of the Tabaksblat code, and (3) the general monitoring of compliance with the Code.

Implementation of Tabaksblat Code

The implementation process within the case-study company started with the recommendation by the Legal Department to the management board and then to the supervisory board to begin the implementation. At that time, the chair of the supervisory board was also member of other supervisory boards in different companies. As there are consultative bodies between Dutch listed companies, the question "how do the other companies deal with the implementation of the Tabaksblat Code?" was discussed within the concerned consultative body.. The larger Dutch listed companies do in fact have contact with one another through several forms of consultation. The secretaries to the Boards of Management have their own meetings, for example, which are arranged by the NIVE⁹³. Further, the Dutch association of business jurists (NGB) organizes meetings for jurists. Since the Netherlands is such a small country, managers and other employees do meet one another in several different associations. This is also the result of the networks of interrelationships between different corporations that are seen as part of Dutch business culture (cf. 3.5.2). The interviewee holds the view that such consultative bodies give rise to benefits in the form of consistency and better policies.

In 2003, the first references to the Tabaksblat Code and the first deviations⁹⁴ from certain best practice provisions appeared in the annual report. The company supported the basic assumptions of the Tabaksblat Code.

⁹³ NIVE: Nederlandse Vereniging voor Managers (Dutch Managers Association)

⁹⁴ The first deviations concerned the number of supervisory board memberships held by members of the Board of Management; the chair of the supervisory board being a former member of the Board of Management; the

Corporate governance first appeared as a topic on the 2004 GMS agenda, and during that GMS a discussion took place on the deviations from the best practice provisions and the implementation of the Tabaksblat Code.

In 2005, the Articles of Association were changed and each deviation was mentioned separately in the annual report. This year marked the first ‘real’ compliance with the Tabaksblat Code.

The Legal Department – headed by the General Counsel – advises the Board of Management and in particular the supervisory board on the Tabaksblat Code and possible references to it in the annual report. The Department’s advice is reflected in the draft annual report.

Application of Tabaksblat Code

From a legal perspective, the Tabaksblat Code applies to N.V.s (public limited companies, i.e. the legal entity combined with the management board and the supervisory board). The constitutive rules included in the Code thus primarily concern these N.V.s. From an organizational perspective, however, the obligations of the management board with respect to the company’s governance also affect the subsidiaries. The consequence, according to the interviewee, is that a Business Unit (BU) manager in the US may never have heard of the Tabaksblat Code, but comes across internal reporting requirements (including the SOX and Tabaksblat Code rules) that have been created in such a way that the management board complies with these requirements ‘automatically’. The BU manager simply complies with the reporting agreements within the N.V., which happen to include the constitutive rules of the corporate governance codes concerning financial reporting. This is the BU manager’s main concern; he/she may not even be aware that complying with the reporting agreements automatically means complying with the Tabaksblat Code at the corporation level. The second concern is that the reporting structures also correspond with the Tabaksblat Code. Only the management board and the supervisory board – not the entire organization – are obliged to comply with the Tabaksblat Code.

General monitoring process

The monitoring institute for the Tabaksblat Code is the Corporate Governance Code Monitoring Committee (cf. 4.2.2). The monitoring process starts with a questionnaire established and sent annually to the listed companies by the University of Groningen on behalf of the Monitoring Committee. The companies fill in the questionnaire, and the results of the university’s analysis of the answers show whether the companies are complying with the rules, and whether and how they are making use of the ‘comply or explain’ rule. The questionnaire is sent in November, because November and December are the months in which the main phase of the annual report process starts. Based on the answers to the questionnaire, an evaluation report is drawn up which, according to the interviewee, can prompt two possible reactions. First, although the Committee is an independent organ, participating companies that disagree with its conclusions are offered the possibility to respond to them. Second, the shareholders may ask for an explanation of the conclusions in their general meeting.

Since the Tabaksblat Code is a code of conduct, it cannot give rise to consequences such as delisting or penalties. The interviewee emphasizes – in particular with regard to the 2006 annual report – that proportionality is important because the Monitoring Committee has provided no substantial criticism with respect to the 2006 Dutch annual report.

supervisory board’s remuneration committee and nomination committee both also be chaired by the chair of the supervisory board; binding nominations for the appointments of members of the Board of Management and the supervisory board.

The interviewee also distinguished between external and internal monitoring. The Committee's monitoring role is part of external monitoring, and is comparable to that of, for example, the Public Prosecutor, the SEC (with respect to compliance with the SOX), the Authority Financial Markets, and others. Internal monitoring concerns the internal audit. The financial reporting rules are partially external, by way of auditing, and partially internal, within the organization and linked with 'line-responsible' employees. For example, the BU manager receives instructions on financial reporting, but the setup of the Letters of Representation – in which the BU managers have to confirm each year that the BU complies with relevant legislation and regulations – is broader. The case-study representative points out that the internal and external monitoring are in fact not linear; rather, every aspect has an external and an internal element.

8.4 The influence of the US Sarbanes-Oxley Act on the case-study company – general

Implementation of Sarbanes-Oxley Act

The case-study company interviewee⁹⁵ explained that the SOX has been applicable to every US listed company since August 2002. For foreign listed companies, however, the part 'Internal Controls over Financial Reporting' (ICoFR) came into effect on December 31, 2006.

The SOX implementation process in the case-study company started in August 2002, and the first phase – covering SOX302 and 906, and the entire Auditor Independence sections – had to be implemented at the end of the 2002 fiscal year. In May 2003, the activities for SOX404 began with a pilot based on 'train-the-trainer' principles, aiming to answer the following questions:

- (1) Are the questions/requirements clear and answerable?
- (2) How much time does the SOX implementation process take?
- (3) Is the IT support sufficient?

In June 2004, the 'Dry Run' started, which involved the entire company describing its design of ICoFR, and in some places test activities took place. The information provided within the 'Dry Run' underwent several quality reviews by (1) the project team, (2) the Internal Audit Department, and (3) the external auditor. These activities led in 2005 to adjustments of the training approach, resulting in:

- (1) Involvement of 600 instead of 60 people (!);
- (2) Greater attention from management;
- (3) Further refinement of approach to test activities.

The 'Dry Run' finished in the first quarter of 2006. Further, the entire organization again confirmed the ICoFR design by means of a 'validation of existence', and the 'key controls over FR' were subsequently tested for functioning. All these activities led to the drawing up of the Management Report in the 2006 annual report (prescribed by the Tabaksblat Code rules) and, after the completion of the US filing, to the SOX404 management statement and the external auditor's attestation report.

Compliance with the SOX requirements is, legally speaking, not applicable to the subsidiaries. Only the CEO and the CFO are accountable; they are required to provide an 'in control' statement. This contrasts with Dutch legislation, in which the entire management board is accountable. The 'in control' statement, however, can only be provided if everything

⁹⁵ The case-study company interviewee asked the company's 'In Control' project manager to answer the interviewer's questions concerning the SOX implementation.

comes together; for example, if the procedures are running smoothly and if the Letters of Representation are signed by the responsible managers.

The external auditor(s) advised and guided the case-study company with respect to the entire SOX implementation process. The accounting firm representative explained that a certain ‘industry knowledge’ has developed, as the large Dutch accounting firms discussed issues like how to evaluate detected deficiencies and how to act in such cases. This kind of consultation between companies is comparable to the case-study company’s consultation groups as explained in the previous sub chapter, and thus both kinds of consultation can be seen as part of Dutch business culture (cf. 3.5.2). The ‘industry knowledge’ regarding the SOX implementation is also a consequence of the activities of the accounting firm’s ‘think tank’ in the US. The accounting firm’s US departments are responsible for the implementation and the supporting software for the integrated audit.

The case-study company interviewee pointed out that the company’s audit committee was also involved in the implementation process in the sense that the *Report of the Supervisory Board* chapter of the 2006 Dutch annual report referred to the audit committee’s discussions on – among other things – the implementation of SOX404. The representative pointed out that the discussions mainly concerned the ‘in control’ statement. He explained that this statement is about whether the management board is controlling the corporation from a financial perspective (by way of reports and controls). If management is not ‘in control’ a problem does arise that can vary from a deficiency (less important) to a significant deficiency (more important) to a material weakness (most important). Thus, the audit committee is particularly interested in whether there are material weaknesses, because these weaknesses have to be reported externally, whereas deficiencies and significant deficiencies do not. The discussions revolved around an update on how the process was developing.

Application of Sarbanes-Oxley Act

The SOX applies to registered public accounting firms⁹⁶ and foreign companies listed in the US⁹⁷. It is rooted in an accounting law, namely the Accounting Industry Reform Act 2002 (cf. 5.2). The PCAOB was established in order to:

Oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. (Sarbanes-Oxley Act 2002, section 101)

The audit and all audit-related rules according to the SOX and Standards can thus be seen as the core element of the law with which the issuers and registered public accounting firms have to comply. The PCAOB investigates accounting firms’ compliance in particular, which has been formulated as follows:

The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the

⁹⁶ (11) The term “public accounting firm” means—(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and (B) to the extent so designated by the rules of the Board, any associated person of any entity described in Subparagraph (A).

(12) The term “registered public accounting firm” means a public accounting firm registered with the Board in accordance with this Act.

⁹⁷ (7) The term “issuer” means an issuer (as defined in section 3 of the Securities Exchange Act of 934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. (Sarbanes-Oxley Act 2002, section 104)

The accounting firm representative explained that his firm has a PCAOB license and is therefore a registered public accounting firm. This license, according to the interviewee, puts the firm on equal footing with an American accounting firm – although not with respect to the director-shareholder client in terms of the end product – since the auditor's statements fall under American supervision (as external auditors need a PCAOB license in order to qualify to provide their statement for US-listed companies.) Everything the accounting firm does is therefore directly covered by the American rules. The interviewee pointed out that many large accounting firms in the Netherlands deliberately choose not to apply for a PCAOB license, and therefore may not perform such integrated audits. If the accounting firm has final responsibility for a cross-listed company, or if the firm audits a division of a large company like General Electric which requires a statement in accordance with the US rules for the parent company's auditor, such a license is important. It is also needed if the parent company's accountant wants to make use of the work of a local accountant, because the parent company could cooperate at different levels with the local (i.e. national-level) accountancy firm if that firm has the required PCAOB license.

General monitoring process

The SEC is the monitoring institution with respect to compliance with the SOX. It does not draw up a report like the Dutch Monitoring Committee, but might ask questions or comment on the Form 20-F. These questions or comments are included in letters sent to the company concerned. The case-study company did in fact receive some letters concerning the conversion of annual accounts from IFRS into US GAAP.

8.5 The case-study company's general 2006 Dutch and US annual report process

The case-study company interviewee states that the annual report process of its 2006 Dutch annual report (English version) can be considered to be the preparation for the company's US Form 20-F. This sub chapter includes the general – and more practical – information about the 2006 annual report and Form 20-F processes. This information concerns (1) the participants in the annual report and Form 20-F processes, (2) the process coordinators, and (3) the time schedule for the 2006 annual report process. The general (practical) tasks and responsibilities of the selected Corporate Communication Units⁹⁸ are described in the following sub chapter (8.6).

A distinction is made below between the role of the external auditor within the general annual report process (as described by the case-study company interviewee) and the role and responsibilities within the specific auditing process as part of the general annual report process (as described by the accounting firm interviewee). Further, the engagement letter and the planning and structuring of the auditing process are included in the 'CCU external auditor' section. The processes concerning the meetings of the supervisory board, the audit committee,

⁹⁸ The following CCUs have been selected with respect to the Tabaksblat Code: the management board, the supervisory board, the general meeting of shareholders, and the external auditor. The CCUs selected with respect to the Sarbanes-Oxley Act are the issuer, the audit committee, the investors, and the registered public accounting firm.

and the management board within the 2006 annual report process are also described, as is the communication between the four selected CCUs in the annual report process.

Annual report process – general

Participants in the annual report process – Dutch 2006 annual report

The company's participants in the annual report process consist of 14 corporate bodies (covering at least 33 individuals), namely the:

1. Corporate staff (including the secretary to the Board of Management);
2. CEO, CFO, and two other members of the management board;
3. Supervisory board;
4. All 13 BU managers – the company has 10 Business Units, some of which have been subdivided – who together form the BU Team;
5. External auditor(s);
6. Six employees from the Controlling Department (including the Financial Reporting section);
7. HR manager/Department;
8. CSR manager/Department;
9. Legal Department;
10. Investor Relations Department;
11. Communication Department;
12. Director of Intellectual Property⁹⁹;
13. Tax Department; and
14. Financial Department.

The fact that so many employees and departments are involved in the annual report process makes clear that the annual report is the most important means of communication within the case-study company. Not all participants are responsible for a certain chapter or text part¹⁰⁰ to be included in the annual report, but they do have to check the chapters which contain content that is considered to be part of their expertise. For example, the Legal Department checks the chapters *Corporate governance*, *Remuneration report*, and *Report of the Supervisory Board*.

Although so many employees and departments are involved, the only consultation or contact between all departments and persons involved in the annual report takes place when the chapters have been drawn up and provided to the relevant participants. The case-study company interviewee stated that the information flow is ultimately upwards, towards the Board of Management. With respect to the annual report process in general, he indicated that:

- (1) Different departments have specific responsibilities;
- (2) The responsible persons have to be pro-active; and
- (3) The case-study company is a large organization which ought to implement the process smoothly, in view of the complexity of the process and the fact that the company is to a certain extent accountable for its own proper functioning.

The third element above corresponds with the view of the Tabaksblat Committee captured in Principle II.1, stating that the management board in particular is responsible for managing the company well, and is accountable for this to the supervisory board and the general meeting of shareholders.

Participants in the annual report process – Form 20-F

The case-study company interviewee points out that the external auditors, the Financial Reporting section (which is part of the Controlling Department), the Communication Department, the Disclosure Committee, the case-study company interviewee's American

⁹⁹ According to the case-study company interviewee, the Director of Intellectual Property checks whether the company's logos and brands have been presented correctly in the annual report, and whether the brands or names of other companies have been abused. The annual report is a public document and it is therefore very important that these elements are checked thoroughly.

¹⁰⁰ Chapter 9 includes the description of the annual report contributors and their responsibilities.

colleague, the Board of Management, and the Audit Committee all participate in the process of establishing the Form 20-F.

Coordination of 2006 annual report process

The Communication Department coordinates the annual report process and is responsible for the quality of the final annual report. In this task, it is supported in a practical sense by the Steering Committee, which consists of the following members:

- Investor Relations representative (secretary);
- General Counsel (chair);
- Financial Reporting representative (member);
- CFO (member);
- External auditor(s) (member(s));
- Director of Communication Department (member);
- Secretary to the Board of Management;
- Communication Department, of which one employee is responsible for implementation and realization (member).

Coordination of 2006 Form 20-F process

The Financial Reporting section (as part of the Controlling Department) plays the coordinating role here.

Time schedule for 2006 annual report process

The case-study company's annual report process lasts at least eight months, since each new annual report process starts in September and publication takes place by early March. Two committees are crucial within this process, namely the Steering Committee and the Disclosure Committee. The Disclosure Committee is chaired by the General Counsel, and includes the Investor Relations manager as secretary, and the Internal Auditor and the director of the Communication Department as members. We have seen that the Steering Committee lends practical support to the annual report process, whereas the Disclosure Committee (which is required by the SEC) is formally appointed and thus part of the company's governance. The Disclosure Committee discusses events that are of material importance to the organization and therefore have to be made public, but which do not have a purely financial character. This means that the Disclosure Committee must assess every publication about the company.

The time schedule shows that although the process starts as early as September, most activities take place in December. It also shows that many internal as well as 'external' persons are involved, and that the English version of the annual report is published before the Dutch version. What is clear is that the annual report process is a very complex process that has to be executed every year.

The case-study company used the following time schedule:

March 2006	The 2006 annual report process started in March 2005. The English version of the case-study company's annual reports is published each year in mid-March, and the Dutch version is available about one week later. Each annual report process starts directly after the publication of the Dutch version of the previous annual report. This means that the process for establishing the new annual report is essentially ongoing.
April-August	The first tasks concern the preparation of proposals for delegating the production tasks for the new annual report. Between April and August, comments on the previous (i.e. 2005) annual report are collected.
September	In September, the Steering Committee meets to discuss the proposals for the delegation of production tasks. Further, the instructions for the Business Units are prepared, since the BU managers have to contribute their text parts to the annual report. The number of prints is also determined.
October/November	The instructions for the BUs are distributed to the responsible managers between mid-October and mid-November. Meetings are also arranged on specific chapters of the annual report. The interviewee is responsible, for example, for the membership list and the chapters <i>Corporate governance</i> , <i>Remuneration report</i> , and <i>Report of the Supervisory Board</i> . The General Counsel is responsible, for instance, for the <i>Risk management</i> chapter and the 'in control' page. Another action point is the setup and execution of interviews with the BU, HR and CSR managements to obtain input for their chapters. In mid-November the structure of the BU chapters is arranged, and the chapters established through the input of the interviews – see above – are distributed to the interviewees for review. The deadline for the review is December 1. The interviewee should, further, provide for editing drafts of the chapters <i>Report of the Supervisory Board</i> , <i>Corporate governance</i> , and <i>Remuneration report</i> . Finally, the group/BU chapters are distributed to the responsible board members for comments.
December	<p>December 1 is an important date, because the comments of the responsible individuals are collected for the annual report team in several ways: for example, through drawing up the drafts and discussing the drafts of the 'Company overview', 'Major events' and financial parts of the <i>Report of the Board of Management</i> chapter with the people concerned. Further, the drafts of the Chapter <i>Report of the Supervisory Board</i> and the data concerning its individual members are completed. Further are the chapters <i>Remuneration report</i> and <i>Risk management</i> as well as the HR and CSR texts completed. The drafts of the BU chapters are also finished.</p> <p>One week later, the first draft of the annual report is distributed to the members of the management board, the Disclosure Committee, the Investor Relations manager, the Financial Department, and the director of the Communication Department. The entire draft is also emailed to a select group of five individuals, including the interviewee and the audit committee chair. Further, parts of the draft are emailed to eight other individuals, among them the HR director and the CSR manager.</p> <p>The management board discusses the first draft in its meeting, and the second draft is drawn up incorporating the comments made in this meeting. The second draft is then distributed to the supervisory board, the management board (again), the corporate staff, the Controlling Department (which includes the Financial Reporting section), the external auditor, the Disclosure Committee, and, in the US, the General Counsel Legal Department and Internal Audit Department. Any of these individuals may comment on this draft until the first week of January. The financial statements are prepared by the Controlling Department manager before mid-December.</p> <p>Parts of the second draft are also emailed to the same eight people who received the first draft.</p>
January 2007	<p>In January, the <i>Chairman's statement</i> and <i>Strategy</i> chapters, for which the CEO is responsible, are finished. These texts are then immediately distributed to the management board, the supervisory board, and the General Legal Counsel Department.</p> <p>The first translation into Dutch is ready in mid-January, and in the third week of January the comments on the English version, the Dutch translation, the <i>Chairman's statement</i>, and the <i>Strategy</i> chapter are collected.</p> <p>The data graphics are provided to the printer and then to the external auditor at the end of January.</p>
February	In February, the management board again discusses the annual report in its meeting. Shortly thereafter is the SOX deadline as well as the deadline for the financial statements. The unaudited annual results are also published. The final content deadline is in mid-February, and the final version is then distributed for approval to the supervisory board and management board. All responsibilities concerning the annual report are signed off, and the supervisory board approves the annual report in the last week of February.
March	After the English version has been approved, the printing process for this version starts in March. Subsequently, the Dutch version is approved, the English version is finalized, and Dutch version is sent for printing. The English version is published and distributed in mid-March, and both versions are published online as well. Finally, the Dutch version is finalized and published.
April	The process ends in April with an evaluation meeting of the Steering Committee and an evaluation by the CEO, CFO, Communication Department director, and Investor Relations manager.

Figure 8.2: Time schedule for 2006 annual report process

The case-study company interviewee pointed out that the annual report process for the Dutch annual report ends in mid-March, and the annual report process for Form 20-F then starts. This Form 20-F process mainly includes the ‘reconciliation’ process, which means that the annual accounts that have been established in accordance with IFRS are adjusted to the US GAAP, using the Dutch annual report as a guideline. These adjusted figures should be presented at the beginning of June. The process can be visualized as follows:



Figure 8.3: Reconciliation process

Most Form 20-F texts – for example, the descriptive text about the corporation – are fixed. The case-study company interviewee explained that the work mainly concerns the fact that “you in fact have to write the letter with a new dictionary. A dictionary in another language.”

8.6 The general tasks and responsibilities of the four selected CCUs

We saw in sub chapter 1.3 that this study focuses on four selected Corporate Communication Units (CCUs). The selection of these CCUs was based on the fact that they hold the most significant positions within the company. This makes them the core of the communication structure, and this combined with the fact that the communication lines are assembled within these CCUs confirms that they are indeed representative for all other CCUs.

It has been explained that although the CCUs with respect to the Tabaksblat Code differ from the CCUs of the SOX in terms of names – and sometimes in terms of their tasks and roles too – they are nevertheless comparable. As this study concerns a Dutch cross-listed company, the CCUs can be compared as follows: the ‘US’ issuer is the corporation, including the board of directors, and will be compared with the ‘Dutch’ management board; the ‘US’ audit committee will be compared with the ‘Dutch’ supervisory board, given that the two-tier board system is a feature of the Dutch corporate governance system (cf. 5.5) and the supervisory board in large corporations usually includes three committees, one of them being the audit committee; and finally, although the ‘US’ investors cover a larger and more differentiated group they will be compared with the ‘Dutch’ general meeting of shareholders.

The following sections describe the different CCUs’ communication activities with respect to the general annual report process. Each interviewee mentioned specific elements. For example, the case-study company interviewee described the general tasks and responsibilities of the supervisory board, the management board, the external auditor, and the general meeting of shareholders; the procedures with respect to the meetings of the supervisory board, the audit committee, and the management board; and the communication between the four selected CCUs. Meanwhile, the accounting firm representative described the role and tasks of the audit committee from the registered public accounting firm’s perspective, as well as the role and tasks of the external auditor and the audit process.

As stated, the following sections therefore concern the communication activities of the supervisory board, the audit committee, the management board/issuer, the general meeting of shareholders/investors, and the external auditor/registered public accounting firm, from the case-study company’s point of view. They also examine the audit process from the accounting firm’s perspective.

8.6.1 CCU supervisory board

The CCU supervisory board assesses and comments on the second draft of the annual report, which is available by the end of December, and on the final version, which is available in late January. Further, in late December each member should inspect whether his or her resume is correct, as it will be included in the annual report. The secretary to the Board of Management is responsible for all communication with the supervisory board. He checks whether each supervisory board member has confirmed the correctness of his or her resume and provides the supervisory board with the annual report drafts, which are part of a document package that the members receive about one week before each supervisory board meeting.

The supervisory board meets seven to eight times a year, and the document package also includes the agenda for the relevant meeting. The communication process involved in each supervisory board meeting consists of the following steps: First, the secretary to the supervisory board establishes a draft of the agenda, which will be discussed with the chair of the Board of Management (CEO) and then with the chair of the supervisory board. After approval by the CEO and chair the agenda, the secretary collects the relevant documents to support the items on the agenda. These agenda items are partly standard topics that correspond with the year cycle of the supervisory board meeting agenda topics. At this point, ad hoc topics may also be added. The secretary takes the meeting minutes and provides them to the Legal Department, the chair of the Supervisory Board, and the CEO for checking. The minutes are then included in the document package for the next meeting, during which they will be formally approved.

The document package for the February supervisory board meeting on the annual report process includes the draft of the annual report. The supervisory board members may comment on the draft either by making notes in the draft papers or in the copies for faxing, or – in the case of very short comments – verbally during the supervisory board meeting. Another possibility is that a supervisory board member may need to call the secretary about another issue, and thus provide his/her comments on the annual report draft at the same time. The majority of the comments, however, are made in writing.

Besides the secretary to the Board of Management, who communicates with the supervisory board about practical issues, the CEO communicates with the supervisory board during its meeting, although the full Board of Management is also present. The CEO, CFO, and external auditor are also present at all audit committee meetings, which take place seven or eight times a year.

In general, it can be stated that the CEO and the audit committee's chair are the core corporate communication partners of the supervisory board. Communication between the supervisory board and the organization – i.e. the other CCUs – is most intense between the chair of the Supervisory Board and the CEO, then between the former and the secretary to the Board of Management followed by the chair of the Audit Committee, and finally between the chair of the Audit Committee and the CFO. This communication intensity can be visualized as follows, where the top-ranking position corresponds with the highest communication intensity:

Position	CCU	CCU
1	Chair of the Supervisory Board	Chair of the Board of Management (CEO)
2	Chair of the Supervisory Board	Secretary to the Board of Management
3	Chair of the Audit Committee	Secretary to the Board of Management
4	Chair of the Audit Committee	CFO

Figure 8.4: Communication intensity between supervisory board and organization

8.6.2 CCU audit committee

The audit committee's main task, according to the Tabaksblat Code¹⁰¹, is to be the primary contact for and to assess the external auditor. Further, the audit committee advises the supervisory board on the auditor's performance and on the remuneration for non-audit services. The case-study company interviewee points out that after each 'usual' audit committee meeting, an extra audit meeting with the external auditors and the internal auditor takes place, in accordance with the Tabaksblat Code¹⁰².

Concerning the process of regular audit committee meetings, the interviewee explained that the preparation for each meeting starts with the secretary to the Board of Management establishing the draft agenda, which he provides to the chair of the audit committee. The chair approves the agenda to be included in the document package for the next meeting. The secretary takes the minutes and sends them to the Legal Department, the CFO, the CEO and finally the chair of the audit committee. The draft minutes are then included in the document package for the next meeting, in which they will be formally approved.

Chapter 6 has shown that the role of the audit committee is also to supervise the management board, in particular the risk management and control systems, the enforcement of legislation and regulations, and the provision of financial information. Chapter 7 has shown that the SOX entrusts the audit committee with many more responsibilities, since it appoints the external auditor, determines the amount of remuneration, and supervises the audit (cf. SOX 301(m)(2)). This is in contrast with the Tabaksblat code, which states that the appointment and remuneration of the external auditor¹⁰³ is a process involving all four selected CCUs in which the audit committee plays only an advisory role.

The accounting firm representative points out that the appointment is a formal decision made by the audit committee, but this decision needs to be taken relatively often; thus, the audit committee makes its decision based on a prior recommendation which may be provided by the management board. The audit committee may also take the advice of the internal auditor into consideration, it may evaluate the external auditor, or the external auditor may perform a customer satisfaction survey; and then, finally, the committee makes its decision. The auditor's remuneration is also based on prior advice. The accounting firm interviewee pointed out that since the audit committee in the Netherlands is part of the supervisory board and members of the audit committee are not full-time members, a great deal of the work will be prepared by the client's departments.

The accounting firm representative explained that the assessment process with respect to the external auditor starts with the client collecting information from the entire company about the external auditor's performance. The audit committee will then question the auditor, who in turn has also collected information about his/her own auditing activities in order to identify what did/did not go well. This information is collected using a 'performance measuring system', which, according to the interviewee, has not been formalized within the accounting industry. Rather, it is a company-specific system which entails that the group

¹⁰¹ III.5.5 and III.5.9

¹⁰² III.5.9: The audit committee should meet with the external auditor as often as it considers necessary but at least once a year, without the management board members being present.

¹⁰³ V.2: The external auditor is appointed by the general meeting of shareholders. The supervisory board shall nominate a candidate for this appointment, for which purpose both the audit committee and the management board advise the supervisory board. The remuneration of the external auditor, and instructions to the external auditor to provide non-audit services, shall be approved by the supervisory board on the recommendation of the audit committee and after consultation with the management board.

accountant asks the local accountant as well as the local management to answer certain questions. In other words, both the client and the auditors have assessment tasks.

The accounting firm supports the audit committee in its role. One way in which it does so is by providing document templates, including for the assessment of the external auditor. The accounting firm representative considered such support to the client's audit committee to be "just a matter of good entrepreneurship", as the accounting firm is eager to retain the client's assignment. Further, the audit committee is a formal party with whom the external auditor has to deal since he/she reports to the committee, but it is also the committee that assesses the external auditor. The interviewee emphasized that it is wise for the external auditor to be prepared for this bipartite relationship with the audit committee. Therefore, the external auditor conducts 'customer satisfaction research', which is a standard procedure that involves asking the client's staff who work with the external auditor about his/her performance, but also about formal issues like the remuneration and the non-audit and audit-related services. The contact between the audit committee and the auditor takes place on a formal level, for example the meetings (at which the internal auditor is also present) after each audit committee's meeting as we have seen above, but also on an informal level. The informal contact includes lunches or dinners, for example, or a meeting with each new external auditor (the rotation system means that the lead auditor should be replaced every five years).

The accounting firm's support of the client's audit committee has been more or less formalized too, as the firm has established an Audit Committee Institute for that purpose. One of the Institute's initiatives is a document on how to shape the Dutch Audit Committee Agenda. In this document, the Institute makes audit committees aware of certain issues that might cause financial disclosure problems. The document also includes a number of appendices containing templates that audit committees might find very useful; for example, an 'Audit committee meeting agenda for the year', a 'Self-assessment' questionnaire for audit committees, an 'Evaluation of External Auditors' questionnaire, and finally a questionnaire for identifying risk-management problems.

8.6.3 CCU management board/issuer

The CCU management board/issuer is the first CCU to see the initial annual report draft, which is completed at the beginning of December and provided to the management board by the Communication Department. This draft includes the *CEO's Letter*, the *Strategy* chapter (for which the CEO is responsible), and the *Report of the Board of Management* (for which the Financial Reporting manager is responsible, but which is presented by the management board). As the Board of Management is formally responsible, as executive, for the full annual report and financial statements, all chapters have to be approved by the management board, which thus has a major assessment function within the annual report process. The responsibilities of the management board with respect to the annual report process are the following:

- (1) To check what others have written (content, presentation), but with emphasis on the *CEO's Letter*, the *Strategy* chapter, and the *Report of the Board of Management*;
- (2) To present the annual report to the supervisory board;
- (3) To answer any questions the supervisory board might have concerning the annual report; and
- (4) To answer company-external questions after publication of the annual report.

The CFO is responsible for the financial statements, and is involved in the way in which the financial statements are presented. The CEO also personally writes the *CEO's Letter*, which is included in the first annual report draft.

The management board's communication steps with respect to the 2006 annual report process start at the beginning of December with a management board meeting to assess the

annual report draft provided by the Communication Department. The director of the Communication Department is present at this meeting given that the input for the annual report draft, as we have seen previously, is primarily provided by the Communication Department. This input incorporates the comments made by the management board, and the Communication Department adjusts the chapters as necessary. The members of the Board of Management comment either in writing or verbally (during the meeting) on the annual report draft, which includes all chapters available at that stage. Communication about the draft chapters does not usually take place before the meeting.

The secretary to the Board of Management fulfils the same routine for the supervisory board meetings as for the management board meetings. This means that the secretary establishes a draft of the agenda, which is sent to the chair of the Board of Management (CEO) and then to the chair for approval. After the CEO and chair have approved the agenda, the secretary finishes the final version of the agenda, including the annual report draft as one of the meeting topics. At this point, the secretary will already have collected the documents needed for the items on the agenda, and the complete document package is provided to the members of the management board a few days before their meeting. The members are expected to read the documents and comment on them. The secretary takes the meeting minutes and sends them to the Legal Department. The minutes are then included in the document package for the next meeting, during which they will be formally approved.

8.6.4 CCU general meeting of shareholders/investors

The CCU general meeting of shareholders/investors has no task or responsibility with respect to the annual report process, as it only adopts the annual report. Moreover, only one communication step concerns the GMS; namely, that the GMS agenda (cf. Figure 8.6) will be published in a national newspaper (*the Financieel Dagblad*) one month before the GMS is scheduled to take place. This agenda includes, among other topics, the adoption of the annual report. A certain communication process can be distinguished with respect to the GMS itself, which starts about a month before the GMS takes place. First, as stated, the agenda is published in a national newspaper advertisement. This advertisement and the agenda on the company's corporate website can be considered to be the invitation for the GMS. The next step concerns the registration date, which for the 2006 annual report was on March 26, 2007. This is the specific date on which potential shareholders actually need to hold company shares in order to be allowed to attend the GMS.

The following step concerns the attendance and voting of the shareholders, which are dependent on where the shareholder lives.

Residence in the Netherlands

Shareholders who live in the Netherlands inform their bank (by email) that they want to attend the meeting. This bank informs the company's bank, which emails a registration certificate for the meeting to each shareholder. In addition shareholders, whom are a member of the Stichting Communicatiekanaal (Communication Channel Foundation) can vote without attending the GMS. This Foundation facilitates distance voting with respect to the GMS. Members receive a voting form by post with an accompanying letter from the CEO. The shareholders can submit their voting instructions by returning the form to the Foundation. Alternatively they can submit their voting instructions by Internet. The voting instructions are exercised by a notary on behalf of the shareholders at the GMS.

Residence in the US

Shareholders who live in the US notify their bank either by email or fax. This bank then contacts Deutsche Bank. Prior to this, the third party which also sees to the Communication Channel Foundation process should already have informed Deutsche Bank that a GMS will take place. Deutsche Bank then establishes an agenda (or form), which the secretary to the Board of Management receives first for approval, for instance to check whether the voting points are clearly separated. After ‘approval’ by the secretary, the agenda (including several voting points, each with three boxes for ‘for’, ‘against’, and ‘abstention’) is sent to the registration holders, i.e. the shareholders in the US. Their shares are either held via the Nederlandsche Bank or they have ADS¹⁰⁴. They then indicate how they want Deutsche Bank to vote for them. From a legal perspective, this is a voting instruction to Deutsche Bank, which is the legal owner of the shares, although the US shareholder remains the beneficial owner. However, according to Dutch law Deutsche Bank at that moment is ‘the shareholder’, and thus represents all the case-study company’s US shareholders.

The company’s organizational activities with respect to the GMS

The case-study company interviewee provided an overview of the organizational activities concerning the 2007 GMS. This overview shows that these activities start in late December and last until the end of April. These activities can be seen as part of the annual report process too, since the annual report is established primarily for the shareholders, and the process ultimately ends with the GMS adopting the annual accounts. The following figure presents the activities:

Late December	Communication Channel checks on the number of participating shareholders	Shareholder Communication Channel
Early February	BoM and SB approval of the agenda and registration date	Case-study company
	Notification of the Communication Channel of the dates for registration, sending, and meeting	Case-study company
Mid-February	Publication of annual accounts	Case-study company
Late February	Final date for shareholders to submit agenda items for the GMS	Shareholders
	Establishment of the CEO’s letter to shareholders with respect to the Communication Channel’s mailing	Case-study company
Early March	Case-study company’s Foundation approves the agenda and nominations	Case-study company
	Press release about BoM/SB changes	Case -study company

¹⁰⁴ The interviewee explained that ADS used to be ADR, short for American Depository Receipts. The juridical right bestowed through owning a share, the right to vote, is linked with the juridical property according to Dutch law. Deutsche Bank has this juridical right. The shareholders in the US have the economic right. There are, however, also American shareholders with common Dutch shares as well as ADRs or only usufruct, economic property. They then have a portfolio containing Dutch shares, probably obtained from the Amsterdam Stock Exchange (Euronext) as well as ADR economic property via Deutsche Bank. Contracts are also involved here, namely between Deutsche Bank and the American shareholder. Therefore, because it has also been embedded in the contract, Deutsche Bank is not only the ‘facilitator’ at a GMS but ‘holding’ in fact for the American shareholders. If the American shareholders want to vote, a voting instruction will be distributed among the concerned shareholders as though they were juridical owners. But the voting instruction is, legally speaking, in fact a ‘directed authorization’ to Deutsche Bank to vote in accordance with the voting instruction from the shares’ economic owner.

	Start of the ADS voting procedure with Deutsche Bank: Deutsche Bank establishes voting instruction forms. Case-study company approves forms after approval of agenda on March 15	Case-study company & Deutsche Bank
	Final date at which shareholders submit request to receive information with the Communication Channel mailing	Shareholders
Mid-March	Publication of the annual report	Case -study company
Mid-March	Notification by the case-study company of the ‘Registered shareholders’ from March 9 if their information will not be sent with the Communication Channel mailing	Case-study company
	Final GMS agenda	Case -study company
Late March	Final date at which ‘Request shareholders’ can announce that they want to lodge an appeal against the Communication Channel Supervisory Board	Shareholders
	Meeting with the company’s bank about the text registration certification, information to be sent with the registration certification, and means of sending	Case-study company
	Publication of the annual report	Case -study company
	Case-study company receives and approves the draft voting instruction forms for proxy voting via the Communication Channel	Communication Channel & case-study company
	Agenda with explanation, annual accounts, resumes of Supervisory Board nominees sent to Listing Agent (i.e. company’s bank)	Case-study company
	Announcement of the GMS in advertisements in two national newspapers	Case-study company
	Announcement advertisement, agenda with explanation, annual accounts, resumes of SB nominees published on the company website (English and Dutch)	Case-study company
	Registration date: anyone holding case-study company shares after stock exchange closing may participate in and speak at the GMS, as well as vote, if they have applied in the correct way.	Banks
Late March	Communication Channel’s SB provides binding advice about whether shareholders’ information may be sent together with the Communication Channel’s mailing	SB Communication Channel
	Final date on which the case-study company should have received the information that the shareholders should have sent with the Communication Channel mailing	shareholders
	‘Mailing firm’ that takes care of the Communication Channel mailing must have received all documents for sending.	Case-study company
Early April	Establishing of chair’s instructions	Case-study company
	Communication Channel mailing sent	Communication Channel
Mid-April	Establishing of Q&As for GMS	Case-study company
	Final GMS ‘rehearsal’	Case-study company
April 18th	18:00 Registration date = the final point in time at which the shareholders may apply for GMS participation	Shareholders
	18:00 Company to have received authorities	Shareholders
April 19th	Request bank to send interim registration list	Case-study company
	Checking of authorities	Case-study company
	Meeting on voting instructions	Case-study company
April 20th	Instruction of desk staff, preparation of key cords and attachment of cardboard voting cards to chip cards	Case-study company
April 23rd	Preparations for the GMS day in case-study company’s head office	Parties hired by case-study company concerning picture and sound, webcast

		and electronic voting system
April 24th	Publication of first-quarter figures	Case-study company
April 25th	11:30 Arrival of voting instructions	Case-study company and Netvote
	10:00 Instruction of desk staff	Case-study company and Netvote
	11:30 Opening of registration desk	Case-study company and Netvote
	14:15 Closure of registration, determination of present share capital, and casting of votes	Case-study company and Netvote

Figure 8.5: Organizational activities with respect to the 2007 GMS

Most of the activities are organizational tasks carried out by the case-study company. The shareholders, however, do play a certain role too. They:

1. May submit agenda items for the GMS;
2. May submit requests to send with the Communication Channel information;
3. May lodge an appeal against the Communication Channel Supervisory Board concerning a refusal of a company to submit an accompanying letter from a shareholder;
4. May apply for participation in the GMS; and
5. Provide the company with their mandates.

Other participants concerning the GMS process are the Communication Channel, Deutsche Bank, other banks, Netvote (for technical support with respect to voting at the actual GMS), and other companies hired to provide other technical support at the GMS. Figure 8.6 thus presents an overview of the practical organizational activities regarding the 2007 GMS process. Although the shareholders' GMS participation and voting would seem to be only minor aspects of the GMS process, they are in fact of major importance. The 2007 GMS agenda included the following items:

1.	Opening
2.	Report of the Board of Management for the financial year 2006
3.	(a) 2006 annual accounts of the corporation decree (voting point)
	(b) Profit destination
	(c) Dividend decree
4.	Discharge (a) Discharge of Board of Management members for their performance in 2006 (voting point) (b) Discharge of Supervisory Board members for their performance in 2006 (voting point)
5.	Supervisory Board Appointment and reappointment of Supervisory Board members (voting points)
6.	Proposal to restrict number of Board of Management members (voting point)
7.	Proposal to restrict number of Supervisory Board members (voting point)
8.	Proposal to authorize Board of Management to (a) issue shares (voting point) (b) restrict or exclude shareholders' preference rights (voting point)
9.	Proposal to authorize Board of Management to obtain common shares on behalf of the corporation in the corporation's capital (voting point)

10.	Proposal to withdraw common shares from corporation's capital (voting point)
11.	Proposal to change the Articles of Association (voting point)
12.	Reports and queries

Figure 8.6: 2007 GMS agenda

Most items in the 2007 GMS agenda are also voting points. Items 2–4 are of utmost importance for each GMS; of these, 3 and 4 could be considered to be the core items since the shareholders should adopt the annual accounts, and discharging the management board and supervisory board in fact means that the shareholders are of the opinion that the boards have performed well.

8.6.5 CCU external auditor/registered public accounting firm

From case-study company interviewee's perspective

The case-study company interviewee stated that a Dutch listed company needs an external auditor in order to fulfill its obligations with respect to both Dutch and US legislation (SOX), since the external auditor should provide an auditor's statement concerning the annual accounts. The Rules of Procedure of the case-study company state that an external auditor will obtain a permanent appointment, whereby the lead auditor should be replaced every five years (in accordance with SOX rules). The audit committee's Rules of Procedure stipulate that the committee assess the external auditor every four years and replace the external auditor if necessary. The interviewee emphasizes that the external auditors are closely involved in the annual report process, while at the same time maintaining their independence. The external auditor's tasks in general are included in the engagement letter; the specific tasks relating to the annual report process are to check the figures in the financial statements, and to counsel/guide the company throughout the SOX implementation process. The engagement letter sets out what the external auditor will do in the coming year. The external auditor's main task is the external audit and the auditing in relation to the US Form 20-F. The Dutch annual accounts should be established in accordance with the IFRS; the American annual accounts in accordance with the US GAAP. As the Dutch annual report is not accepted in the US, a Dutch company listed in the US is obliged to present a Form 20-F, meaning that all figures have to be determined again in accordance with US GAAP, and the financial reports have to be rewritten (a process known as 'reconciliation'). The case-study representative pointed out that, on top of this, the Americans have extended demands with respect to information about the corporation. All this leads to a completely different annual report. It is also the task of the external auditor to assist the company with this process.

The interviewee explained that it is of utmost importance that the external auditors and other relevant CCUs are sufficiently involved in the process, given that only one supervisory board meeting will take place (in late February). During this meeting, the relevant information and documents provided to the supervisory board for the purpose of the meeting must be approved, first by the management board, and second by the audit committee. There is a great deal of time pressure in the annual report process between February and March, because on February 9 the interim figures are presented by the audit committee, and on February 28 the supervisory board meeting takes place. The external auditors provide their attestation during that meeting. This means that all financial information and figures have to be supplied by all levels in the organization, put into the correct format, and then approved internally. The Controlling Department subsequently provides the figures to the external auditors, who thus communicate with the Controlling Department during this time.

The external auditor attends all meetings of the audit committee, not only those relating to the annual report process. Further, the external auditor¹⁰⁵ reports directly to the audit committee, not to the management board. The audit committee meeting process starts with the preparation for each meeting, whereby the secretary to the Board of Management provides a draft agenda first to the internal auditor and the CFO for comments and approval, and subsequently to the audit committee chair for approval. The version approved by the chair becomes the final version of the agenda.

After each audit committee meeting, consultation between the external auditor and the audit committee takes place. The external auditor may provide documents for an audit committee meeting, or be asked his/her opinion with regard to certain issues. The external auditor's most important communication 'partner' is the CFO, who is ultimately responsible and accountable for the financial accounts (SOX). According to the Tabaksblat Code, the audit committee should be the auditor's communication partner with respect to irregularities and day-to-day issues, whereas the auditor only attends the supervisory board meeting in which the annual accounts are discussed. Further, the auditor should report the findings of the audit to both the supervisory board and the management board.

Given his/her pivotal role within the company, the CEO also attends the audit committee meeting along with the CFO. However, the latter holds the main responsibility with respect to financial issues.

From accounting firm representative's perspective

The accounting firm interviewee described the actual auditing process in more detail. Since the auditing process is virtually continual, it is difficult to state at what point in time it starts. In general, however, the process begins with the writing of a tender or proposal, followed by the appointment of the external auditor for a certain number of years (depending on the auditor's role for that particular client). The audit of a financial year in fact starts as early as January 1, when the auditor looks ahead to the coming year and determines whether important transactions are to be expected. This means that the new process starts before that of the previous year has finished. After the tender or proposal has been established, the engagement letter is drawn up, to be signed by (1) the responsible partner (i.e. the lead accountant of the proposal team, called the 'global lead partner'); and (2) the responsible client representative (either an audit committee member or a supervisory board member). It is rare these days for a management board member to sign the engagement letter, as this task has been delegated to the abovementioned member. What this entails is that the signing partner from the external auditor's accounting firm is the final responsible partner.

The engagement letter applies to all auditing activities for a certain client, and thus with respect to both the SOX and the Tabaksblat Code. After the proposal has been approved, the engagement letter takes some time to prepare, as the external auditor needs to manage all kinds of juridical liability. The engagement letter is a very standardized document, and in this regard the accounting firm interviewee stated that it is the role of his department to establish templates for such situations. These templates are numerous, for instance a template for the integrated audit (i.e. the SOX) or for a Dutch corporation (i.e. with a paragraph about the

¹⁰⁵ The Tabaksblat Code requires the audit committee to be the main contact for the external auditor if he/she discovers irregularities in the content of the financial reports (III.5.5), and the audit committee and external auditor should meet as often as possible (III.5.9). This stresses the importance of the 'daily' communication between the audit committee and the external auditor. With respect to the last phase of the annual audit, the auditor should, however, attend the supervisory board meeting about the financial statements and report the findings of the audit of the annual accounts to the management board and supervisory board simultaneously (V.4).

Tabaksblat Code), or a template that combines both, or if not, a statement explaining this deviation, and so on. Various steps in setting up the engagement letter can be distinguished, which are explained below.

Engagement letter process (cf. 8.6.5)

The process of setting up the engagement letter consists of the following stages:

1. The team establishes a standardized template or engagement letter, as mentioned above;
2. The responsible partner does the fine tuning based on fee-negotiations or a proposal. As a proposal is once-only, but an appointment is often for several years, fee negotiations will then take place each year. This is included in the engagement letter;
3. The engagement letter, in particular in the case of high-risk assignments and ‘everything American’ (which are pre-eminently high-risk assignments), should be assessed in advance by the contract unit within the interviewee’s department, which agrees on contracts. The interviewee explains that the firm uses general conditions, but US legislation sometimes requires deviation from these conditions, some sections are not allowed under US legislation, and others are not acceptable for the client.
4. The contract unit approves the final version of the engagement letter;
5. The engagement letter is sent to the client;
6. If the client does not agree, negotiations will follow, but these are regarded to be part of the juridical fine tuning, because the economic risks such as working hours and costs are already covered within the engagement letter. The accounting firm representative defines the auditor’s fee as the “financial translation of the effort”.

As we have seen above, according to SOX 301(m)(2), the audit committee:

- Appoints the external auditor;
- Determines the amount of remuneration; and
- Supervises the audit.

According to the Tabaksblat Code (V.2), however, the GMS, as the corporation’s highest level in the Netherlands, decides on the appointment of the external auditor, although:

The supervisory board nominates a candidate for this appointment, for which purpose both the audit committee and the management board advise the supervisory board. (Tabaksblat Code 2003, V.2)

Therefore, it can be concluded that because the case-study company is a Dutch company with a two-tier board, the GMS is to be seen as the corporation’s ‘highest organ’. The SOX, in contrast, requires that the audit committee appoints the external auditor.

Planning and structure of audit process

The final responsible partner – or ‘global lead partner’, the signing partner – is responsible for the planning and structuring of the audit process. Accounting teams perform the audit, which means that one team works for a certain client. The team is fixed as far as possible, with each auditor having the usual promotion possibilities ending in the position of partner. The accounting firm representative points out that auditors working with trainees or university supervisors should not do the same work for more than three or four years. The interviewee considers the composition of such an audit team as ‘office planning’, as it functions as a kind of market at which demand and supply meet, whereby the demand is the tasks/assignments that need to be fulfilled, and the supply is the number of people available. If sufficient staff are not available in the relevant office, a search of other offices internationally will be conducted. The audit teams should consist of people with the right skills, knowledge, and techniques, which is the responsibility of the final responsible partner. The interviewee emphasized that it is very important that the accounting firm has a qualified team. A client may, for example, use different IT systems and ask for someone who understands these systems (IT auditors). The interviewee further explained that an audit team for a multinational may consist of hundreds of accountants. The accounting firm has a ‘quality monitoring system’ which involves yearly quality evaluations by way of visits to different offices;

selection of partners' dossiers; certain selected assignments, which will be checked against a fixed protocol of questions; and finally 'co-reading', where someone looks over the auditor's shoulder, so to speak, while he/she is working.

The audit plan sets out the structure of the audit process. This audit plan will be used in accordance with the accounting firm's Audit Methodology – a separate Integrated Audit Manual is available for the SOX requirements, as the Audit Methodology does not apply to the SOX – which includes the relevant auditing rules transformed into practical work papers that the auditors need to fill in, pay attention to, collect information for, etc. These auditing rules include the Dutch accountancy rules, the COS¹⁰⁶, which were established as Dutch legislation by the NIVRA¹⁰⁷ on the basis of the International Standards on Auditing (ISAs), and which include control and other standards. The US Audit Standards were previously established by the AYECA (the US version of the NIVRA), but the PCAOB's Auditing Standards now apply. The accounting firm interviewee points out that the rules of AS2 and AS3 should be 'translated' into work papers and procedures for the auditors in the field. The ISAs, the COS rules, and the US rules are used to establish such work papers. For example, SOX404 is composed of 171 words, whereas the explanations published by the SEC and PCAOB consist of 10,000 words, and each accounting firm needed 100,000 words to cover these explanations in instructions, manuals, and work papers.

The methodologies of the different accounting firms differ little, because all firms have to comply with the same ISAs, COS rules, and generally accepted US accounting standards, the GAAS. The interviewee stressed that accounting firms cannot 'compete' in terms of methodology, but 'how' the audit will be done is significant: whether the auditor uses software, whether IT specialists are involved, how the work will be synchronized, etc. Such operational issues determine how the audit team functions worldwide.

The work papers include, as we have seen above, the requirement to collect information. For example, the requirement to collect information on the main risks with respect to multinational assignments means not only the risks in the Netherlands, but also the risks concerning production in the US, or research in Korea, and so on. This process is directed top down, but information must also be provided bottom up. The auditors 'in the field' are supported by specific audit software. Further, instructions are provided to the local accountants, which gives rise to the need for a reporting model. According to this model, the local accountant should:

- (1) Report on the composition of the team, to demonstrate that it is acceptable;
- (2) Indicate whether the team members have been accredited, because those who need to provide a statement in 'the US environment', as the accounting firm interviewee called it, must be accredited by way of a certain amount of training, which the interviewee called 'flying hours';
- (3) Declare that he/she has received the instructions;
- (4) Declare that he/she does not have specific information;
- (5) Declare that he/she has received the management letter.

The local accountant should adhere to the above reporting moments, and will be checked up on if he/she fails to do so. The reporting moments are very formalized; the accounting firm interviewee stated:

It should be all formal, that has to do with our profession. The duties and activities have only been done if they have been documented. At least, that's the view of the institutions supervising us.

The auditor should report as early as possible on any problems, for example half-way through the audit process. This should be followed one month later with a report on which of these

¹⁰⁶ COS: Controle en overige standaarden (Control and Other Standards)

¹⁰⁷ NIVRA: Koninklijk Nederlands Instituut van Registeraccountants (Netherlands Institute of Registered Accountants), comparable to the US AYECA

problems have been solved. The auditor only reports to the accounting firm and the group accountant, who also could be of another accounting firm, because there is only one accounting firm involved in checking the assignment.

According to the interviewee, accounting firms do work together as long as there is only one signing accounting firm. For example, while ABN AMRO has been taken over, the ABN AMRO accountant will still do the 2007 audit, but another accountancy firm will monitor the ABN AMRO accountant and provide the auditor's statement. It is common that accounting firms work together, therefore, but the firms involved should adhere to specific co-work regulations. These worldwide regulations concern issues like (1) how to make use of the activities of another accounting firm, and (2) how far one accounting firm may make use of the statement of another accounting firm. In this regard, it is important to know that the accountants of other firms are accredited (in particular concerning SOX audits).

The accreditation of an auditor (included in the code of conduct for certified accountants¹⁰⁸) ensures the auditor's quality by confirming that he/she is:

- (a) Professional;
- (b) Independent; and
- (c) Gathers information on a sound foundation/basis.

Besides the formal reporting as expressed in the reporting moments, informal reporting is also part of the auditing process. The interviewee stated this often takes place due to the need for rapid action. Informal reporting concerns, for example, questions by email about coordination aspects, or – faster still – phone calls that should be reported in writing afterwards. In any event, everything an accountant does should be rooted in a formal and sound foundation.

8.6.6 Communication between selected CCUs

Although three of the four CCUs in particular play a major role in the annual report process, the four CCUs in fact meet each other only once a year, during the GMS. This meeting is not a consultation between the CCUs, but the shareholders should adopt the financial statements during this meeting. The external auditor is also present. The only other meeting opportunity is an extraordinary meeting in the case of a specific and very significant issue. The minutes taken at the GMS are checked by the secretary, then the CEO, and finally the chair of the supervisory board, before they are published on the company's corporate website.

8.7 Summary

This chapter can be seen as an introduction to analysis step 2, in which the case-study company's actual 2006 annual report (Chapter 9) and Form 20-F (Chapter 10) will be investigated. The case in this study has two goals. The first is to show how codified rules of 'good governance' are used to clarify 'good governance' within a company, as the case study allows for comparison of the 'ideal' annual report genre the 'practical' annual report (i.e. comparison of the 'ought' situation with the 'is' situation). To this end, the case study actually includes two comparisons: (1) the 'ought' situation of the communication actions required by the Dutch and US corporate governance codes will be compared with the 'is' situation of the 2006 Dutch annual report and the 2006 US Form 20-F; but also (2) both 'ought' and both 'is' situations will be compared. The results of the two comparisons will show whether and how

¹⁰⁸ Known in the Netherlands as the VGC (Verordening Gedragscode voor AA accountants)

formal transparency has been achieved, and thus also whether and how ‘good governance’ has been constituted. The second goal is to demonstrate the relevance of the constitutive rules of an institution (‘good governance’). In other words, this study sheds light on the implications of Searle’s theory for a specific corporation, in that it investigates how the game of ‘good governance’ has been played in this particular case.

This chapter started with an overview of the legal and other regulatory requirements that – in addition to the Tabaksblat Code rules – determine the integrity of the Dutch annual report genre in order to provide a complete overview, and to determine whether these requirements also stipulate a fixed structure for the separate chapters and required sub texts within the annual report genre network. This overview thus supports analysis step 2 with respect to the 2006 Dutch annual report (Chapter 9) specifically.

This chapter further included the specific elements of the case-study investigation. It described the selection process of the case-study company, and indicated that four in-depth interviews have been conducted with the case-study company interviewee. The interviewee was specialized in corporate governance in general and in the Tabaksblat Code in particular, and also played a pivotal role between the case-study company’s management board and supervisory board with respect to communication. Further, two in-depth interviews were conducted with a second interviewee, a representative of a large Dutch accounting firm registered with the PCAOB. This interviewee was specialized in auditing in general and in the integrated audit in particular. As stated, the case-study investigation included in chapters 9 (2006 Dutch annual report) and 10 (2006 Annual Report on Form 20-F) draws on these in-depth interviews, on the 2006 annual reports themselves, and on the documents and references to websites provided by both interviewees.

Also described in this chapter was the implementation process concerning the Tabaksblat Code, which started in 2003 and finished in 2005, and the SOX implementation process, which started in 2002 and finished in 2006. The case-study company interviewee explained that the Tabaksblat Code only applies to the public limited company together with the management board and supervisory board. The SOX also applies to the public limited company listed in the US. The monitoring body with respect to the Tabaksblat Code is the Corporate Governance Code Monitoring Committee, for which the University of Groningen sends an annual questionnaire to the company, while the Committee itself establishes a report based on the outcomes of the questionnaire. The listed companies may react to the Committee’s conclusions. The SEC is the monitoring institute concerning the SOX, and may write to the company with questions about or comments on its Form 20-F. The company is required to answer these enquiries.

The main part of this chapter, however, concerned the case-study company’s general annual report process. The case-study company should provide two different annual reports, whereby the Dutch annual report process is regarded to be the preparation for the Form 20-F process. The annual report process started in March 2006, directly after the previous annual report was finished, and lasted until April 2007. The Form 20-F process started directly after the publication of the Dutch annual report in mid-March 2007, and lasted until June 2007. The participants in the Dutch annual report process were 14 corporate bodies; not all of these were responsible for a chapter of the 2006 (English version) annual report, but they were required to check whether the content of the chapters that fall within their area of expertise was correct. The participants in the Form 20-F process were the external auditor, the Financial Reporting section of the Controlling Department, the Disclosure Committee, the Communication Department, the Board of Management, and the Audit Committee. The Dutch annual report process was coordinated by the Communication Department supported by the Steering Committee, while the Form 20-F process was coordinated by the Financial Reporting section.

This chapter also described general tasks and responsibilities with respect to the annual report process of the four selected Corporate Communication Units – the management board, supervisory board, general meeting of shareholders, and external auditor (Tabaksblat Code); and the issuer, audit committee, investors, and registered public accounting firm (SOX). The supervisory board's main task is to assess and comment on the second draft of the annual report. Communication between the supervisory board and the organization – i.e. the other CCUs – is most intense between the chair of the supervisory board and the chair of the Board of Management (the CEO), then between the former and the secretary to the Board of Management, followed by the chair of the audit committee, and finally between the chair of the audit committee and the CFO.

The audit committee plays an important role as the contact for the external and internal auditors, and as the supervisory body with respect to the management board's activities concerning risk management and control systems. This latter task is of major importance for the annual accounts included in the Dutch annual report. Further, the audit committee advises the supervisory board on the external auditor's appointment and assessment. The audit committee also approves Form 20-F.

The management board's most important task is to assess the annual report's content and presentation. Specifically, this means checking the texts included in the annual report, in particular the CEO's Letter and the chapters *Strategy* and *Report of the Board of Management*. Other important tasks are to present the annual report to the supervisory board, and to answer any questions about the annual report from the supervisory board or from people outside the company after publication. As chair of the Board of Management, the CEO is responsible for and involved in the presentation of the financial statements, and also writes the CEO's Letter. The Board of Management approves Form 20-F before the audit committee does the same.

The general meeting of shareholders has no specific task within the annual report process, but in a practical sense (cf. Figure 8.5), the shareholders' participation in the GMS and their voting process are of major importance. Further, the GMS is the only annual meeting at which all four selected Corporate Communication Units are present.

The external auditor plays a very important role, given that the auditor is legally obliged to formally comment on the financial statements based on his/her assessment of the company's figures. The main tasks are to check the financial statements and to guide the case-study company throughout the SOX implementation process. The main communication partners within the annual report process are the audit committee and the internal auditor. The accounting firm representative explained that as an entire audit team is involved in auditing a large corporation, the composition of this team is very important and, with respect to an integrated audit, every auditor should be accredited. To monitor the audit team members, the accounting firm uses a quality monitoring system involving quality evaluations and co-reading. The audit team uses an audit plan, which sets out the structure of the audit process. This audit plan is based on the accounting firm's Audit Methodology – and a separate Integrated Audit Manual for the SOX audit – which includes the relevant auditing rules transformed into practical work papers that the auditors need to fill in. The auditors are also supported by specific audit software. Finally, the accounting firm makes use of a reporting model, which sets out certain moments within the audit process at which the auditor should report on his/her activities and/or findings. This reporting model aids in supervising the auditor's work.

Analysis of 2006 Annual Report – Tabaksblat Code

9.1 Introduction

We saw in section 2.4.1 in Yin's (2003) definition of a case study that the case-study inquiry benefits from the prior development of theoretical propositions to guide data collection and analysis. The theoretical propositions in this study consist of two basic elements, namely (1) Searle's (2005) descriptive theory of institutions, and (2) the prescriptive constitutive rules included in the Tabaksblat Code and the Sarbanes-Oxley Act. Both of these are investigated within the case study, in order to shed light on how the 'game' of corporate governance is played in practice.

The case study includes two comparisons. The first is that the 'ought' situation of the communication actions required by the Dutch and US corporate governance codes will be compared with the 'is' situation of the 2006 Dutch annual report and the 2006 US Form 20-F. The second will compare both 'ought' situations with both 'is' situations. The results of the two comparisons will show whether and how formal transparency has been achieved. If all Dutch cross-listed companies' annual reports will demonstrate the required integrity, 'good governance' is expected to have been accepted and thus will 'good governance' have been institutionalized.

This chapter includes the comparison of the 'ought' situation with the 'is' situation with respect to the case-study company's 2006 Dutch annual report, while Chapter 10 does the same with respect to the 2006 Annual Report on Form 20-F. Therefore, this chapter shows whether the text-external and text-internal factors that determine the integrity of the Dutch annual report genre according to the Tabaksblat Code (cf. Chapter 6) – and thus together construct the 'ought' situation – can be identified in the case-study company's 2006 Dutch annual report. If the 'is' situation corresponds fully with the 'ought' situation, the case-study company's 2006 Dutch annual report can be considered to demonstrate the integrity of the Dutch annual report genre network, implying that formal transparency has been achieved and consequently that the Dutch institution 'good governance' has been constituted. This chapter thus covers the following sub question:

- III.1 How do the 2006 annual report's structure and content reflect the adjustments as required by the Tabaksblat Code?

The actual case-study company's 2006 annual report forms the starting point for the comparison of the 'is' and the 'ought' situation. We saw in section 8.1.2 that the Dutch annual report genre should be established in accordance not only with the rules of the Tabaksblat Code, but also with Dutch legislation. However, the 'is' situation relates only to the constitutive communication rules of the Tabaksblat Code.

Structure of the 2006 annual report

The structure of the case-study company's 2006 Dutch annual report can be found in Appendix F. The most significant chapters for this analysis are the following:

- Corporate governance
- Report of the Board of Management
- Report of the Supervisory Board
- Risk management
- Remuneration report
- Auditor's report

The relevant text parts will be referred to as follows:

- (1) Major parts will be marked in bold;
- (2) Chapters will be marked in italic; and
- (3) Sections and sub sections will be in quotation marks.

Chapter outline

This chapter compares the ‘is’ situation with the ‘ought’ situation as described in Chapter 6. In other words, it investigates whether the text-external (cf. 6.9.1) and text-internal factors (cf. 6.9.2) can be found in the case-study company’s 2006 Dutch annual report. The structure of this chapter is based around these text-external and text-internal factors.

The text-external factors consist of (1) discursive procedures, including the annual report contributors (9.2) and the structure of the annual report process (9.3), which includes analysis of the process with respect to the annual report-related A- and B-rules (9.3.1) and the non-annual report-related C- (9.3.2) and D-rules (9.3.3). Sub chapter 9.3 is quite extended, as it describes where the relevant rules have been found within the 2006 annual report, and any notable findings and/or comments or clarifications provided by the interviewee(s). The remaining text-external factors – namely (2) the disciplinary culture, which consists of generic norms – are analyzed in sub chapter 9.3, together with the analysis of the annual report process. Discursive practices (3), including (a) the choice of genre and (b) the communication mode, are described in 9.4.

Next, the text-internal factors are described in sub chapter 9.5. Section 9.5.1 examines the situational context (a); 9.5.2 analyzes the findings concerning (b) the communicative purpose; 9.5.3 looks at the move structures (c) and relevant themes (d); and 9.5.4 focuses on the intertextual aspects (e). Finally, sub chapter (9.6) provides a summary of the chapter.

The information included in this chapter was obtained partially through the analysis of the English version of the case-study company’s Dutch 2006 annual report, and partially through the input provided by the case-study company interviewee and the accounting firm interviewee. (The latter in particular provided the information on the audit process as part of the annual report process.)

9.2 Discursive procedures – (a) The annual report contributors

This sub chapter describes the annual report contributors, i.e. the responsible persons, and discusses what ‘responsibility’ in this context actually means.

Persons responsible for certain annual report text parts

The case-study company interviewee stated that although many employees and departments are involved in the annual report process (cf. 8.5), the responsibility for completing each annual report chapter is divided among a certain number of employees (because one individual should hold the main responsibility for each chapter). The employees responsible for completing the 2006 annual report chapters were the following:

Responsible person	Text part
CEO	<i>Chairman's statement</i> chapter
	<i>Strategy</i> chapter
Financial Reporting manager	Responsible for drafting/planning the annual accounts
	<i>Report of the Board of Management</i> chapter (excluding the 'Internal controls' section (see audit committee chair))
	<i>Financial Statements</i> chapter
	Responsible for the financial tables
Legal Department	<i>Risk management</i> chapter
Board of Management members	'Internal controls' section (included in the <i>Report of the Board of Management</i>)
	Text parts about the Business Units
	Text parts about the product groups
Secretary to the BoM	<i>Report of the Supervisory Board</i> chapter
	<i>Corporate governance</i> chapter
	<i>Remuneration report</i> chapter
HR manager	Text part about HR (incl. in the chapter <i>Our people</i>)
CSR manager	<i>Corporate Social Responsibility</i> chapter
Investor Relations manager	Text part about share price (including the chapter <i>Shareholder information</i> , section 'Company share price')

Figure 9.1: Persons responsible for 2006 annual report

The Board of Management is responsible for the annual report and accounts. The overview shows that the Financial Reporting manager and the secretary to the Board of Management (BoM) are both responsible for completing three chapters. The BoM chair (i.e. the CEO) is responsible for two chapters, while the BoM as a group is responsible for the text parts about the Business Units, the separate texts about the product groups, and the 'Internal controls' section. If we compare the responsibility of the case-study company employees for certain chapters with the required contributions and contributors according to the Tabaksblat Code (cf. 6.9.1), we see that some differences arise. Chapter 6 stated that the Code identifies the CCU supervisory board¹⁰⁹, the CCU management board, and the CCU external auditor as the annual report contributors. Within the broader annual report, the CCU supervisory board is responsible for the supervisory board report, including the remuneration report and the reports of the supervisory board's committees, namely the audit committee, the remuneration committee, and the selection and appointment committee. The overview, however, shows that in the case-study company, the secretary to the BoM is responsible for completion – on behalf of the supervisory board and its committees – for the chapters *Report of the Supervisory Board* and *Remuneration report*, whereby the former includes the 'reports'¹¹⁰ of the separate

¹⁰⁹ The CCU supervisory board includes the audit committee, the remuneration committee, and the selection and appointment committee.

¹¹⁰ The interviewee explained that the annual report does not include the reports of all committees; for example, it only includes references to the activities of the audit committee and nomination committee.

supervisory board committees in the sections ‘Audit Committee’, ‘Remuneration Committee’, and ‘Nomination Committee’.

The supervisory board is responsible for the publication of the transactions of supervisory board members¹¹¹ and, likewise, the BoM is responsible for the publication of the transactions of its own members¹¹². Although these requirements are not related to any separate report, the *Financial Statements* chapter contained a reference to the rules concerned in the form of a statement about the non-existence of such transactions.

Sub chapter 6.6 revealed that the CCU management board is responsible for its statement about the internal risk management and control systems. The overview shows that the BoM members are responsible for the text parts about the BUs and the product groups, and for the ‘Internal controls’ section of the chapter *Report of the Board of Management*. The Board of Management has overall responsibility for the whole annual report, but the individual members are also responsible for the previously mentioned text parts as part of the process of compiling the annual report.

The third contributor is the external auditor, who is responsible for his/her report concerning the audit. The external auditor does not appear in the overview; however, the auditor’s report is included separately in the *Financial Statements* chapter.

Description of responsibility for a chapter

The deadlines for handing in a draft apply to the person responsible for a specific chapter or chapters (see above). These persons should ensure that they obtain all relevant input for ‘their’ chapter(s) from others, wherever necessary. The interviewee distinguished two ‘circles’ with respect to the annual report process, namely a small and a large circle. The large circle covers the complete annual report process, including all deadlines. The small circle encompasses the persons responsible for one or more chapters. The first deadline is December 12, when the BoM meeting takes place in which the members first see the annual report draft. This means that *before* December 12, the person responsible for a specific chapter or chapters should present the draft(s) to the right department for checking by staff with the appropriate expertise. The case-study company interviewee emphasized that this all revolves around ‘self-responsibility’, but a time schedule for the 2006 annual report process is available (Figure 8.2) that specifies when the draft ought to be sent to person/department A, then to B, C, D, etc.

The information provided by the interviewee makes clear that the individuals responsible for a certain chapter or chapters are not necessarily the contributors to that chapter/those chapters, since the responsible employee might obtain input from others. This is in contrast with the conclusion drawn in 6.9.1 that the contributors are also the responsible persons.

More information about the general tasks and responsibilities of each of the three CCUs involved in drawing up the annual report can be found in sub chapter 9.3, on the structure of the annual report process.

To sum up

The case-study company makes a clear distinction between the overall participants in the annual report process and the employees who are actually responsible for certain parts of the annual report. We saw in chapter 6 that the Tabaksblat Code considers the contributors to be the same individuals as the responsible persons. If we compare the ‘smaller’ circle of

¹¹¹ III.6.3, Tabaksblat Code. This rule concerns transactions of supervisory board members that could lead to conflicts of interest. Such transactions should be published.

¹¹² II.3.4, Tabaksblat Code. This rule concerns transactions of management board members that could lead to conflicts of interest. Such transactions should be published.

responsible employees as mentioned above with the obligatory annual report contributors according to the Tabaksblat Code (cf. 6.9.1) – i.e. the CCUs supervisory board (including its committees), management board, and external auditor – it becomes clear that the supervisory board has not been mentioned as a responsible CCU for the case-study company's 2006 annual report, and that more corporate bodies and employees are involved than only the CCU management board and CCU external auditor.

9.3 Discursive procedures – (b) The structure of the annual report process

This sub chapter analyzes the structure of the 2006 annual report process in view of the rules set down by the Tabaksblat Code (cf. 6.9.1). It investigates whether these rules have been followed in the case-study company's 2006 annual report and/or as stated by the case-study company interviewee. To do so, it explains per rule where the rule can be identified or is referred to, and how the rule or reference has been formulated. These per-rule explanations are labeled with the subheading 'Analysis of rule ...' In places where the case-study company interviewee provided an explanation, elaboration or comment on the rule concerned, the subheading 'Comment on ...' is used.

The relevant rules were explained in section 6.9.1. The first two groups of rules are norms that involve content requirements specifically for the annual report itself. These consist of the annual report-related A-rules¹¹³, which are part of one or more communication lines between the four selected CCUs, and the annual report-related B-rules¹¹⁴, which are not part of any communication line. A third group of rules consists of the remaining A-rules¹¹⁵ that directly influence the annual report process, and the last group¹¹⁶ includes the final A-rules that support – and thus indirectly influence – the annual report process. The overview of all A-rules can be found in Appendix C.

The following sections present the results of the analysis of the 2006 annual report process. These sections are structured according to the annual report-related A- and B-rules (9.3.1) per CCU, then the non-annual report-related A-rules (9.3.2) that influence the annual report process directly (group C) per CCU, and finally the non-annual report-related A-rules (9.3.3) that support the annual report process and thus influence the process indirectly (group D) per CCU.

9.3.1 Annual report-related A- and B-rules

CCU supervisory board (including the audit committee, remuneration committee, and selection and appointment committee)

¹¹³ Annual report-related A-rules (cf. Figure 6.17): Determination and Disclosure of Remuneration principle, II.1.2, II.2.12, II.1.4, II.3.4, III.5, III.5.2, III.5.3, III.5.10, and III.6.3

¹¹⁴ Annual report-related B-rules (cf. Figure 6.18): II.1.5, II.2.9, II.2.10, III.1.2, III.1.3, III.1.5, III.1.7, III.1.8, III.2.1, IV.3.9, and V.4.3

¹¹⁵ Non-annual report-related A-rules (i.e. group C): III.1, III.1.1, III.1.6, III.1.9, V.1, V.1.1, V.1.3, V.2, V.2.2, V.2.3, I, III.1.9, III.4, III.4.1, III.5.5, III.5.8, V.1.2, III.5.4, III.5.13, II.1, and V.4

¹¹⁶ Remaining non-annual report-related A-rules (group D): III.6.1, III.5.1, II.2.6, III.6, III.6.5, III.6.6, IV.3, IV.3.5, IV.3.7, III.6, III.6.5, II.1.7, II.2.6, II.3.2, IV.1, IV.3, IV.3.5, IV.3.7, III.7, IV.1, IV.1.1, IV.1.6, and V.2.1

Analysis of rule III.1.2

The supervisory board should establish the supervisory board report (annual report-related B-rule, III.1.2). This report is included in the annual report as required by the Tabaksblat Code.

Analysis of rule III.5

This rule concerns the fact that if a supervisory board consists of more than four members, it shall appoint from among its members an audit committee, a remuneration committee, and a selection and appointment committee, and the function of each committee is to lay the groundwork for the decision-making of the supervisory board. The chapter *Corporate governance* within the annual report contains a separate section about the specific duties of the committees, as formulated in the Tabaksblat Code. It can be noted that, until 2005, the Nomination Committee and the Remuneration Committee were combined in one committee.

The supervisory board report should include how the duties of the committees have been carried out in the financial year, corresponding with annual report-related A-rule III.5.3 about the obligation of each committee to report its deliberations and findings to the supervisory board. This has been found in the chapter *Report of the Supervisory Board*, sections ‘Audit Committee’, ‘Remuneration Committee’, and ‘Nomination Committee’. One of the duties of the remuneration committee¹¹⁷ is to prepare the remuneration report, which in the annual report in question was included as a separate chapter (*Remuneration report*). The case-study company interviewee confirmed that no separate audit committee report was included in the annual report, but references (cf. 9.2) were made to the most important tasks of the audit committee. According to the interviewee, these references suffice because the Tabaksblat Code does not provide further details on its expectations concerning the audit committee report. Finally, the section ‘Appointment, independence and composition’ included in the chapter *Corporate governance* could be seen as an indication of the activities of the nomination committee.

Analysis of rule III.1.3

Annual report-related B-rule III.1.3 concerns the disclosure of specific information with respect to each supervisory board member. The information about profession, principal position, nationality, other positions, date of initial appointment, and current term of office has been clearly formulated in the chapter *Supervisory Board*. The members’ age could be deduced from their year of birth, and their gender was apparent from their first names in combination with their photographs.

Analysis of rule III.1.5

Annual report-related B-rule III.1.5 can be found in the chapter *Report of the Supervisory Board*, section ‘Supervisory Board activities’. Rather than pointing out any ‘frequent absence’ of supervisory board members from supervisory board meetings as indicated in the rule, the corresponding text in the annual report was formulated positively as “All meetings were [...] well attended by all Supervisory Board members”.

Analysis of rule III.5.2

Another annual report-related A-rule (III.5.2) concerns the composition of the supervisory board, which can be found in the chapter *Report of the Supervisory Board*, section ‘Composition of the Supervisory Board’. This section describes which members have resigned or will resign, and which individuals have been or will be appointed as members.

¹¹⁷ Annual report-related A-rule: Determination and Disclosure of Remuneration principle

The most significant information concerns two elements. First, the chair of the supervisory board was chair of the BoM (i.e. the CEO) for quite some years, then a member of the supervisory board for four years; he will not be available for reappointment. Second, the supervisory board proposes a reduction in the number of supervisory board members from ten to eight members, which the supervisory board and the BoM consider a logical consequence of the separation of the company. This rule also indicates the number of meetings – seven in total, with the full BoM present – of which one was fully dedicated to the company's strategy. Further, one separate meeting was held, for part of which the CEO was present, during which the board:

1. Conducted a self-assessment;
2. Appraised its committees, working methods, procedures, and performance;
3. Evaluated the functioning of the BoM and its individual members;
4. Assessed the supervisory board its relationship with the BoM;
5. Discussed the composition of the supervisory board and its committees (cf. Appendix G).

The main items discussed during the regular meetings were:

- Financial and operational performance;
- Share price development;
- Operational planning;
- Course of business;
- The annual financing and investment plan;
- The overall company strategy and strategic options (incl. objectives, associated risks, and mechanisms for controlling financial risks).

Analysis of rule III.1.7

Specific topics discussed with regard to annual report-related B-rule III.1.7 can be found in the chapter *Report of the Supervisory Board*, and concern the financial statements¹¹⁸, the company strategy, corporate governance, and risk management; and, all in the one section, the approval of major investments, acquisitions, and divestments¹¹⁹. The main topic, as mentioned above, was the company strategy, since the BoM and the supervisory board discussed in 2006 a major strategic decision concerning the separation of the company. Further discussion topics concerned a certain acquisition, the implementation of SOX404, and risk management (chapter *Report of the Supervisory Board*, section 'Supervisory Board activities'). We have seen previously (cf. 8.4) that according to the accounting firm representative, the external auditor is involved in assisting the company with the implementation of the SOX.

Analysis of rule III.1.8

Requirement III.1.8 (annual report-related B-rule) about the references made to the discussions (and conclusions thereof) on corporate strategy and assessment of the BoM can also be found in the chapter *Report of the Supervisory Board*. Some of these references were present in the items discussed above (analysis III.1.7), and concern the company's overall strategy¹²⁰, strategic options, and direction; as well as the evaluation of the functioning of the

¹¹⁸ Section 'Financial statements and dividend proposal'

¹¹⁹ Section 'Supervisory Board activities'

¹²⁰ One meeting was fully dedicated to the company's strategy: "A separate meeting [...] during which the supervisory board [...] evaluating the functioning of the Board of Management and its individual members"; "The Supervisory Board discussed such issues as company strategy [...]" ; "In 2006, the Supervisory Board again devoted considerable time to discussions on the company's strategy"; "The Supervisory Board reviewed and discussed in-depth with the Board of Management the overall company strategy and strategic options [...]" ; "During regular meetings, the company's strategic direction was a major point of discussions."

BoM and its individual members. Further, one reference to a conclusion of the discussions on corporate strategy can be identified: “The Supervisory Board approved the decision to separate [the company] [...].” The reference to the evaluation of the BoM appears in the following text, which has been mentioned already with respect to A-rule III.5.2:

The Supervisory Board held a separate meeting [...] evaluating the functioning of the Board of Management and its individual members. (Chapter *Report of the Supervisory Board*, section ‘Composition of the Supervisory Board’)

Analysis of Determination and Disclosure of Remuneration principle

One of the supervisory board’s major contributions to the annual report is the remuneration report. The chapter *Report of the Supervisory Board* in the 2006 annual report includes the norms with respect to the remuneration report as required by the Tabaksblat Code, but there is also a separate chapter entitled *Remuneration report*. The principle ‘Determination and Disclosure of Remuneration’ (annual report A-rule) can be found in the chapter *Remuneration report*, ‘General’ section, which quotes the rule itself:

The Supervisory Board’s Remuneration Committee prepares all relevant information and provides advice to the Supervisory Board on all matters relating to the remuneration and other conditions of employment of the Board of Management.

The remuneration policy, which is mentioned explicitly as part of this rule, can also be found in this chapter; the section ‘Remuneration policy’ explains that the remuneration package consists of a base salary, performance-related short-term incentive, performance-related stock options, performance-related shares, pension provisions, and other benefits). Further, this section also indicates that the case-study company itself is convinced of its compliance with the remuneration principles, declaring that:

The company’s remuneration policy, including all structures and policies related to the remuneration and employment contracts of the Board of Management, is in line with the Dutch Corporate Governance Code.

Analysis of rule II.2.9

Rule II.2.9 (annual report-related B-rule) concerns the implementation of the remuneration policy in the past financial year, which can be found in the section ‘Remuneration in 2006’ of the chapter *Remuneration report*. This section is divided into the sub sections ‘General’, ‘Base salary 2006’, ‘Short-term incentive (annual bonus) 2006’, and ‘Long-term incentives 2006’.

Analysis of rule II.2.10

Annual report-related A-rule II.2.10 refers to many different obligatory content elements of the remuneration report, which will be shown below, but also includes the obligation to explain how far best practice provision II.2.7 has been endorsed. This is an important rule as it concerns severance payments for BoM members, stating that:

The maximum remuneration in the event of dismissal is one year’s salary (the ‘fixed’ remuneration component). If the maximum of one year’s salary would be manifestly unreasonable for a management board member who is dismissed during his first term of office, such board member shall be eligible for a severance pay not exceeding twice the annual salary.

The case-study company has decided to deviate from best practice provision II.2.7. The chapter *Corporate governance*, section ‘Remuneration’, explains this deviation as follows:

Since it is not believed to be in the interest of the company to renegotiate the existing contracts of the members of the Board of Management, the company has decided not to follow code provision II.2.7 for the members of the Board of Management appointed before 2004. However, the Supervisory Board has the intention to take the provisions of the code as guidance for establishing severance payments.

The chapter *Remuneration report*, section ‘Employment agreements’, reinforces the case-study company’s argument by repeating the explanation above.

In view of the deviation from II.2.7, it could be questioned whether the case-study company genuinely complies with the entire rule II.2.10. Appendix H shows how the 2006 annual report addresses the remaining content elements of II.2.10. Each first section included in the figure in Appendix H describes the specific content element, and the following section describes where and how this content element appears in the 2006 annual report. The overview shows that of the 10 content requirements, only one (H)¹²¹ has not been met.

The extended elaboration in Appendix H of the company’s compliance with rule II.2.10 includes a reference to another rule (II.2.7) that – although not mentioned separately as an annual report-related B-rule – is also extremely important. Compliance with II.2.10 should automatically entail compliance with II.2.7, as we have seen above, but this is not the case concerning the case-study company (cf. above).

Comment on rule II.2.10

The case-study company deviates from this rule by stating that it is not in the company’s interest to renegotiate contracts established before 2004. For this reason, the supervisory board will determine the severance payment based on the remuneration committee’s recommendation. The case-study company interviewee stated that there are no criteria for determining severance payment and the general meeting of shareholders (GMS) only approves the remuneration *policy*, which includes the way in which the BoM and supervisory board members are remunerated. Since the abovementioned rule concerns not remuneration but severance payment, the GMS plays no role there.

The interviewee elaborated on the discussion¹²² about severance payments by stating that – from Anglo-Saxon point of view – underlying the severance payment discussion is the fundamental misconception of shareholders ‘owning’ the corporation (cf. 3.4.2). The shareholders seem to be the owners, but the interviewee considered it a better description that the shareholders provide capital, and obtain dividends and a share-value increase in return for the risk they run. He agreed with the view that the provision of capital could be seen as a contract whereby the capital provider receives only some form of ‘risk bonus’. He held the view that the lack of an equilibrium is dangerous because many shareholders are only making short-term investments, whereas large firms are principally in it for the long-term and the interests of short-term and long-term investments naturally differ. He said that: “We’re pre-eminently short-term-minded, but the institution of a large corporation is characterized by long-term decisions.”

The involvement of short-term investors (e.g. hedge funds) gives rise to a tension or imbalance concerning the attribution of more power to the shareholders (which, according to the interviewee, is not a mistake in itself). Long-term investors would prove to be very helpful for the company. A problem only arises if a competent management board with long-term

¹²¹ Content of (H): An explanation of why any right of a management board member to options, shares, or other variable components is not performance-related.

¹²² The interviewee described the evolution of the role of the shareholders: A starting corporation needs starting capital, and the time to make a contribution is perhaps then, when T=0, because at that moment it could be stated that the investors together own the corporation. But from the very first day, goods will be bought with the invested capital – perhaps at a good price – which brings about more value. The following steps are hiring people, making contracts, and implementing dynamic processes. The interviewee stated that at that moment the corporation could still be seen as ‘property’; the management has been hired to achieve greater return with the shareholders’ capital, and that return also belongs to the shareholders, but it could also be stated that merely providing capital is to be seen as a contract whereby the capital provider only receives a form of risk bonus.

plans does not get the opportunity to function well because of the influence of short-term investors.

The only remedy, according to the case-study company interviewee, is to talk with the shareholders. While good communication will not solve all problems, it is very important nonetheless. The interviewee explained that one way of communicating with the shareholders is through road shows, in which the CEO and CFO visit and talk with the larger shareholders without providing inside information. Other large companies arrange road shows as well. These do not have a fixed frequency, but take place two or three times a year. Such road shows are seen as a positive development, since having good contact with the shareholders is becoming more and more important. The case-study company interviewee explained that the road shows will occur more frequently in the future, although a balance would need to be found, as the CEO and CFO cannot explain everything or travel around endlessly. In any event, conducting road shows has been a common trend in the US for years, and the interviewee stated that “Americans expect a company to do so”. In Europe, too, specifically the Netherlands and the UK, road shows are also expected to take place. This entails face-to-face meetings and simply sitting down with shareholders. According to the interviewee, shareholders appreciate this kind of contact, although they are of course always free to send a letter or search for other kinds of contact.

Analysis of rule II.2.12

Annual report-related A-rule II.2.12 requires explanation of special remuneration for (former) management board members in a certain financial year. The case-study company complies with this rule in different parts of the annual report, most notably the chapter *Financial Statements*, section ‘Former members of the Board of Management’:

In 2006, charges relating to former members of the Board of Management amounted to [...], mainly related to pension expenses.

In addition, the chapter *Remuneration report*, section ‘Remuneration in 2006’, sub section ‘Short-term incentive (annual bonus) 2006’ explains that the bonus increased because the target performance was achieved and the P&D Dialog¹²³ score exceeded 100%. The increase in the chair’s bonus reflects the increase of the ‘at target’ bonus.

Analysis of rule III.5.10

Annual report-related A-rule III.5.10 focuses on the most significant elements of the remuneration policy, which should be included in the supervisory board report. This rule appears not in the chapter *Report of the Supervisory Board* but rather in the *Remuneration report*, ‘General’ section, and concerns details on the following:

- The objective of the remuneration policy;
- The determination of and differentiation between the remuneration levels;
- The differentiation based on comparisons with other large Dutch multinational companies;
- Variable remuneration dependent on short- and long-term performance.

¹²³ The Performance and Development (P&D) Dialog is an appraisal system that was implemented throughout the company in 2005 and consists of a ‘reasonableness test’, in which the supervisory board critically assesses the actual ambition level of the performance targets in light of the assumptions made at the beginning of the year. It also includes an assessment of the progress made in achieving long-term strategic objectives. This method of determining bonuses also forms the basis of the compensation framework for company executives as introduced in January 2005.

Analysis of rule III.6.3

Annual report-related A-rule III.6.3 is about the transactions of supervisory board members that could lead to conflicts of interest. The only reference to this rule is a statement about the non-existence of such transactions, in the notes to the consolidated financial statements in the chapter *Financial Statements*:

In the ordinary course of business the company has transactions with various organizations with which certain of its members of the Supervisory Board or Board of Management are associated but no transactions responsive to this item were conducted in 2006. (Note 25, ‘Related party transactions’)

Analysis of rule III.2.1

The last annual report-related B-rules with respect to the supervisory board report concern the statements of independence of the supervisory board members (III.2.1, III.2.2, and III.2.3). Although the case-study company – objectively seen – deviates from these rules, and the company itself confirms that it is “formally not in compliance with Code Provision III.2.3”, the chapter *Corporate governance*, section ‘Appointment, independence and composition’, nevertheless states that:

All supervisory board members meet the independence requirements as stated in the Code [...], except for [two members]. In this respect, it should be noted that [one of these two members] is a former member of the Board of Management, who retired from this position in 2003. [This member] will step down as member of the Supervisory Board at the 2007 General Meeting of Shareholders.

The company holds the opinion that while it does not comply formally with the rule, it does comply in practice, since all except two supervisory board members are independent. The Tabaksblat Code, however (cf. III.2.1), requires all supervisory board members to be independent, “with the exception of not more than one person”. The case-study company clearly does not comply with this rule, given that two supervisory board members do not fulfill the description of independence in III.2.1.

The first of these was a member of the BoM in the five years prior to his appointment as supervisory board member, which deviates from the independence criterion in III.2.2(a)¹²⁴. Further, the reason for this deviation has not been explained explicitly, although the fact that the relevant member will step down as supervisory board member in 2007 could be seen as an explanation since it indicates that the tenure will finish within a short period of time.

The second was a former member of the management board of a bank that provides services to the case-study company and, moreover, was still a consultant to that bank. This is not in accordance with rule III.2.2(c), which states that a member may be independent if he/she has not:

Had an important business relationship with the company [...] in the year prior to the appointment. This includes the case where the supervisory board member [...] is a management board member or an employee of any bank with which the company has a lasting and significant relationship.

This deviation has been explained in that the company has a “long-standing policy” by virtue of which it “welcomes the recent knowledge and expertise of the affairs and business of the company”. The report further states that while this second non-independent member is still a consultant “on macroeconomic policies” to the relevant bank, he is “in this capacity not involved in its management”.

¹²⁴ III.2.2(a): A supervisory board member is independent if he/she “has been an employee or member of the management board of the company [...] in the five years prior to the appointment”.

Comment on rule III.2.1

The case-study company concluded that the former bank management board member “should be considered an independent supervisory board member”, although it does not check whether such members are in fact not involved with the management board of the other institution (in this case the bank).

The interviewee explained that the supervisory board members report on all their positions and additional jobs every year, and that their integrity is not in doubt but rather a condition *sine qua non* for being supervisory board members. This integrity or ‘honor’ aspect of supervisory board membership alone attracts people to become members, according to the interviewee, since the members’ salary is not reason enough to accept a supervisory board position. It would therefore be very surprising if the members provided incorrect or incomplete information about their additional positions. The secretary to the BoM asks the members every year (cf. 8.5) to check the list of their additional jobs, but does not verify whether members actually work as advisory counsel, for example, for a company elsewhere. If such information proved to be incorrect, not only would the supervisory board member him-/herself be highly embarrassed, but so too would the company and the other supervisory board members. The annual report would no longer be correct, and journalists would come looking for an explanation. In short, it would not be good for public relations. Still, the interviewee stressed that the Tabaksblat Code defines best practice, but compliance is not obligatory from a legal standpoint.

CCU management board

The contributions of the BoM concern five rules.

Analysis 1, rule II.1.4

The first rule (annual report-related A-rule, II.1.4) includes the management’s statement with respect to the internal risk management and control systems, and can be found in different texts within the annual report. The analysis of this rule is somewhat extended, starting with the comment of the case-study representative.

Comment on analysis 1, rule II.1.4

The case-study representative stressed the importance of risk management for the company. He stated that one aspect of risk management is that every year the company maps its risks at all levels, in particular at the level of the BUs, but also at the corporate and management levels (the latter is discussed further with the supervisory board). The interviewee considered this to be “anticipatory, of course”, but also a necessary part of transparency. That the organization is transparent about the risks it faces is also a part of the Tabaksblat Code. The interviewee regarded this to be:

Logical, because the shareholders invest in your company, so they should also understand what the risks are. We’re all familiar with the saying “results from the past do not offer guarantees for the future”.

The risk management process starts in January for the BoM, but earlier in the year for the corporate staff and the BU managers, and involves each employee analyzing his/her own unit for risks. The annual report ultimately presents the risks for the corporation in its entirety, which the case-study company interviewee saw as appropriate because this is what is relevant for the shareholders. A group of two or three people, formally belonging to the corporate staff (together with the BoM) maps the risks. This group is very active and has a specific program that it pursues with the management teams concerned, which makes use of various mechanisms as well as the risks that have been mapped the year before. The group:

- (1) Identifies the risks;
- (2) Estimates the probability of these with respect to impact; and finally
- (3) Ranks the importance of the risks.

The case-study company interviewee explained that, for example, a chlorine train being derailed would have a huge impact, but the probability of it happening is very small. This is thus corrected for, just as it would be by an insurance company. The results are then collected, because ultimately it is of course important for the management board to understand not only where the bigger risks are to be found within the organization, but also where a combination or accumulation of small problems could lead to a bigger risk. It is also important to identify any patterns that may be observed.

The interviewee stated that the external auditor's role in the risk management process could be to form the group that inventories the potential risks. The GMS plays no role in risk management; ultimately, the BoM is responsible for the management of the organization. The interviewee saw risk management as a condition for accomplishing transparency within a company, and therefore one of the responsibilities of the BoM:

The management board is responsible for complying with all relevant laws and regulation, for managing the risks associated with the company's activities, and for the financing the company¹²⁵.

Analysis 2, rule II.1.4

Regarding compliance with rule II.1.4, the chapter *Risk management* starts with a section entitled 'Unidentified risks are a threat; identified risks are a managerial issue.' Thus, "risk management is one of the essential elements of the company's corporate governance", which calls for "creating a proper balance between entrepreneurial attitude and risk levels associated with business opportunities". To demonstrate the importance of risk management for the case-study company, the annual report describes the internal measures that reflect the company's position. For example:

1. All managers at all levels are responsible for risk management as an integral part of their day-to-day operations and decisions;
2. All managers are required to identify risks affecting their business and to manage them adequately (supported by the company's Risk Management framework), and to ensure the governance of the risk boundaries by way of:
 - a. The Company Statement;
 - b. The Business Principles;
 - c. The Internal Authority Schedules;
 - d. The Corporate Directives in several different areas (Finance and Control, Insurance; Health, Safety and Environment; HR; Communications; and Legal and Intellectual Property).

These 'risk boundaries' are highly diverse. For example, the Company Statement, which – according to the case-study company's website – sets out what the "company stands for", and includes the company aims, ambitions, objectives, and commitments. The interviewee elaborated on several other 'risk boundaries', which are included in the following section.

Comment on analysis 2, rule II.1.4

The case-study company interviewee explained that the Authority Schedules reflect the fact that the organization has to make choices about who decides on what. The Authority Schedules are considered to be a control measure because they allow the Board to decide on large investments to be made at BU level. The organization being aware of certain plans in time is certainly a control-related matter. This is one of the oldest control mechanisms, but also one of many. The case-study company interviewee explained that the key with respect to the relationship between 'communications' and risk management is formulation, because how

¹²⁵ Tabaksblat Code, principle II.1: Task and procedure of the management board.

things are formulated is extremely important. All information to be published must be carefully weighed, since all external communication can influence the market expectation (i.e. the exchange rate).

The Business Principles as ‘risk boundary’ are rules meant for the employees, who should comply with them. These rules are also included in the 2006 annual report, and concern the company’s core values, responsibilities (such as, for example, creating long-term value for its stakeholders and an attractive working environment for the employees), and compliance with laws. They further include the company’s statement with respect to supporting the principles of free enterprise and fair competition, business integrity, community activities, and proper communication. The BoM remains responsible for the Principles, and the General Counsel reports every year on compliance of the company’s employees with the Business Principles.

Another measure to decrease the risks mentioned in the annual report is risk reporting:

The perceived likelihood, the assessed impact, and the effectiveness of control measures in place to deal with risks and reporting on these elements is an integral part of the Business Planning & Review cycle.

The case-study company interviewee pointed out that this cycle is called a ‘rolling forecast’, and requires that each quarter the BoM and the BU managers look ahead to the expectations/forecast for the upcoming year. A budget plan for the upcoming year has to be made at some point each year. The interviewee expected that possible risks would be discussed in those sessions as well. This Business Planning & Review cycle, according to the interviewee, is inherent in good governance as it revolves around anticipating the future.

Other risk-avoidance measures mentioned in the annual report are the internal control system, audit procedures, and independent appraisals which approve the reasonable assurance of the effectiveness of the company’s risk management approach, in line with the COSO framework.

The chapter *Risk management* also describes the risk of the company being exposed to “non-compliance with environmental laws, regulatory enforcement, property damage, and possible personal injury and property damage claims resulting there from”, but it points out that these risks can be avoided by “contingency plans and crisis management”. The interviewee explained that contingency plans “absolutely” belong to good corporate governance, and the BoM should be held to account for these. In other words, although contingency plans are not a direct Tabaksblat Code requirement, they are part of risk management, for which the management board – according to the Tabaksblat Code (and the SOX) – is accountable.

Analysis 3, rule II.1.4

The first BoM rule (II.1.4) can be found in the chapter *Report of the Board of Management*, section ‘Internal controls’. It is preceded by the declaration that the management board is responsible for the establishment and adequate functioning of internal controls in the company, and followed by the statement that the board has consequently implemented a broad range of processes and procedures designed to provide control over the company’s operations (cf. Analysis 1, rule II.1.4). These also include specific measures, such as a risk management system, a system of controls, and a system of Letters of Representation by the responsible management at various levels within the company. The Letters of Representation (cf. 8.3) are yearly letters (in line with US legislation) in which the respective BU managers confirm compliance with all relevant legislation and internal rules concerning financial and non-financial issues, and declare that they are not aware of any material weaknesses within their part of the organization. These letters are in fact more SOX-related, as they represent the ‘in control’ statement of all management levels within the corporation.

All anti-risk measures mentioned with respect to II.1.4 are aimed at:

A reasonable level of assurance that the significant risks of the company are identified and managed and that the company's operational and financial objectives are met in compliance with applicable laws and regulations.

A Compliance Committee has been established to support and monitor compliance with laws and regulations and with the company's internal rules. The interviewee explained the role of the Committee, which is described in the following section.

Comment on analysis 3, rule II.1.4

The US Foreign Corrupt Practices Act (FCPA) requires the establishment of a Compliance Committee and accompanying Code of Conduct in order to prevent bribery. The Committee consists of six members, namely:

- (1) The chair (General Counsel), who is a central person with respect to the whistleblowers regulation and a trusted person for the Board of Management;
- (2) The secretary, who is a jurist due to his/her integrity and closeness to the General Counsel;
- (3) The secretary to the Board of Management (who is also a jurist), because he forms the interface with the BoM, plays a pivotal role within the case-study company, and is partially responsible (together with the Legal Department) for governance;
- (4) The internal auditor, on account of being responsible for the controls;
- (5) The HR manager, because as the interviewee described, "compliance is about people"; and
- (6) The CSR manager, because compliance could be considered a company's responsibility towards society.

The Committee's authority is to investigate complaints by gathering information. The interviewee explained that a distinction is drawn between general complaints and complaints about financial reporting. The communication phases with respect to the complaints procedure are the following.

General complaints procedure

In the case of general complaints, the employee concerned should inform his/her 'boss's boss' – not the line manager, since this individual could be the cause of the complaint – who will inform the General Counsel. The General Counsel discusses the complaint within a small group of Compliance Committee members, consisting of an employee from the Legal Department as secretary, the HR director, and the Audit director. The complaint is then discussed further in the full Compliance Committee, which meets every quarter.

A new element is the Compliance Focal Points within the BUs. Each BU has appointed one individual¹²⁶, who should:

1. Organize courses on the Business Principles;
2. Have good contact with the BU jurist;
3. Try to locate responsibility for compliance at the BU level;
4. Build up a more robust system that leads to better compliance with laws and regulations.

These individuals meet every six months with the Compliance Committee.

Complaints procedure concerning financial reporting

Complaints about financial reporting ought to be made via the secretary to the BoM to the audit committee, but this procedure has been simplified such that complaints go directly to the General Counsel.

The Committee's assignment, however, is much broader than its authority since it concerns not only the complaints procedure but also the establishment of compliance¹²⁷

¹²⁶ Usually a member of the relevant BU management team, but possibly an HR representative; several controllers and one BU manager are appointed as Compliance Focal Points.

within the organization. The interviewee stated that “a healthy organization should keep thinking about compliance issues; it is in fact a continuous process”. Further, the Compliance Committee functions as an advisory body for the BoM (concerning the whistleblowers regulation¹²⁸), and is accountable for its functioning to the BoM. According to the interviewee, the Committee is legally bound to guarantee that people can complain in confidence as well as ensure due process. The Committee has no autonomous authority to take a matter to court, but if it investigates a case and finds that an employee has done something illegal, the employee in question should contact a lawyer and the Committee will start a separate procedure. The communication steps with respect to the Compliance Committee consist of the following:

1. The General Counsel reports on the Committee’s activities every year to the supervisory board and four times a year to the Board of Management;
2. The General Counsel presents his report, which only includes general information, at a BoM meeting, and depending on the complaints may advise on actions to be taken;
3. The BoM, however, takes the decisions on major issues, since actions concerning complaints are regarded to be internal affairs, and the BoM is responsible for the entire organization.

Analysis 4, rule II.1.4

A reference is also made in the chapter called *Risk management*, which includes a detailed description of the risk management system with regard to the strategic, operational, and compliance risks, identifies the principal risks, and confirms that the “opinions and conclusions have been discussed with the Audit Committee, the Supervisory board and the external auditor”.

The actual management statement has been formulated in the chapter *Report of the Board of Management*, section ‘Internal controls’, as follows:

Although the company routinely works toward improvement of its processes and procedures regarding its financial reporting, the Board of Management is of the opinion that these processes and procedures:

- Provide a reasonable level of assurance that this annual report does not contain any material misstatements;
- Have operated properly in the year 2006, and
- will also operate properly in 2007.

The BoM should also confirm that the issues concerning the internal risk management and control system have been discussed with the supervisory board, the external auditor, and the audit committee. Correspondingly, the section ‘Internal controls’ in the *Report of the Management Board* chapter includes the following text:

The above opinions and conclusions have been discussed with the Audit Committee, the Supervisory Board and the External Auditor.

Analysis of rule II.1.2

The second rule (annual report-related A-rule II.1.2) on the operational and financial objectives and the strategy to achieve these objectives can be found in the chapter *Report of the Board of Management*, section ‘Internal controls’. Regarding the strategy, it is stated that

¹²⁷ By way of the ‘competition program’ and a ‘Competition compliance manual’, which are explained in the analysis of II.1.5.

¹²⁸ The General Counsel, as chair of the Compliance Committee, deals with the complaints that he receives as a consequence of the whistleblowers regulation. Besides the more general whistleblowers regulation, there is also a specific corporate procedure for complaints on practices violating the Business Principles, HRM, HSE, and Security Policy Statements, and Corporate Directives. This procedure applies for employees in those instances where national codes of conduct do not provide for a country-specific reporting procedure.

processes and procedures have been designed to provide control over the company's operations (cf. Analysis of rule II.1.4). All these processes and procedures are aimed at providing a reasonable level of assurance that the significant risks have been identified and managed, and that the company's operational and financial objectives are being met in compliance with applicable laws and regulations.

Analysis of rule II.3.4

The third rule (annual report-related A-rule, II.3.4) is comparable to rule III.6.3 for the supervisory board, and concerns possible transactions that could lead to conflicts of interest. Note 26, 'Related party transactions', in the notes to the consolidated financial statements of the chapter *Financial Statements*, states that no such transactions exist.

Analysis of rule II.1.5

Annual report-related B-rule II.1.5 concerns the company's sensitivity with respect to external factors and variables, which can be found in the chapter *Risk management*, section 'Major risk factors', sub section 'External risks'. These include:

- The intense competition from new products and lower-cost generic products;
- Product regulation;
- Environmental liabilities;
- Liabilities arising out of non-compliance with laws and regulations;
- Bad publicity and damage to the company's brands as well as exchange rate fluctuations;
- Downgrading by credit rating agencies;
- Inability to access raw materials, etc.

Comment on II.1.5

The annual report mentions that (a) the practical application of the Business Principles and (b) the "reinforced competition law compliance program" are the case-study company's remedies for non-compliance with legislation and regulation.

The first of these, (a), concerns the Business Principles, which stress that employees should comply with the law and other regulations assisting the Board of Management in creating structures to ensure compliance with the Business Principles, according to the interviewee, is the core business of the Compliance Committee (cf. Comment on analysis 3, rule II.1.4), together with dealing with complaints about non-compliance. The Business Principles state that the management board will not hold the management responsible for any losses resulting from compliance with the Principles. The interviewee explained this by giving the example that in certain countries bribery of government officials does take place by third parties from time to time. Compliance with Business Principles may mean losing business as bribery is illegal. Such loss of business will not be held against management.

The interviewee described the second remedy (b) as the "competition law compliance program". This program involves each new employee obtaining a brochure and, within a year, an interactive competition law compliance program that he/she must follow. New employees receive repeated emails reminding them that they are obliged to follow the interactive competition law compliance program. A record is kept of which new employees have and have not done so, and 'refresher recalls' require employees to do certain parts of the program again. According to the interviewee, the Compliance Committee is always thinking about how to improve compliance (cf. Analysis II.1.4).

We have already seen in the analysis of rule II.1.4 that an internal Code of Conduct, along with the establishment of a Compliance Committee, is a US legislative requirement. This Code of Conduct has recently been completed, and the CEO is involved to emphasize its importance. As stated above, this Code and the Committee are part of the formal structures aiming to prevent bribery, for example. The interviewee stated that the outside world is

expecting more and more from listed companies as a consequence of the Ahold and Enron scandals, and the company is expected to ensure solid governance, which is understood as being ‘in control’. This means that structures within the company’s organization have to be established to guarantee compliance with the law and with the internal rules. As the interviewee explained: “It starts at the top and then it can also be seen in the annual report”.

The Compliance Committee is the ‘home’ within the organization, but there is also a very strong legal component. The chairs have all been General Counsel. It is all about external expectations, but also about internal expectations, since the BoM wants to prevent problems – and not only because it is accountable for mismanagement – like the penalties it has received for competition issues in the past. Compliance with competition legislation, according to the case-study company interviewee, has nothing to do with ‘window dressing’. The company also wants to prevent any decrease in its value that could occur as a consequence of paying penalties or making prohibited agreements. The company must be able to detect and prevent such problems, and therefore has to establish a certain structure and reporting procedure in order to do so. This structure encompasses several instruments, such as the code of conduct, which includes, for example, rules about travelling. The code of conduct is quite extensive and its rules focus mainly on the ‘average’ employee, who is required to know these rules. The Business Principles include rules at a more abstract level.

Another instrument or remedy is the ‘Competition law compliance manual’, which is an instruction book explaining what is and is not legally allowed with respect to competition concerning price agreements, market distribution, abuse of dominant positions, etc. The interviewee held the view that a large organization needs many rules, but that this is not surprising as the organization is complex. He stated that a certain aversion against rules is in order to prevent too many rules being made, but being part of a large organization has advantages and disadvantages and these should be in balance. A disadvantage is that a large, complex organization may lead to a great deal of bureaucracy, while an advantage is, for example, the purchasing power it may have when buying raw materials. The organization thus has to simply accept that rules are needed. These rules also include ‘basic governance rules’ such as the relevant legislation, the Articles of Association, and Civil Code 2. The case-study company interviewee pointed out that most employees are not involved in these kinds of rules. Rather, they are the concern of the secretary to the BoM, the BoM, and the Legal Department. These rules are, according to the interviewee, important at the highest level. The internal rules include the Corporate Directives (which are a ‘must’) and the policies (which are a ‘want’), for example the HR policy on equal treatment must, to a varying degree, be known to employees and management of the company. The Authority Schedules include the decision-making authority; for example, the BU manager, the BoM, or the supervisory board may make or approve investment decisions.

Returning to the competition law compliance program, HR also plays a role with respect to new employees, and CSR is involved since the HR and CSR directors are also members of the Compliance Committee. Rating agencies with respect to CSR may look at these kinds of aspects. The importance of the case-study company’s CSR report is explicitly visible in the fact that the 2006 annual report was published together with a separate CSR report. The interviewee explained that both reports were presented together in order to make visible the importance of CSR for the company. The CSR report is highly significant, as it shows what the company contributes to society. It is a formal document, signed by an external auditor because, according to the interviewee, it is “important for the credibility of the document to let auditors give their opinion, at least about the procedures”. The interviewee explained that the external audit with respect to CSR is meant for the company’s external stakeholders, and is also a matter of credibility. The case-study company holds the no. 1 position in the Dow Jones Sustainability Index for 2006, which is important with respect both

to transparency within the company and to shareholder confidence. The latter aspect in particular is considered to be of major importance. The interviewee stressed that the company's quality is based on, for example, the fact that the company takes CSR seriously; quite apart from how important people find this for future generations, it also says something about the management. He held the view that there is a strong link between taking CSR seriously and good management. This is an essential aspect of how shareholders – and society, i.e. future employees – see the company. According to the interviewee, it has been shown that all kinds of groups view companies that feel strongly about CSR very positively. As we have seen, bad publicity is considered to be an external risk factor, and good publicity could therefore be seen as a means of risk management.

Not only bad publicity but also downgrading by credit rating agencies is considered to be an external risk factor. The case-study interviewee explained the influence of rating agencies as very important. Credit rating agencies measure the creditworthiness of a corporation by asking the question “to what extent is the bank willing to lend the company money?” If a rating agency sees that the tradability of the company's shares may be limited through governmental regulations, its creditworthiness will be down graded. The case-study company has an A- and an A3-rating, as mentioned in the annual report, whereby the difference between the two ratings depends on the agency providing this rating. According to the interviewee, if a company neither has to borrow money nor has a loan, this rating is not overly important. For banks and insurance companies the risks will be counted and then processed within the required premium. Such a credit rating is important for the company's image and, to this end, is specifically important for the shareholders. If the organization reaches the junk-bond status¹²⁹ it has a major problem. Ultimately, the credit rating issue concerns the share trading at stock exchanges.

Another external risk factor concerns the exchange rate fluctuations of diverse currencies. The company's remedy for this kind of risk is a hedge policy consisting of exchange contracts. The interviewee considered this policy to be “just sensible managing of financial resources”.

Analysis of rule IV.3.9

The last annual report-related B-rule (IV.3.9) concerning the management board is about the existence of potential antitakeover mechanisms. The first reference to this rule can be found in the chapter *Corporate governance*, section ‘Anti takeover provisions and control’:

According to provision IV.3.9 of the Code, the company is required to provide an overview of its actual or potential anti-takeover measures and of the circumstances in which they may be used.

The first antitakeover measure concerns priority shares, which has been explained as follows:

The Foundation of the company has confirmed that it intends to make use of its binding nomination rights in the event of exceptional circumstances only.

Comment on IV.3.9

The interviewee explained that the same may apply if one shareholder, or more shareholders acting in a concerted way, are holding a substantial percentage of the company's issued common shares without making an offer, or if, in the opinion of the Board of the Foundation, the exercise of the voting rights by one shareholder, or more shareholders acting in a concerted way, is materially in conflict with the interests of the company and its enterprise. The case-study company interviewee points out with respect to the Foundation that Dutch companies have traditionally had protection mechanisms (cf. 3.5.3), and that in hostile

¹²⁹ A company gets a junk-bond status if it has sunk very deeply in the rating.

situations, the Foundation could vote in such a way that all decisions can be made by the priority shareholders. The Foundation, according to the interviewee, can be seen as a protection mechanism because certain decisions are reserved for the Foundation in accordance with the Articles of Association. The most important decision that could be taken is for the Foundation to decide to make use of its binding nomination rights for the appointment of the BoM and supervisory board members. According to the interviewee, this entails “some kind of protection at that point in time.”

In such cases, the supervisory board and the BoM, in accordance with their statutory responsibility, will evaluate all available options with a view to serving the best interests of the company, its enterprise, and its shareholders and other stakeholders. In order to allow for sufficient time to conduct such an evaluation, the Board of the Foundation reserves the right to make use of its binding nomination rights for the appointment of members of the Supervisory Board and of the BoM in such circumstances. The priority shares are thus combined with the right to make a binding nomination. The same section, ‘Anti takeover provisions and control’, describes a general solution to a hostile takeover bid, namely

The Supervisory Board and the Board of Management reserve the right to use all powers available to them in the interest of the company and its enterprise.

With respect to protection mechanisms in general, the case-study company interviewee held the view that:

The common opinion in developed countries is that a transparent market and an international, well functioning financial market are conducive to economic growth. Not too many local protection mechanisms should therefore exist.

CCU external auditor

Analysis of rule V.4.3

The only annual report-relevant rule with respect to the external auditor is B-rule V.4.3, concerning the auditor’s report. This report is included as a separate chapter (*Auditor’s report*) within the chapter *Financial Statements*, section ‘Report on the Financial Statements’, which confirms that the auditors have audited the financial statements as included in the annual report. In the same *Auditor’s report* chapter, the section ‘Management’s responsibility’ has been included, regarding the statement that the BoM is responsible (cf. 8.1.2) for the:

Preparation and fair representation of the Financial Statements in accordance with [IFRS] as adopted by the EU and with Part 9 of Book 2 of the Netherlands Civil Code, and for the preparation of the Report of the Board of Management in accordance with Part 9 of Book 2 of the Netherlands Civil Code. This responsibility includes ‘designing, implementing and maintaining internal control relevant to the preparation and fair representation of the Financial Statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making the accounting estimates that are reasonable in the circumstances.’

Further, the report includes the section ‘Auditor’s responsibility’, in which the auditor expresses his/her opinion of the Financial Statements based on his/her audit. The auditor states that the audit was conducted “in accordance with Dutch law”, which

“requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatements”.

This is followed by the statement that the audit involves performing procedures (such as important risk assessments) to obtain audit evidence about the amounts and disclosures in the Financial Statements. Internal control plays a significant role with respect to the design of audit procedures, although these are not meant for “the purpose of expressing an opinion on the effectiveness of the entity’s internal control”. Further, the report also includes the evaluation of the appropriateness of the accounting policies, the reasonableness of the

accounting estimates made by management, and finally the overall presentation of the Financial Statements. The final statement reads:

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for audit opinion.

These opinions are included in the chapter *Auditor's report*, section 'Report on the Financial Statements', sub sections 'Opinion with respect to the consolidated Financial Statements' and 'Opinion with respect to the consolidated Company Financial Statements'.

The auditor's report additionally includes the auditors' actual opinions with respect to the consolidated financial statements and the company financial statements, which are described as giving a "true and fair view of the financial position of the company". The auditors' opinions also include that the cash flows are in accordance with IFRS "as adopted by the EU and with Part 9 Book 2 of the Netherlands Civil Code".

The report ends with a section 'Report on other legal and regulatory requirements' including the following text, which clearly refers to the legal requirements (cf. 8.1.2) with respect to the auditor's report:

Pursuant to the legal requirement under 2:393 sub 5 part e of the Netherlands Civil Code, we report, to the extent of our competence, that the Management report [...] is consistent with the Financial Statements as required by 2:391 sub 4 of the Netherlands Civil Code.

To sum up

The norms for the annual report genre as required by the Tabaksblat Code can be all detected in the 2006 annual report, except for compliance with two rules, namely II.2.7 (included in II.2.10) and III.2.1 (and III.2.2/III.2.3). Compliance with respect to III.5.3 is not completely clear.

Further, most rules can be found within the obligatory texts as required by the Tabaksblat Code, although some appear in other parts. This concerns CCU supervisory board rule III.5, which should be part of the supervisory board report but appears instead in the chapter *Corporate governance*, and rule III.5.3, which could be expected to be included in the supervisory board report but can also be found in the chapter *Remuneration report*. Next, III.1.8 should only be included in the supervisory board report but also appears twice in the *Remuneration report*, and II.2.12 should only be included in the *Remuneration report* but can also be found in the chapter *Financial Statements*. Rule III.5.10 might be expected to be included in the supervisory board report but appears in the chapter *Remuneration report*, and finally – since the company deviated from III.2.1¹³⁰ – this rule was not found in the supervisory board report but only in the chapter *Corporate governance*.

All norms for the CCU management board were expected to be found in the chapter *Report of the Board of Management*, but II.1.4 was also found in the chapter *Risk management*; rule II.3.4 was only found in the chapter *Financial Statements*; rule II.1.5 only in the chapter *Risk management*; and IV.3.9 only in the chapter *Corporate governance*.

All norms for the external auditor were found as required in the chapter *Auditor's report*, which is included in the chapter *Financial Statements*.

9.3.2 Non-annual report-related A-rules with direct influence – Group C

This group consists of A-rules that do not belong to the annual report-related A-rules, but nevertheless have a direct influence on the annual report process.

¹³⁰ III.2.3 includes III.2.3

CCU supervisory board

Supervisory Board – BoM

Analysis of rule III.1

The first rule (III.1) about the supervisory board's supervision task with respect to the management board can be detected in the chapter *Corporate governance*, section 'Supervisory Board'. This involves supervision of the BoM's policies and the general conduct of company business.

Further confirmation of the supervisory board's supervision task can be found in the text "Additionally, we request the shareholders to discharge [...] the members of the Supervisory Board for their supervision of management", which is included in the chapter *Report of the Supervisory Board*, section 'Financial statements and dividend proposal'.

Analysis of rule III.1.6

The next rule (III.1.6) further emphasizes the supervision task of the supervisory board, as it explains more clearly what this supervision involves¹³¹. It can be found in the chapter *Corporate governance*, section 'Supervisory Board'.

Analysis of rule III.1.1

Rule III.1.1 consists of the requirement to draw up regulations, one section of which shall include the relationship between the management and supervisory boards. Neither this rule itself nor any reference to it has been found in the 2006 annual report. The case-study company interviewee, however, refers to the Articles of Association and the Rules of Procedure of the Supervisory Board and the Board of Management with respect to the relation between the BoM and the supervisory board, which can both be found on the company website. These Articles are obligatory for all Dutch corporations – both private and public limited companies – and are quite extended.

Comment on III.1.1

The Articles include rules that have been translated from legislative rules into practical rules. They are adjusted regularly, and are considered to be a starting document for every corporation. The Articles describe the role and powers of the shareholders, the BoM, and the supervisory board, as well as all kinds of aspects concerning shares, such as how they will be issued and withdrawn, and who may approve these decisions. This means that the 'rules of the game' for the BoM and other employees are the Business Principles, but the rules of the game for the shareholders, BoM, and supervisory board are the Articles. The BoM and the supervisory board, however, also adhere to the more specific Rules of Procedure¹³². There is a certain overlap between the Articles of Association and the Rules of Procedure. The interviewee pointed out that the latter is a specific subset of the code of conduct of rules that should not clash with those of the former. The Articles of Association, stand above the partially self imposed Rules of Procedure in the governance hierarchy. They consist of rules that can be defined, according to the interviewee, as "interpersonal relations rules". The Articles are mainly a product of the law and if the company does not comply, the shareholders may take them to court.

¹³¹ 1. Achievement of the company's objectives; corporate strategy and the risks inherent in the business activities; structure and operation of the internal risk management and control systems; financial reporting process; compliance with legislation and regulation.

¹³² Cf. group D, CCU Supervisory board, SB-AC/RC/SAC

The process with respect to changing the Articles of Association is the following: Changes to the Articles are in principle initiated by the BoM and proposed to the Foundation, which is in fact part of the supervisory board (its management consists of the supervisory board members who are not audit committee members). Discussions within the supervisory board then takes place. Any concrete changes should be proposed by the case-study company's Foundation of Priority Shareholders, after which the changes will become a GMS agenda item. The GMS finally approves the amendments to the Articles.

Analysis of rule V.1

V.1 again concerns the supervisory board's supervision, specifically focused on whether the management board fulfills its responsibility to ensure the quality and completeness of publicly disclosed financial reports. The texts found with respect to III.1 and III.1.6 are also applicable to V.1, but so too is the following, from the chapter *Report of the Supervisory Board*, section 'Financial statements and dividend proposal':

In addition, the 2006 financial statements were a topic of discussion for the full Supervisory Board with the full Management Board, in the presence of the auditors. Based on these discussions, the Supervisory Board believes that the 2006 financial statements of the company meet all requirements for correctness and transparency and that they form a good basis to account for the supervision provided.

Analysis of rule III.1.9

Rule III.1.9 concerns the responsibility of the supervisory board and its members to obtain all information needed from the management board (and external auditor). Evidence of this could only be found in the chapter *Report of the Supervisory Board*, section 'Supervisory Board activities', in a comment on the 'information action' from the BoM towards the supervisory board:

The Board of Management keeps the Supervisory Board regularly informed of intended changes and appointments of senior managers.

Although the annual report only refers to the communication from the BoM to the supervisory board, it could be assumed that the supervisory board obtains the relevant information from the management board at least during the supervisory board meetings, at which the full BoM is always present. Further, the case-study company interviewee described (cf. Figure 8.4: Communication intensity between SB and organization) the high communication intensity between the supervisory board/the supervisory board chair and the chair of the BoM (the CEO), which presumably leads to mutual information exchange.

Analysis of rules V.1.1 and V.1.3

These rules are more or less related to the previous norm, as V.1.1 is about the supervision of compliance with internal procedures with regard to financial information, and V.1.3 stipulates that the supervisory board shall see to it that the internal procedures¹³³ are established and maintained. References to both rules can be found in the chapters (1) *Corporate governance*, (2) *Report of the Supervisory Board* (cf. analysis III.1 and V.1), and (3) *Report of the Board of Management*, section 'Internal controls' stating that:

These processes and procedures include measures regarding the general control environment, such as Business Principles, Corporate Directives and Authority Schedules, as well as specific measures, such as a risk management system, a system of controls, and a system of letters of representation by

¹³³ Further, V.13 indicates that the management board ensures that financial information from business divisions and/or subsidiaries is reported directly to the management board, and that the integrity of the information is not compromised.

responsible management at various levels within the company. All these processes and procedures are aimed at a reasonable level of assurance that the significant risks [...] are met in compliance with applicable laws and regulations. With respect to support to and monitoring of compliance with laws and regulations including the company's Business Principles, a Compliance Committee¹³⁴ has been established.

Analysis of rule V.2

Rule V.2 involves the complex procedure for the external auditor's appointment, whereby the GMS appoints the auditor after the supervisory board has nominated a candidate and the audit committee and management board have advised the supervisory board. This is reflected in the chapter *Corporate governance*, section 'Auditors':

The external auditor is appointed by the General Meeting of Shareholders on the proposal of the Supervisory Board.

And:

The Audit Committee advises the Supervisory Board, which will communicate the result of this assessment [auditor's assessment] to the General meeting of shareholders.

The audit process as described in 8.6.5 showed that the external auditor is appointed by the GMS, and the SOX requires the lead auditor to be replaced every five years.

Further, V.2 indicates that the external auditor's remuneration and instructions to provide non-audit services will be approved by the supervisory board on the recommendation of the audit committee and after consultation with the management board. This part of the rule can be found in the chapter *Corporate governance*, section 'Committees':

The Audit Committee has been delegated direct responsibility for the compensation and the oversight of the auditors and the services they provide to the company. The auditors are prohibited from providing certain non-audit services to the company. In order to anchor this in the company's procedures, the Supervisory Board adopted the "Company's Auditors Independence Policy" and the related "[...] Audit Committee Pre-Approval Policy on Audit, Audit-Related, and non-Audit Services".

The Engagement Letter includes, according to the description of the accounting firm representative and the case-study representative (cf. 8.6.5), the specific services that will be provided by the external auditor as well as all other agreements between the company and the auditor, including with respect to remuneration. The official procedure for, structure of, and agreements on the auditor's remuneration are expected to be included in the Engagement Letter as well.

Analysis of rule V.2.2

Rule V.2.2 indirectly refers to the role of the supervisory board with respect to the external auditor. The supervisory board has a passive role, whereas the audit committee plays a more active and important role here. V.2.2 is related to the previous rule, and can be found in the same chapter and section:

The Audit Committee [...] which will communicate the results of this assessment to the General Meeting of Shareholders

and

The Audit Committee and the Board of Management annually report their dealings with the external auditor to the Supervisory Board and discuss the auditor's independence.

Reference to the auditor's independence, however, can also be found in the chapter *Report of the Supervisory Board*, section 'Audit Committee', which states that the "Audit Committee regularly discussed [...] the external auditor's performance and independence".

¹³⁴ Cf. 9.3.1, CCU management board

The assessment of the external auditor and the communication of the main conclusions to the GMS (V.2.3) have already been mentioned in the previous norms (V.2 and V.2.2) concerning the text included in the chapter *Corporate governance*.

Supervisory Board – General Meeting of Shareholders

Analysis of rule I

The first rule (I) in this communication line with respect to the annual report process can be identified in the chapter *Corporate governance*, ‘General’ section, since this principle concerns the supervisory board’s and management board’s responsibility for the corporate governance structure and for compliance with and enforcement with the Code. Both boards are accountable for this to the GMS, and the latter should assess the reasons should either board fail to live up to this responsibility. The 2006 annual report refers to this rule in the following text:

The company’s management and supervision structure is organized in a so-called two-tier system, comprising a Board of Management, solely composed of executive directors, and a Supervisory Board, solely composed of non-executive directors. The two Boards are independent of each other and are accountable to the General Meeting of Shareholders for the performance of their functions.

The company also states that “The Board of Management and the Supervisory board believe that the company’s Corporate Governance structure [...] is the most appropriate for the company at this point in time”, although the possibility of future changes is not excluded. Compliance with the Code has been formulated as follows: “Most notable are the Dutch Corporate Governance Code adopted in 2003 [...]”, and “the company agrees both with the general approach and with the vast majority of its principles and best practice provisions”. The company thus *agrees* explicitly with most Tabaksblat code rules. It might be not clear whether *agrees* equals *complies*. The exceptions are set out in the chapter *Corporate governance*. The responsibility of the GMS with respect to its approval of the reasons for non-compliance is expected to be included implicitly.

Analysis of rule V.2.3

The second rule (V.2.3)¹³⁵ concerning the communication line between the supervisory board and the GMS has been explained in the previous section, on the communication line between the supervisory and management boards.

Supervisory Board – External Auditor

Analysis of rule III.1.9

The communication line between the supervisory board and the external auditor involves one rule (III.1.9), which states that it is the supervisory board’s responsibility to obtain all relevant information from the management board and the external auditor. This has been discussed in the section on the communication between the supervisory and management boards.

Chair of the Supervisory Board – Supervisory Board/Management Board

Analysis of rule III.4

The next rule, III.4, concerns the relationship between the supervisory board chair/supervisory board and the management board. The chair has certain tasks, which are referred to in the chapter *Corporate governance*, section ‘Appointment, independence and composition’:

The chairman of the Supervisory Board determines the agenda and chairs the meetings of the Supervisory Board, monitors the proper functioning of the Supervisory Board and its committees, arranges for the adequate provision of information to the members of the Supervisory Board, and acts

¹³⁵ V.2.3: “The conclusions of the external auditor’s assessment should be communicated to the GMS.”

on behalf of the Supervisory Board as the main contact for the Board of Management. He also initiates the evaluation of the functioning of the Supervisory Board and the Board of Management¹³⁶, and chairs the General Meeting of Shareholders.

That the company's supervisory board chair actually performed his duties can be deduced from the text included in the chapter *Report of the Supervisory Board*, section 'Supervisory Board activities', which states that "The Chairman of the Supervisory Board prepares the meetings with the assistance of the CEO", and:

The Supervisory Board held a separate meeting, which was attended in part by the CEO, during which the Supervisory Board conducted a self-assessment and appraised its committees, working methods, procedures, and performance, as well as evaluating the functioning of the Board of Management and its individual members. The Supervisory Board also assessed its relationship with the Board of Management and discussed the composition of the Supervisory Board and its committees.

Comment on III.4

The interviewee described how the chair of the supervisory board monitors and evaluates the functioning of the members of the supervisory board and its three committees (as well as the BoM and its individual members). The interviewee pointed out that this evaluation includes several steps, namely:

- (1) Once a year, an evaluation of the individual members of the BoM takes place;
- (2) The functioning of the BoM as a group and the interaction with the supervisory board is then evaluated;
- (3) The chair of the supervisory board is also evaluated;
- (4) The functioning of the supervisory board as a group is evaluated; and finally

The individual members of the supervisory board are evaluated.

The interviewee does not attend this meeting (cf. point (5), but does attend the meeting on the evaluation of the BoM as a group and its interaction with the supervisory board, the evaluation of the chair of the supervisory board, and the evaluation of the functioning of the supervisory board as a group. These last three evaluations take place in one long meeting, during which use is made of a form (cf. Appendix G) that the interviewee as secretary to the BoM sends beforehand. The supervisory board members fill in the form and return it one week before the meeting. The secretary then summarizes these responses. The summaries are used during the meeting in small discussions initiated by the secretary, who asks whether the members indeed recognize themselves in the summaries. The evaluation form is therefore intended as a starting point to facilitate a more in depth discussion. The form used applies to all three evaluations, given the Tabaksblat Code's requirement that an evaluation take place (cf. III.4). The interviewee considered evaluation a positive thing, but pointed out that the results of the evaluation are not meant to be made public, or even distributed among a large group. He underlined the importance of this group of people trying to prevent possible problems from continuing to simmer by evaluating and discussing the evaluation, which might lead to improvements. As an example, he further mentioned that one of the evaluations made clear that there was a need for more supervisory board meetings to be planned, and this in fact led to more meetings from 2009 onwards.

Analysis of rule III.4.1

The following rule (III.4.1) includes all tasks of the chair of the supervisory board. The reference to this rule can be identified partially in the texts mentioned with respect to the previous rule. Additionally, the chapter *Report of the Supervisory Board*, section 'Supervisory

¹³⁶ Cf. Appendix E.

Board activities', states that "all meetings were plenary sessions with the full Board of Management", and that:

The Board of Management keeps the Supervisory Board regularly informed of intended organizational changes and appointments of senior managers.

The Supervisory Board evaluation form (cf. Appendix G) shows that some of the chair's tasks will be evaluated. For example, Part A, 'Supervisory Board Evaluation', includes section 2, 'Provision of Information', which involves some of the chair's tasks (e.g. timely provision of information for the meeting agenda and documentation). Further, section 3, 'Introduction and special information programs', includes questions about the introduction program and training for new supervisory board members, for which the chair is also responsible.

Audit Committee – Supervisory Board

The rules included in this communication line (V.2 and V.2.2) were explained in the section on the communication line between the supervisory and management boards.

Audit Committee – Management Board

Analysis of rule III.5.4

Not only the supervisory board but also the audit committee supervises the activities of the management board (III.5.4). This is mainly described in the chapter *Corporate governance*, section 'Committees', as follows:

The Audit Committee assists the Supervisory Board in overseeing the quality and integrity of the accounting, auditing, reporting and risk management practices of the company, as well as on a number of other subjects, as included in its charter¹³⁷.

The committee also holds responsibility with respect to the auditor's independence, remuneration, and provision of non-audit services, as reflected in the same section as above:

The Audit Committee has been delegated direct responsibility for the compensation and the oversight of the auditors and the services they provide to the company. [...] In order to anchor this in the company's procedures, the Supervisory Board has adopted the company's "Auditors Independence Policy" and the related "Audit Committee Pre-Approval Policy on Audit, Audit-Related, and Non-Audit Services."

The audit committee's role with respect to the external auditor is also reflected in the fact that the committee meets the auditor(s) after each of its regular meetings (cf. 8.6.2).

The section 'Internal controls' included in the chapter *Report of the Board of Management* describes the monitoring relationship between the audit committee and the management board as follows:

The above opinions and conclusions [with respect to the adequate functioning of the internal controls] have been discussed with the Audit Committee, the Supervisory Board and the external auditor.

And (somewhat less obviously):

All these processes and procedures are aimed at a reasonable level of assurance that the significant risks of the company are identified and managed and that the company's operational and financial objectives are met in compliance with applicable laws and regulations. With respect to support to and monitoring of compliance with laws and regulations including the company's Business Principles, a Compliance Committee has been established.

Further, the following text in the chapter *Report of the Supervisory Board*, section 'Financial statements and dividend proposal' refers to the supervision of the financial statements:

The 2006 Financial Statements were discussed extensively with the auditors by the Audit Committee and in the presence of the Chairman of the Board of Management and the CFO.

¹³⁷ The charters of all committees can be found in the Rules of Procedure for the Supervisory Board on the case-study company's corporate website.

Comment on III.5.4

As indicated in 8.6.1, the case-study company interviewee stated that the CEO and the Audit Committee chair are the core corporate communication partners of the Supervisory Board. Communication between the Supervisory Board and the organization – i.e. the other CCUs – is most intense between the Supervisory Board chair and the CEO, then between the chair of the audit committee and the CFO, both on content and then on form and process between the secretary to the BoM and the CEO and the secretary and the respective chairs of the Supervisory Board and Audit Committee

Audit Committee – External Auditor

Analysis III.5.5

The audit committee is the main contact for the auditor (III.5.5), which is apparent from the statement in the chapter *Report of the Supervisory Board*, section ‘Audit Committee’, that “A meeting with only the internal auditor, and one with only the external auditor present, was also held”. This is also reflected in the chapter *Corporate governance*, section ‘Committees’, as related to the previous norm (III.5.4). The interviewee (cf. 8.6.2) stated that the audit committee meets the external auditor(s) after every regular committee meeting.

Analysis of rules III.5.8 and III.5.9

The second and third rules (III.5.8/III.5.9) concern the presence of the external auditor at the audit committee’s meetings, which is formulated in the chapter *Report of the Supervisory Board*, section ‘Audit Committee’, as follows:

In principle, the CEO and CFO [...] and the lead partner of the external auditor [...] attend all regular meetings [...]. A meeting, [...] and one meeting with only the external auditor present, was also held.

Further, in the chapter *Report of the Supervisory Board*, section ‘Financial statements and dividend proposal’, the following relevant text can be found: “The Financial Statements were discussed [...] with the auditors by the Audit Committee [...].” The case-study company interviewee stated that the internal auditor and CFO always attend the audit committee’s meetings (cf. 8.6.5).

Analysis of rule V.1.2

Rule V.1.2 concerns the fact that the audit committee determines how the auditor is involved in the content and publication of the financial reports other than the annual report. Neither the content of this rule nor a reference to the rule itself could be found in the annual report, or in the answers given during the interviews, probably because the rule does not directly concern the annual accounts. Its importance for the annual report process, however, is obvious, since all financial reports are part of the annual report process, and are considered to form part of the preparations for the Financial Statements in the annual report.

Audit Committee – General Meeting of Shareholders

This communication line concerns rule V.2.3, on the external auditor’s assessment by the audit committee, the results of which will be communicated to the GMS. This has been discussed in the section on the communication line between the supervisory and management boards.

Selection and Appointment Committee – Supervisory Board/Management Board

Analysis of rule III.5.13

Rule III.5.13 concerns the duties of this committee, which can be found in the chapter *Corporate governance*, section ‘Committees’:

The Nomination Committee focuses on drawing up selection criteria and appointment procedures for Supervisory Board and Board of Management members, assessing the size and composition of both Boards, assessing the functioning of the individual members, making proposals for appointments and reappointments, and supervising the Board of Management on the selection of senior management.

That the committee actually performed these duties is apparent from the following text in the chapter *Report of the Supervisory Board*, section ‘Nomination Committee’:

The Nomination Committee made proposals as described above for the appointment of [...] in 2007 in the Supervisory Board and for the reduction of the number of Supervisory Board members by two.

This text corresponds with another text part in the same chapter, section ‘Board of Management changes’.

CCU management board

Management Board – Supervisory Board

Analysis of rule II.1

II.1 concerns the management board’s discussions about the internal risk management and control systems with the supervisory board, which can be found in the chapter *Report of the Board of Management*, section ‘Internal controls’, specifically in the text “the above opinions and conclusions have been discussed with the [...] Supervisory Board”.

The management board should also inform the supervisory board about relevant topics; this is apparent in the chapter *Report of the Supervisory Board*, section ‘Supervisory Board activities’, which states that:

The Board of Management keeps the Supervisory Board regularly informed of intended organizational changes and appointments of senior managers.

Further, II.1 indicates that the management board is accountable to the supervisory board for managing the company, which can be found in the chapter *Report of the Supervisory Board*, section ‘Financial statements and dividend proposal’:

[...] the 2006 financial statements were a topic of discussion for the full Supervisory Board with the full Board of Management in the presence of the auditors.

And:

[...] we request that shareholders discharge the Members of the Board of Management of their responsibility for the conduct of business in 2006 [...].

Analysis of rules V.1.3 and V.2.2

This communication line also includes rules V.1.3 and V.2.2, which have been explained in the section on the communication line between the supervisory and management boards. In 8.6.1, the interviewee emphasized the importance of the communication line between these two boards, since first and foremost the CEO communicates with the supervisory board during the supervisory board meeting in which the full BoM is present. The CEO and CFO (and the external auditor) are present at all audit committee meetings, which take place seven or eight times a year. According to the interviewee, communication between the Supervisory Board and the organization – i.e. the other CCUs – is most intense between the chair of the Supervisory Board and the CEO (cf. Figure 8.4).

Management Board – Audit Committee

This communication line concerns one rule (II.1) which has been explained in the previous section on the communication line between the management and supervisory boards.

Management Board – General Meeting of Shareholders

Rule I, as the defining rule of this communication line, has been explained in the section on the communication between the supervisory board and the General Meeting of Shareholders.

CCU general meeting of shareholders

General Meeting of Shareholders – External Auditor

The rules V.2 and V.2.2 were discussed in the section on the communication between the supervisory and management boards.

CCU external auditor

External Auditor – Supervisory Board/Management Board

Rules V.4 and V.4.1 are part of the relevant communication line, but were explained in the communication line *Chair of the Supervisory Board – Supervisory Board/Management Board*

To sum up

The case-study company complies with most of the non-annual report-related A-rules included in group C. However, from the annual report can not be deducted that it does comply with V.1.2, I and III.1.9, and it only partially complies with V.2. Compliance with III.1.1 could not be confirmed through the annual report, but is described in the Rules of Procedure included in the Articles of Association that apply specifically to the BoM and the supervisory board.

9.3.3 Non-annual report-related A-rules with indirect influence – Group D

This group of rules consists of the remaining A-rules¹³⁸ that are part of one or more communication lines, and that indirectly influence and support the annual report process.

CCU supervisory board

Supervisory Board – Chair of the Supervisory Board

Analysis of rule III.6.1

Rule III.6.1 concerns the fact that the supervisory board should report any potential or future conflicts of interest to the chair of the supervisory board, and provide him/her with the relevant information. Corresponding text can be found in the chapter *Corporate governance*, section ‘Appointment, independence and composition’. This text refers to the supervisory board’s Rules of Procedures, which includes the same rule.

Comment on III.6.1

The case-study company interviewee explained that the Rules of Procedure are the supervisory board’s ‘own’ rules (cf. 9.3.2); although the members do not write the Rules themselves, they do approve them. The supervisory board’s compliance with the Rules is a ‘collective responsibility’ of the supervisory board, in which the secretary to the BoM plays a facilitating role. The chair of the supervisory board may call the members to account with respect to compliance.

¹³⁸ A-rules that are neither part of the annual report-related A-rules nor the A-rules that directly influence the annual report process (group C).

Supervisory Board – Audit Committee/Remuneration Committee/Selection and Appointment Committee

Analysis of rule III.5.1

This communication line concerns rule III.5.1, stating that the supervisory board should establish regulations for each committee, which shall at least state that a maximum of one member of each committee need not be independent. The case-study company has complied with this rule, as shown in the statement included in the chapter *Corporate governance*, section ‘Committees’ that:

Each Committee has a charter describing its role and responsibility and the manner in which it discharges its duties and reports to the full Supervisory Board. These charters are included in the Rules of Procedure, published on the company’s corporate website. The Committees report on their deliberations and findings to the full Supervisory Board.

Like the full supervisory board and the full BoM, the supervisory board’s committees should comply with the Rules of Procedure. The interviewee pointed out that the compliance of the three committees with the Rules is also a collective responsibility, whereby the chair can call them to account.

Comment on III.5.1

The communication process with respect to the Rules of Procedure begins with each supervisory board meeting, starting with the respective committee reports. This, according to the interviewee, is one of the reasons why the supervisory board meeting always takes place after the audit committee’s meeting. The chair of each committee leads the discussion, while the secretary to the BoM takes the minutes. More about the communication process can be found in the next section.

Supervisory Board – Management Board

Analysis of rule II.2.6

The case-study company deviates from the annual report process-supporting rule (II.2.6) of this communication line, as indicated in the chapter *Corporate governance*, section ‘Rules of Procedure, codes of conduct, complaints procedures’:

The company has chosen not to follow the provisions of the Code (II.2.6) requiring notification by members of the Board of Management of all changes in holdings of shares in Dutch listed companies, as it believes that in addition to the cited restrictions, this will create an unnecessary administrative burden.

The above quote includes mention of the way in which the case-study company deals with the transactions of BoM members. It can be considered the introduction to the explanation of the deviation from rule II.2.6, stating that:

The Supervisory Board has adopted Rules of Procedure that address internal procedural issues for the Board of Management. The members of the Board of Management are subject to the Company’s Rules on Inside Information, which limits their opportunities to trade in the company’s – and in certain circumstances – other company’s shares. Transactions in company’s shares executed by the Board of Management are notified to the Dutch Authority for the Financial Markets in accordance with Dutch law and, if necessary, to other relevant authorities.

Comment on II.2.6

The interviewee explained that II.2.6 might refer to, for example, the CEO’s shares in another Dutch listed company. The CEO should report holding these shares. The company’s point of view is that this is in principle a private matter, and the company’s Rules on Inside Information deal with this situation. These Rules point out that making use of inside information by executing transactions in company or other securities is prohibited if the person concerned has inside information regarding such securities. The Rules on Inside

Information are part of the Rules of Procedure, as discussed above (cf. 9.3.2). The interviewee explained that any share transactions by BoM members should be notified to the Authority Financial Markets (AFM). The same applies for any changes in shares held by supervisory board members. The interviewee stressed the importance of the supervisory board's compliance with the Rules on Inside Information too, since this would prevent certain uncomfortable situations.

The interviewee explained that this situation is possible in the Netherlands since the 'highest' corporate body, the GMS, has several instruments to express its dissatisfaction, namely by (1) suspending or dismissing the Supervisory Board members, (2) withholding discharge, and (3) asking questions about compliance with the Rules of Procedure. The shareholders have the opportunity to use these instruments once a year at the GMS. The road shows (cf. 9.3.1) may also enable the shareholders to express complaints. However, it is better because of the role of the supervisory board according to the law and good governance plus the fact that it meets six times a year that the supervisory board carries out discussions and monitoring tasks. The interviewee highlighted the significant monitoring role of the shareholders as follows:

The shareholders are ultimately the overall monitors.

The abovementioned section 'Rules of procedure, codes of conduct, complaints procedures' also stipulates that the Rules on Inside Information:

Provide that the Compliance Officer¹³⁹ may determine that transactions in securities other than the company's securities are prohibited, irrespective of whether he or she has inside information and has notified the relevant designated persons thereof.

It could be presumed that this text fragment justifies the deviation from II.2.6. The interviewee explained that, besides the supervisory board (and shareholders), the internal auditor also has a monitoring role with respect to the Rules on Inside Information, since the auditor monitors compliance with the Rules in particular. The interviewee further explained that the company has 'open' and 'closed' periods, in which the employees may trade. The internal auditor determines these periods depending on what is happening in the organization. If irregularities were to arise, the internal auditor as monitoring body would be involved; the auditor is able to monitor the situation via the audit compliance procedure, and in particular monitors the use/abuse of inside information. If people did 'the wrong thing', it would not be directly visible. The case-study company interviewee pointed out that legislation aims to prevent such use/abuse of inside information through the requirement for BoM (and supervisory board) members to notify any transactions and changes in their share portfolios to the AFM. The Rules are a policy document; internal rules established in order to 'modify' or convert legal rules into practical rules. Because the law stipulates that no employee should act with help of inside information, this is in fact need not be included in the regulations too. According to the interviewee, also worthy of note is the fact that the Tabaksblat Code mentions the rule as well, considering that the Code should add to rather than repeat existing legislation.

Analysis of rule III.6

Compliance with the next rule (III.6) entails that the supervisory board is responsible for deciding on how to resolve conflicts of interest between the management board (or its individual members) and the company. This can be detected in two text parts within the chapter *Corporate governance*, section 'Appointment, conflicts of interest'. Firstly:

¹³⁹ The Compliance Officer is the General Counsel and the chair of the Compliance Committee.

Decisions to enter into transactions under which Board of Management members would have conflicts of interest that are of material significance to the company, and/or the relevant Board of Management member, require the approval of the Supervisory Board and will be mentioned in the Annual Report.

This text very closely resembles that included in principle III.6, concerning the transactions of supervisory board members that could lead to conflicts of interest. The company used almost the same text, but substituted ‘supervisory board members’ with ‘Board of Management members’. The second relevant text part was found in the section ‘Appointment, independence and composition’, and concerns the first part of principle III.6, related to the transactions of supervisory board members that lead to conflicts of interest and that could be of material significance for the company:

The Supervisory board is governed by its Rules of Procedure, which include detailed provisions on how to deal with conflicts of interest and potential conflicts of interest between members of the Supervisory Board and the company.

Analysis of rule III.6.5

This rule is related to the previous principle (III.6), concerning the issue of potential conflicts of interest between members of the management board and the company. Rule III.6.5 can be identified in the chapter *Corporate governance*, section ‘Appointment, conflicts of interest’, namely:

The handling of (potential) conflicts of interest between the company and members of the Board of Management is governed by the Rules of Procedure for the Board of Management.

Supervisory Board – General Meeting of Shareholders

Analysis of rules III.6 and III.6.5

The rules III.6 and III.6.5 have been partially discussed in the previous communication line. The relevant part of III.6 for this communication line, however, concerns the fact that the supervisory board is also responsible for deciding on how to resolve conflicts of interest between major shareholders and the company. No reference to this could be detected in the 2006 annual report, but it does appear in the Rules of Procedure for the Supervisory Board. Rule III.6.5 is about regulations concerning conflicts of interest that the supervisory board should draw up. In the annual report, only the Rules of Procedure contain rules with respect to handling of conflicts of interest for management board and supervisory board members, as mentioned in the previous section.

Analysis of rules IV.3 and IV.3.5

The next rules are IV.3 and IV.3.5, with respect to the supervisory board’s and management board’s duty to provide the shareholders with equal and simultaneous information of influence on the share price and all possible information, that it requires for the exercise of the powers of the GMS. Corresponding text has been found in the chapter *Corporate governance*, section ‘Relations with shareholders and other investors’, namely:

In conformity with relevant laws and regulations, the company provides all shareholders and other parties in the financial markets with equal and simultaneous information about matters that may influence the share price, thereby taking into account possible exceptions permitted by those laws and regulations.

The quoted text is the same as that in IV.3. The same section in the annual report also emphasizes the value of shareholder relations and the fact that the company uses the Shareholders’ Communication Channel (cf. 8.6.4) to distribute the GMS agenda and to allow shareholders who hold their shares through an associated bank to participate in the proxy voting at the annual GMS. Holders of American Depository Shares are also given the opportunity to vote by proxy, as we have seen previously (cf. 8.6.4).

Rule IV.3.5 concerns the fact that if information requested by the GMS is contrary to an overriding interest of the company, the supervisory board (and management board) will not provide this information. In the 2006 annual report this has been set out in the chapter *Corporate governance*, section ‘Relations with shareholders and other investors’ as follows:

The General Meeting of Shareholders will be provided with all requested information, unless the Supervisory Board and the Board of Management are of the motivated opinion that this is contrary to an overriding interest of the company.

This text makes clear that the essential part of the rule has been adopted, but that not only the supervisory board may refuse to provide the information; so, too, could the BoM, as stated in the Tabaksblat Code.

Analysis of rule IV.3.7

The emphasis on the relationship between the company and the shareholders is also formally determined by rule IV.3.7, which states that the shareholders should be kept informed through the use of a ‘shareholders’ circular’. No reference to this rule could be found in the 2006 annual report, because the ‘shareholders’ circular’ is only required in specific circumstances¹⁴⁰. It can thus be assumed that none of the reasons for establishing a ‘shareholders’ circular’ as mentioned in the rule applied to the case-study company in the year under review.

The interviewee of the case-study company stressed, as we have seen above, the importance of a good relationship with the shareholders. One way to improve and maintain good relationships is the road shows (cf. 9.3.1).

Supervisory Board – External Auditor

Analysis of rule III.6

Rules III.6 and III.6.5 are the relevant rules with respect to this communication line. These rules have been discussed in the section on the communication line between the supervisory and management boards. Rule III.6, however, includes the following text specifically concerning the external auditor:

The supervisory board is responsible for deciding on how to resolve conflicts of interest between management board members, supervisory board members, major shareholders and the external auditor on the one hand and the company on the other.

While the 2006 annual report did not refer to this part of rule III.6 (also cf. previous section, on the communication line *Supervisory Board – General Meeting of Shareholders*), the company’s Rules of Procedure for the Supervisory Board do deal with it explicitly.

CCU management board

Management Board – Supervisory Board

Analysis of rule II.1.7

The company has decided to deviate from the only relevant rule (II.1.7) for this communication line, explaining in the chapter *Corporate governance*, section ‘Appointment, conflicts of interest’ as follows:

The exception to this rule is that in the year prior to their retirement, Board of Management members are allowed to hold more than two supervisory board memberships in order to allow them to prepare for postretirement, as long as this does not interfere with the performance of their tasks as members of the Board of Management. Acceptance of external supervisory board memberships is subject to the

¹⁴⁰ These specific circumstances may include, for example, if a right of approval is granted to the GMS or if the BoM or supervisory board requests a delegation of powers.

approval by the Supervisory Board, which power has been delegated to the Chairman of the Supervisory Board.

Comment on II.1.7

The case-study company interviewee confirmed that the chair determines which tasks are considered to be contrary to the supervisory board members' present tasks. The interviewee explained that two assessments take place before a board member can take up a supervisory board membership at another listed company. The first assessment reveals the potential or future conflicts of interest. If any such conflicts of interest are evident, the membership will be refused; if not, the membership will be approved. The second assessment is conducted by the supervisory board nominee personally, as it is his/her responsibility to guard against conflicts of interest. Should any such conflicts arise, how the relevant members should react depends on the nature of these conflicts. It may be sufficient to simply not attend certain meetings. Thus, the member concerned in fact decides on the steps to be taken. No criteria for determining what is and is not a conflict of interest are available as this is up to the judgement and integrity of the board members. The Rules of Procedure include an entire section concerning conflicts of interest for the protection of governance.

Management Board – Chair of the Supervisory Board

Analysis of rule II.2.6

The first rule, II.2.6, contains the following text with respect to this communication line:

A management board member shall give periodic notice, but in any event at least once a quarter, of any changes in his holding of securities in Dutch listed companies to the compliance officer or, if the company has not appointed a compliance officer, to the chairman of the supervisory board.

We have seen already in the section on the communication line between the supervisory and management boards that the company has decided to deviate from this rule (cf. *Supervisory Board – Management Board*).

Analysis of rule II.3.2

Rule II.3.2 indicates that BoM members should immediately report any existing or potential conflict of interest that is of material significance to the company and/or to themselves to the chair of the supervisory board. As this resembles rule III.6.5 (cf. section *supervisory board - management board*), the same text part in the chapter *Corporate governance*, section 'Appointment, conflicts of interest' applies here.

Management Board – General Meeting of Shareholders

Analysis of rule IV.1

The relevant rule here is IV.1, including that decisions of the management board on a major change in identity or character of the company or enterprise should be approved by the GMS. The relevant text can be found in the chapter *Strategy*, 'General' section:

During 2006, we have been preparing for the separation of [...]. We received [...] strong support at the Extraordinary Shareholders' Meeting in [...].

The cited text shows that the approval of the GMS has been characterized as "strong support". The same D-rule (IV.1) is also part of the communication line *General Meeting of Shareholders – Supervisory Board/Management Board*, whereby the part of the rule stating that "The GMS should be able to assert such influence on the supervisory board policy in order to play an important role in the company's system of 'checks' and 'balances'" applies.

The minutes of the GMS 2007 (i.e. those relating to the 2006 annual report) revealed that the European Works Council had been kept informed. The case-study company interviewee pointed out that the company has an information obligation but not a consultation

obligation with respect to the European Works Council. This information obligation entails that the company should inform the works council of substantial changes involving more than two European countries.

The three remaining rules (IV.3, IV.3.5 and IV.3.7) were discussed in the section on the communication relationship between the supervisory board and the GMS.

CCU general meeting of shareholders

General Meeting of Shareholders – Supervisory Board/Management Board

Analysis of rule III.7

Rule III.7 states that the GMS determines the remuneration of the supervisory board members. The relevant text can be found in the chapter *Report of the Supervisory Board*, section ‘Remuneration Committee’:

In 2006, the Remuneration Committee made recommendations on the remuneration and the remuneration policy of the members of the Board of Management, including personal targets, and made recommendations on the remuneration of the Supervisory Board, which were approved by the Supervisory Board and adopted by the 2006 General Meeting of Shareholders.

One further sentence found in the chapter *Remuneration report*, section ‘Remuneration policy’, states that “This remuneration package is based on a remuneration policy as adopted by the General Meeting of Shareholders [...].” This sentence, however, only refers to the remuneration of BoM members.

Analysis of rule IV.1

IV.1 concerns the powers of the shareholders, stating that:

Corporate governance requires the fully-fledged participation of shareholders in the decision-making in the general meeting of shareholders.

And that:

It is in the interest of the company that as many shareholders as possible take part in the decision-making in the general meeting of shareholders.

Further, this principle refers to the fact that “The company shall, in so far as possible, give shareholders the opportunity to vote by proxy and to communicate with all other shareholders.” The most important part of the principle, however, is that:

The general meeting of shareholders should be able to exert such influence on the policy of the management board and the supervisory board of the company that it plays a fully-fledged role in the system of checks and balances in the company.

Compliance with this principle is reflected in the chapter *Corporate governance*, section ‘Relations with shareholders and other investors’, which describes the relationship with the shareholders and the GMS. The main points of this relationship are:

- A GMS is held each year;
- The agenda and the notes to the agenda are published in advance;
- The GMS decides on adoption of the financial statements, the dividend proposal, and the discharge of the members of the supervisory board and the BoM;
- The GMS is provided with all requested information;
- The Shareholders’ Communication Channel distributes the agenda and allows the shareholders to vote by proxy.

It can be concluded that the case-study company is fully aware of the importance of the GMS and the fact that shareholders should have the opportunity to vote. Further, that the GMS adopts the financial statements and decides on the discharge of the supervisory board and BoM members indicates that the GMS indeed uses its powers. We have seen previously with respect to the monitoring role of the GMS regarding the Rules of Procedure (cf. 9.3.3) that the GMS can be seen in the Netherlands as the highest corporate body, and that not discharging

the supervisory board and BoM is one of the strongest ways¹⁴¹ in which the GMS can express its dissatisfaction and, moreover, use its powers in order to intervene in corporate affairs. The shareholders' powers have been formally laid down in the Articles of Association.

Comment on IV.1

The case-study company interviewee held the view that the Tabaksblat Code has enhanced the shareholders' powers in such a way that an imbalance has arisen between the stakeholders' interests. The interviewee pointed out that companies should put a great deal of effort into providing the shareholders with enough opportunities to vote and exercise their power, and thus the case-study company has enabled proxy voting via the Internet for its shareholders. However, only seven shareholders used this means of voting. The interviewee explained that further steps had been taken to facilitate participation in the GMS and voting at the GMS via the company's website in future. This is yet another example of efforts undertaken by the company, which quite some effort and cost to facilitate an increase in participation in the GMS by shareholders.

Analysis of rule IV.1.1

The case-study company has decided to deviate from provision IV.1.1¹⁴², as stated in the chapter *Corporate governance*, section 'Appointment, conflicts of interest':

Although a deviation from provision IV.1.1 of the Code, the Supervisory Board and the Board of Management hold the view that these provisions will enhance the continuity of the company's management and policies.

The interviewee reformulated the explanation as "The deviation enhances the continuity of the company's management and policy"; thus, the company has deviated from the rule "because in the company's view it is in the company's interest and continuity to deviate".

Comment on IV.1.1

The case-study company interviewee stated that there are not usually binding nominations with respect to the supervisory board and BoM members. The nomination procedure (I) for a new supervisory board member is as follows:

- (1) The Foundation of Priority Shareholders, referred to as the Foundation (cf. 9.3.1), decides not to make use of its binding nomination rights. The Foundation's management consists of the five Supervisory Board members who are not members of the Audit Committee;
- (2) The Supervisory board then, by default (see Articles of Association) puts forward a non-binding nomination proposal.
- (2) The non-binding nomination proposal, as an agenda item, is presented to the GMS for approval;
- (3) The nomination requires an 'ordinary' majority of votes.

Besides this usual procedure, other procedures (II) are also possible¹⁴³.

¹⁴¹ The GMS instruments: (1) suspend or dismiss the supervisory board members, (2) not providing discharge, (3) asking questions about compliance with the Rules of Procedure, (4) using road shows to express their concern or dissatisfaction.

¹⁴² Including that a company that does not have a two-tier board may pass a resolution to cancel the binding nature of a nomination for the appointment/dismissal of a supervisory board member.

¹⁴³ Namely: (1) The proposed non-binding nomination is not approved, and a vacancy arises; (2) A shareholder may propose a nominee, in which case the nomination procedure is as follows: (a) The nominee should be presented in a timely manner; (b) The shareholder should request that the company make the nomination proposal a voting item; (c1) The company may refuse to include the nomination proposal as an agenda item if this were not in the interests of the company; (c2) If the nomination proposal is made an agenda item, the nomination is only approved if at least 2/3 of the votes represent more than half of the issued capital. This means at least 2/3 of the shareholders need to apply for the GMS, and in the vote 100% of these must represent half of the issued capital (this is a cumulative requirement).

The non-binding nomination proposal by the company's Foundation (I, 1) requires a 'normal' majority of votes. If a situation arises in which the corporation requires protection, the Foundation could propose a binding nomination, which the GMS cannot refuse. The GMS makes a nomination, but it is principally the supervisory board that makes a proposal based on the Foundation's advice. Thus, the shareholders make their nomination on the non-binding recommendation of the supervisory board members. Only in an extraordinary situation can a binding nomination be made, which the GMS should accept. An extraordinary situation could be a hostile takeover, for example, but the supervisory board and BoM decide on whether a situation is to be considered extraordinary. Since the Board of the Foundation consists of supervisory board members who are not audit committee members, and the Foundation is a holder of 'priority shares' – and, in turn, the meeting of holders of 'priority shares' has nomination rights *and* the right to approve amendments to the Articles of Association – this means that the supervisory board (or the representatives of it, i.e. the Foundation) ultimately makes both binding and non-binding nominations for BoM and supervisory board members.

Analysis of rule IV.6

The last relevant rule (IV.1.6) includes the resolution to approve the policy of the management board as well as the supervision exercised by the supervisory board, which shall be voted on separately in the GMS. This has, of course, not been found in the annual report, but appears on the agenda of the 2007 GMS (cf. Figure 8.6) and in the minutes of the 2007 GMS, indicating that 99.71% voted to discharge the BoM and 99.70% voted to discharge the supervisory board. The interviewee also confirmed that the discharge takes place separately.

General Meeting of Shareholders – External Auditor

The only relevant rule here is V.2.1, which states that the external auditor may attend the GMS to clarify his/her statement on the fairness of the annual accounts. This rule is reproduced in the following text from the chapter *Corporate governance*, section 'Auditors':

The lead auditor is present at the General Meeting of Shareholders and may be questioned with regard to his statement on the fairness of the financial statements.

To sum up

The case-study company deviates from three provisions (II.2.6, II.1.7, and IV.1.1). The company's compliance with one principle (IV.1) is somewhat unclear.

Compliance with III.6 with respect to the communication lines *Supervisory Board – GMS* and *Supervisory Board – External Auditor* is not evident in the annual report, but is included in the Rules of Procedure.

The discharge of the supervisory and management boards should be separate voting points at the GMS (IV.1.6); naturally, this was not included in the annual report, but can be identified in the 2007 GMS agenda and minutes.

Finally, compliance with IV.3.7 (shareholders' circular) is not indicated in the annual report because none of the reasons for establishing such a circular applied to the case-study company in the year under review.

9.4 Text-external factors – Discursive practices

(a) Choice of genre

The case-study company had no choice of genre, since the 2006 Dutch annual report is a legal obligation (cf. 8.1.2). The 2006 annual report consists of many chapters (cf. Appendix F),

which could perhaps be considered genres or sub genres (cf. 6.9.1). This makes it a very complex genre network, as it not only consists of, for example:

1. The Chairman's statement;
2. The following reports:
 - a. Report of the Board of Management;
 - b. Report of the Supervisory Board;
 - c. Remuneration report; and
 - d. Auditor's report,

but also includes many references demonstrating compliance with the annual report requirements according to the Tabaksblat Code, as we saw in 9.3 on the structure of the annual report process. This intertextual aspect is elaborated further in 9.10.

(b) Communication mode

The communication mode of the annual report-related A- and B-rules is, as described in 6.9.1, formal, official, and neutral. The case-study company indeed uses this formal and official language, although the communication mode is not considered to be neutral since the annual report is a product of the case-study company.

Some interesting features with respect to the formulation of the annual report rules within the 2006 annual report are worth noting. First, any frequent absence of the supervisory board members should be announced in the annual report. The case-study company, however, has chosen to formulate its reference to this rule in a positive sense, as:

All meetings were [...] well-attended by all Supervisory Board members.

Second, rule III.1.9 requires the supervisory board to obtain information from the management board. The annual report includes explicitly that the board of management informed the supervisory board:

The Board of Management keeps the Supervisory Board regularly informed of intended changes and appointments of senior managers.

Third, the principle Determination and Disclosure of Remuneration has been reproduced exactly in the annual report:

The Supervisory Board's Remuneration Committee prepares all relevant information and provides advice to the Supervisory Board on all matters relating to the remuneration and other conditions of employment of the Board of Management.

Fourth, possible transactions of supervisory board members that could lead to conflicts of interest should be mentioned in the annual report. The case-study company referred to this – very formally – as follows:

[...] no transactions responsive to this item were conducted in 2006.

Fifth, the reference to the independence of the supervisory board members – from which the case-study company has chosen to deviate – has been formulated somewhat illogically, as the company is “formally not in compliance with Code provision III.2.3”, but:

All Supervisory Board members meet the independence requirements as stated in the Code [...], except for [two members].

Related to this is the formulation that each member “should be considered as an independent Supervisory Board member”, while the case-study company has its own perception of independence.

Finally, some references to norms¹⁴⁴ include explicit references to, for example, the Tabaksblat Code and Dutch law. Most of these appear in the chapter *Auditor's Report*.

¹⁴⁴ Determination and Disclosure of Remuneration principle; II.2.10; III.2.3; IV.3.9.

9.5 Text-internal factors

9.5.1 Situational context

The context has been divided into the immediate context, which directly influences the genre concerned, and the wider context, which influences the genre more indirectly (cf. 2.3).

With respect to the annual report process, the case-study company interviewee (cf. 9.2) distinguished between a small circle and a large circle as part of the immediate context.

The case-study company's small circle consists of the people responsible for compiling¹⁴⁵ one or more chapters. Although the external auditor is not formally part of the small circle, the auditor should provide one of the most important parts of the 2006 annual report – namely, the Auditor's report including the Auditor's statements. The large circle consists of all participants involved in the annual report process. The people in the small circle do not correspond with CCUs contributing to the annual report as mentioned in Chapter 6, as the contributors were the supervisory board, management board, and external auditor. However, the people belonging to the small circle influence the annual report genre directly, and are therefore part of the immediate context. In addition, the annual report A- and B-rules (the annual report norms) are part of the immediate context as well.

Further, sub chapter 9.2 showed that the case-study company needs the support of many more individuals, departments, committees, and documents – whether or not as a consequence of internal or external rules – in order to be able to comply with the annual report rules. The first supporting element mentioned with respect to the annual report-related A- and B-rules is the Performance and Development (P&D) Dialog¹⁴⁶, an appraisal system for all employees.

Other supporting elements have been described with respect to the CCU Management Board and its obligation to “declare in the annual report that the internal risk management and control systems are adequate and effective” (II.1.4), namely:

- (1) The company's Risk Management framework;
- (2) The risk boundaries, governed by:
 - (a) Company Statement;
 - (b) Business Principles;
 - (c) Internal Authority Schedules;
 - (d) Corporate Directives;
 - (e) Business Planning & Review Cycle ('rolling forecast');
 - (f) Contingency plans;
 - (g) System of controls; and
 - (h) System of Letters of Representation.

The case-study company uses a risk management process in which a small group of people (cf. 9.3.1) uses a specific program to map any risks detected, and subsequently assesses them. All these supporting elements are related to the COSO Enterprise Risk Management framework.

Further, the Compliance Committee and the Code of Conduct – both consequences of the external rules (US FCPA) to prevent bribery – not only play a supporting role, but are also of major significance when it comes to compliance across the entire company. The Compliance Committee is also important with respect to the complaints procedure (cf. 9.3.1)

¹⁴⁵ Responsible persons: CEO, Financial Reporting manager, Audit Committee chair, Board of Management members, secretary to the Board of Management, HR manager, CSR manager, and Investor Relations manager.

¹⁴⁶ CCU SB, II.2.12

and the Compliance Focal Points, which have been established in order to create overall compliance. Another supporting element¹⁴⁷, again related to the Compliance Committee, concerns the case-study company's 'competition law compliance program' (cf. 9.3.1), which is an interactive digital program, and the company's 'Competition law compliance manual'. The company's credit rating and CSR rating (and its CSR report) could be considered supporting elements too, since both¹⁴⁸ are risk-prevention measures which enable the BoM to declare that the internal risk management and control systems are adequate and effective.

In addition, the company's Foundation¹⁴⁹, consisting of holders of priority shares, can be seen as a supporting element given that the case-study company interviewee considered it to be a protection measure.

Finally, the IFRS and the Dutch Civil Code are external rules that are also to be seen as supporting elements, as they require the external auditor to establish his/her Auditor's report. The following figure presents the small circle:

	Small circle (incl. annual report-related A- and B-rules)	
Supporting elements	Persons responsible for compiling one or more chapters	Chapters/sections/text parts
(see above)	CEO	1. Chairman's statement 2. Strategy
	Financial Reporting manager (part of Controlling Department)	1. Report of the BoM (excl. 'Internal controls' 2. Financial Statements
	Legal Department	Risk management
	BoM members	1. BU chapters 2. Pages about product groups
	Secretary to BoM	1. Report of the Supervisory Board 2. Corporate governance 3. Remuneration committee report
	HR manager	HR part ('Our people')
	CSR manager	CSR report
	Investor Relations manager	Share price
	External auditor	Auditor's report

Figure 9.2: Context small circle

Figure 9.2 shows that the annual report norms are supported by a variety of elements, namely the responsible persons and 'their' annual report chapter(s), and the relevant supporting elements. These latter elements are divided into several groups:

- (1) The Risk Management Framework, which covers four groups – systems, documents, risk management process, and legislation – each with their own sub divisions;
- (2) The P&D Dialog;
- (3) The Code of Conduct;

¹⁴⁷ II.1.5

¹⁴⁸ Like all supporting elements described with respect to the analysis of and comment on rules II.1.4 and II.1.5.

¹⁴⁹ IV.3.9

- (4) The Compliance Committee, which has been sub divided into people, documents, and program, each with their own sub divisions as well.

The supervisory board is not responsible for an annual report chapter, but it does play a significant role in that it ultimately approves the annual report before publication. The small circle's supporting elements consist of internal rules, namely the:

- Company Statement;
- Business Principles;
- Internal Authority Schedules;
- Corporate Directives;
- Contingency plans;
- CSR report;

and external rules, namely the IFRS accounting rules and the Dutch Civil Code. While the system of Letters of Representation and the complaints procedure are consequences of US legislation (SOX), as are the Compliance Committee and the Code of Conduct (FCPA), and the company's Risk Management Framework (which is based on the COSO ERM framework), all five of them have been established within and by the case-study company, and are thus influenced by the ideas, insights, and needs of the company.

The large circle includes the coordinators of the annual report process, namely the Communication Department supported by the Steering Committee (cf. 8.5), and the annual report participants discussed in 8.5 (13 corporate bodies¹⁵⁰ consisting of at least 33 individuals). We have seen that the participants include the responsible persons. Since the case-study company should comply with the relevant annual report rules according to the Tabaksblat Code, the CCU Supervisory Board (including its committees) can be seen as a significant annual report participant too, specifically because it supervises the BoM and, for example, adopts policies and regulations. All these participants and coordinators are thus part of the larger circle, and have direct and/or indirect influence on the annual report process. The large circle, however, is itself supported by further aspects; that is, the company's compliance with the C- and D-rules.

Large circle					
C-rules	AR responsible persons	AR participants		AR coordinators	D-rules
	Cf. Fig. 9.2	Corporate staff incl. secretary to BoM	13 BU managers	Communication Department	
		Controlling Department	CSR manager	Steering Committee	
		Intellectual Property manager	Financial Department		
		BoM; CEO, CFO, 2 members	Legal Department		
		External auditor	HR manager		
		Investor relations	Communication Department		
		Tax Department			

¹⁵⁰ 13 corporate bodies: corporate staff (including secretary to the Board of Management); CEO, CFO, and two other Board of Management members; all 13 BU managers; the external auditor(s); six employees from the Controlling Department (including Financial Reporting section); the HR manager; the CSR manager; the Legal Department; the Investor Relations Department; the Communication Department; the Intellectual Property director; the Tax Department; and the Financial Department.

Figure 9.3: Large circle

The C- and D-rules have been sub divided again into supporting aspects. For the C-rules, these aspects can be divided into documents (the Articles of Association, the Engagement Letter, and the Supervisory Board evaluation form) and policies (the Auditor's Independence Policy and the Audit Committee Pre-Approval Policy on Audit, Audit-Related, and Non-Audit Services). For the D-rules, the supporting elements consist of processes (i.e. the proxy voting process, in which the Shareholders' Communication Channel plays an important role), and documents (i.e. the shareholders' circular – which in fact was not relevant for the 2006 annual report – and the 2007 GMS minutes and agenda).

The large circle covers internal rules that have been established by the case-study company as a consequence of external rules. The Articles of Association, for instance, should be established in accordance with Dutch legislation, and they include the Supervisory Board's Rules of Procedure, which in turn contain the charters of the supervisory board's committees as well as rules concerning conflicts of interest. Further, the Articles of Association include the Rules of Procedure for the Board of Management, which themselves contain the Rules on Inside Information and rules concerning conflicts of interest. The exact content of the Articles, however, is an internal company issue.

The Engagement Letter is a US legislation obligation, and particularly concerns the company's audit committee and the external auditor's accounting firm. It could be considered a kind of contract, the content of which depends on the contracting parties.

The Supervisory Board evaluation form is based on the Tabaksblat Code requirement that the supervisory board should evaluate:

- (1) Itself;
- (2) The Supervisory board as a group;
- (3) The individual Supervisory Board members; and
- (4) The chairman of the supervisory board.

Thus, the fact that evaluations must take place is the consequence of external rules, but the actual content of those evaluations may vary. However, Appendix G shows that the content used by the case-study company is very similar to the content of the relevant Tabaksblat Code rules.

Likewise, the policies are mainly a consequence of the SOX, but the case-study company determines their actual content. The publication of the 2007 GMS minutes is a Tabaksblat Code requirement¹⁵¹.

The Shareholders' Communication Channel is itself not the result of an external rule; however, the fact that the case-study company should enable shareholders to make use of proxy voting is an external rule (Tabaksblat Code¹⁵²).

The meetings of the supervisory board, audit committee, and BoM, and the documents related to these meetings (cf. 8.6), for example the agenda and minutes, can all be considered part of the larger circle too, although they have not been presented as separate items in the relevant figures above.

¹⁵¹ IV.3.8: The report of the general meeting of shareholders shall be made available, on request, to shareholders no later than three months after the end of the meeting, after which the shareholders shall have the opportunity to react to the report in the following three months [...].

¹⁵² IV.1: Powers. Principle: Good corporate governance requires the fully-fledged participation of shareholders in the decision-making in the general meeting of shareholders. It is in the interest of the company that as many shareholders as possible take part in the decision-making in the general meeting of shareholders. The company shall, in so far as possible, give shareholders the opportunity to vote by proxy and to communicate with all other shareholders.

The case-study company interviewee pointed out (cf. 8.3) that each rule has an internal and an external aspect. He categorized the internal and external rules as follows:

- (1) External rules, namely basic governance rules consisting of law, Articles of Association, and the Dutch Civil Code; and
- (2) Internal rules, whereby the Corporate Directives are a ‘must’ and the policies a ‘want’.

The above description of the annual report context has made clear that this context is highly complex, with the immediate context consisting of the small and large circle, and the wider context involving the relevant external rules. We have seen that the internal and external rules are in fact interrelated¹⁵³, as shown in the following figure, which demonstrates the complexity of the context of the annual report genre network:



Figure 9.4: Annual report context

9.5.2 Communicative purpose

The 2006 annual report is a legal obligation¹⁵⁴ (cf. 8.1.2), and Figure 8.1 presented all related legal requirements. The communicative purpose, according to Dutch law, should be transparency, especially regarding the annual accounts, the financial state of affairs, the company’s risks and uncertainties, and future expectations. In short, the annual report could be regarded to be a particularly shareholder-oriented document.

The Tabaksblat Code, in contrast, considers transparency to be part of good entrepreneurship, because it relates to transparency in managerial decision-making and across the entire system of ‘checks’ and ‘balances’. In the chapter *Report of the Supervisory Board*, section ‘Financial statements and dividend proposal’, the case-study company mentions that the 2006 financial statements have been discussed by the full supervisory board with the full BoM, in the presence of the auditors, and that the supervisory board believes – based on these discussions – that the financial statements “meet all requirements for correctness and transparency and that they form a good basis to account for the supervision provided”. This makes clear that transparency is principally related to the annual accounts and thus corresponds with legislation, but that it also relates to the right ‘checks’ and ‘balances’: the discussions about the financial statements have been described as a “good basis to account for the supervision provided”, which is the basic element of the Dutch corporate governance system (cf. 3.5) given that the supervisory board should monitor the management board on behalf of the shareholders (cf. 4.4.1).

¹⁵³ The boundary between the immediate context and the wider context is, due to their interrelationship, not expected to be as clearly visualized in practice as in Figure 9.4.

¹⁵⁴ As are the annual accounts and the auditor’s report.

The communicative purpose of the 2006 annual report is thus transparency. Since the annual report is a genre network, the overall communicative purpose of the separate texts/genres can be expected to be transparency as well.

9.5.3 Move structures and themes

Move structures

The majority of the relevant move structures with respect to the annual report-related A- and B-rules as prescribed by the Tabaksblat Code (cf. 6.9.1) could be detected in the 2006 annual report, with only few deviations (cf. 9.3.1). The A-rule deviations from the required move structures concern rule II.1.4, and one content element (H) of II.2.10. Further, with respect to rules II.3.4 and III.6.3 on potential supervisory board and management board transactions, the case-study company declares the non-existence of such transactions (cf. 9.3.1). Regarding the B-rules, the company failed to mention the gender and age of each supervisory board member explicitly (III.1.3). The move structures with regard to rules III.1.7 and III.1.8 correspond with those mentioned in section 6.9.2.

Themes

Each of the annual report-related rules (cf. 6.9.2) has been linked with a specific corporate governance theme. The case-study company complies with the majority of the rules, which means that these rules have the corresponding theme as revealed in Chapter 6. However, the company deviates from rules II.2.7 (and therefore perhaps also II.2.10) and III.2.1 (cf. 9.3.1 and 9.4). Further, compliance with respect to III.5.3 is not completely clear. These three rules belong to the ‘corporate governance structure’ theme, and thus do not occur in the 2006 annual report.

9.5.4 Intertextual aspects

Sub chapters 9.3–9.5 have shown that the 2006 annual report is a very complex genre network. References to compliance with the required annual report-related rules could be found in many different chapters and sections of the 2006 annual report. The complexity of the genre network is a result of three different levels of interrelations, varying from (1) a more general level, where the norms occur in different chapters, to (2) the detection of norms in different sections, and (3), the most detailed level, where the description of compliance includes an external reference.

The first and second levels of the intertextual aspects are shown in the overview of annual report-related A- and B-rules presented in figures 9.5–9.7. These includes only the relevant chapters and sections of the 2006 annual report.

Chapter Section	Supervisory Board	SB report	Corporate governance	Remuneration report	Auditor's report
	B-III.1.3	B-III.1.2		A-Determination and Disclosure of Remuneration principle	B-V.4.3
Committees					
AC/RC/NC		A-III.5.3			
Remuneration			A-II.2.7 explanation deviation		
Appointment, independence, and composition			III.2.1 (III.2.2 and III.2.3) explanation deviation		
Antitakeover provisions and control			B-IV.3.9		
SB activities		B-III.1.5 B-III.1.7 B-III.1.8			
Financial Statements and dividend proposal		B-III.1.7			
SB composition		A-III.5.2			

Figure 9.5: Intertextual aspects 1

Chapter Section	Remuneration report
General	A-Determination and Disclosure of Remuneration principle A-II.2.10 A (statement) A-III.5.10
Remuneration policy	A-Determination and Disclosure of Remuneration: remuneration policy A-II.2.10 A (explanation) A-II.2.10 C (composition) A-II.2.10 E (description and summary) A-II.2.10 F (summary) A-II.2.10 G (description)
Remuneration in 2006	B-II.2.9 A-II.2.12
Employment agreements	A-II.2.7 (explanation of deviation) A-II.2.10 B (explanation) A-II.2.10 D (summary) A-II.2.10 I A-II.2.10 J
Pensions	A-II.2.10 I

Figure 9.6: Intertextual aspects 2

Section	Chapter	BoM report	Risk management	Financial Statements
Former BoM members				A-II.2.12
Related party transactions				A-III.6.3 A-II.3.2
Unidentified risks are a threat; identified risks are a managerial issue			A-II.1.4	
Major risk factors			B-II.1.5	
Internal controls		A-II.1.4 A-II.1.2		

Figure 9.7: Intertextual aspects 3

The overviews show that the annual report norms can be identified in a total of 8 out of 19 chapters¹⁵⁵ and in 18 different sections. Two occur twice in different chapters and/or in different sections of the same chapter: III.1.7 appears in the chapter *Report of the Supervisory Board* in the sections ‘Supervisory Board activities’ and ‘Financial statements and dividend proposal’; while II.1.4 appears in the chapter *Report of the Board of Management*, section ‘Internal controls’, as well as the chapter *Risk management*, section ‘Unidentified risks are a threat; identified risks are a managerial issue’. One rule (II.2.10) can be found in the chapter *Remuneration report* with its individual content elements located in separate sections, namely ‘General’, ‘Remuneration policy’, ‘Employment agreements’, and ‘Pensions’. For rule II.2.10, some of the content aspects in fact appear in two different sections: II.2.10 A can be found in the sections ‘General’ and ‘Remuneration policy’, while II.2.10 I appears in the sections ‘Employment agreements’ and ‘Pensions’.

The third level of complexity with respect to the intertextual aspects concerns both internal and external references to certain annual report rules, as explained below.

Internal references

These can be sub divided into two groups. The first is internal references which themselves include an internal reference. For example, II.1.7 and II.1.8 refer to the discussions on the financial statements that the supervisory board had together with the BoM in the presence of the external auditors, and that the audit committee had with the auditors in the presence of the CEO and CFO. The second group of internal references is those including an external reference. For instance, several rules refer to the Tabaksblat Code¹⁵⁶, and one rule refers to the IFRS and the Civil Code¹⁵⁷.

External references

External references to the corporation’s own regulations and discussions can also be identified, mainly in the reference to rule II.1.4 in the annual report. These include references to:

1. The company’s Risk Management framework;
2. The Company Statement;
3. The Business Principles;

¹⁵⁵ The separate chapters are: *Company’s overview*, *Key developments*, *Shareholder information*, *Chairman’s statement*, *Strategy*, *Report of the Board of Management*, *Supervisory Board*, *Report of the Supervisory Board*, the text parts on the four different BUs, the HR chapter covering three different chapters, *Risk management*, *Corporate governance*, *Remuneration report*, and the *Financial Statements* including the Auditor’s report.

¹⁵⁶ Principle Determination and Disclosure of Remuneration; rules II.2.10 (D), III.2.1, and IV.3.9

¹⁵⁷ Rule V.4.3

4. The Internal Authority Schedules;
5. The Corporate Directives;
6. The Business Planning & Review cycle; and
7. Discussions about issues concerning risk management and control systems with the Supervisory Board, the external auditor(s), and the Audit Committee

Further, rule II.1.2 included references to:

1. The Business Principles;
2. The Corporate Directives;
3. The Internal Authority Schedules;
4. Risk management systems;
5. Control systems;
6. The Letters of Representation.

The only company-external reference concerned the COSO framework.

Broadly speaking, the foregoing serves to illustrate the obvious complexity of the 2006 annual report as a genre network.

9.6 Summary

This chapter provided the answer to sub question III.1: how do the 2006 annual report's structure and content reflect the adjustments as required by the Tabaksblat Code? In doing so, it analyzed the case-study company's 2006 annual report, supported by the information from the in-depth interviews with the case-study company interviewee and the auditing firm representative. The interviews and the analysis allowed for determination of whether the requirements of the Tabaksblat Code with respect to the generic integrity of the Dutch annual report could be identified. The aspects of generic integrity cover both the text-external and text-internal factors, as summarized below.

Text-external factors

This chapter has shown that the annual report contributors as mentioned by the Tabaksblat Code are not the same as those involved in the case-study company's 2006 annual report. Whereas the Tabaksblat Code identifies the CCU Supervisory Board, CCU Management Board, and CCU External Auditor as the contributors, many more participants (i.e. 14 corporate bodies) are in fact involved as the responsible persons for one or more annual report chapter(s). Whereas the Tabaksblat Code sees the CCU Supervisory Board as responsible for its own report, in the case-study company the secretary to the BoM is in fact responsible to compile for that chapter. Further, the management's statement should be included in the *Report of the Board of Management*, which is indeed the case within the company under review; however, this chapter in practice falls under the responsibility to compile of the Financial Reporting manager, and the section 'Internal controls', in which the statement appears, is the responsibility of the Board of Management

As shown above, the structure of the annual report process is highly complex and extended. Sub chapter 9.3 examined compliance with the three groups¹⁵⁸ of Tabaksblat Code rules, and showed that the case-study company deviates from two A- and B-rules. The first deviation concerns II.2.7, on the maximum severance pay for BoM members. Since this rule is included in II.2.10, it is questionable whether the case-study company in fact complies with

¹⁵⁸ Group A/B includes the annual report-related A- and B-rules; group C includes the A-rules that are not part of the first group, but that influence the annual report process directly; and group D includes the remaining A-rules that have an indirect influence on the annual report process.

II.2.10. The case-study company interviewee stated that there are no criteria for determining severance payment, and the GMS only approves the remuneration policy.

The second deviation concerns III.2.1, on the independence of supervisory board members. References to the annual report-related A- and B-rules could not always be found in the text parts as required by the Tabaksblat Code.

According to the case-study company interviewee, risk management is very important with respect to the annual report-related rules. The annual report provides explanations of many risk-prevention measures¹⁵⁹.

With respect to the C-rules, compliance with principle I is unclear, and compliance with III.1.1 is demonstrated not in the annual report but in the Rules of Procedure.

The annual report includes an implicit reference to compliance with III.1.9.

The case-study company does not comply with D-rules II.2.6, II.1.7, and IV.1.1. Evidence of compliance with III.6 was found not in the 2006 annual report, but in the Rules of Procedure. Compliance with IV.1 is somewhat unclear. Further, compliance with IV.1.6 was demonstrated in the 2007 GMS agenda and minutes but not in the annual report. Finally, compliance with IV.3.7 is not applicable.

The case-study company had no choice in terms of genre, since the annual report – as well as the annual accounts and the auditor's report – is a legal obligation. Contrary to the Tabaksblat Code requirements, the communication mode is formal and official, but not neutral, in that the annual report is a genre product of the case-study company. The formulations with respect to the content of the rules vary from company-own formulations, to exact reproductions of rules as formulated in the Tabaksblat Code. Further, some formulations include implicit or explicit references.

Text-internal factors

The context encompasses the immediate and the wider context. Within the immediate context, the case-study company interviewee distinguished between a small and a large circle. The small circle includes the persons responsible for compiling one or more annual report chapter(s) (cf. Figure 9.2) as well as supporting elements (e.g. the P&D Dialog appraisal system) that enable the company to comply with the annual report-related rules. The large circle again includes the persons responsible for annual report chapters, but also the annual report process coordinators and the annual report participants. It further includes supporting elements enabling compliance with the C- and D-rules (cf. Figure 9.3), and internal and external rules (the latter in fact being part of the wider context). The immediate context (small and large circle) and the wider context (external rules) are strongly interrelated.

The communicative purpose is transparency, which is principally related to having the right 'checks' and 'balances'.

The majority of the move structures with respect to the annual report norms were present. However, the report deviated from II.2.10 H, and the move structures concerning II.3.4 and III.6.3 were substituted by a statement of 'non-existence'. Finally, III.1.3 did not include the move structures 'age' and 'gender'.

The themes related to the annual report-related A- and B-rules with which the case-study company complies were all present in the 2006 annual report.

The annual report-related A- and B-rules were detected in 8 out of 19 annual report chapters and in 18 different sections. The complexity of the genre network is a result of three different levels of interrelations varying from a more general level, where the norms occur in

¹⁵⁹ Risk-prevention measures: system of controls, Letters of Representation, contingency plans, Company Statement, Business Principles, Internal Authority Schedules, Corporate Directives, Business Planning & Review Cycle, CSR, and credit rating.

different chapters, to the detection of norms in different sections, and finally the most detailed level, where the description of compliance includes an external reference.

The detailed analysis of the case-study company's 2006 annual report as included in this chapter showed that the company complies with the majority of the rules, and it may thus be concluded that formal transparency has been achieved. While the company deviated from certain important rules (concerning, for example, the independence of the supervisory board members and the severance payments), the Tabaksblat Code does not prioritize the rules; it merely indicates that you need to either comply or explain why you are not in compliance. Further, the Tabaksblat Code itself is sometimes unclear with respect to what companies should do (e.g. regarding the variable part of the remuneration).

Analysis of 2006 Annual Report on Form 20-F – Sarbanes-Oxley Act

10.1 Introduction

This chapter includes the comparison of the ‘ought’ situation with the ‘is’ situation with respect to the case-study company’s 2006 Annual Report on Form 20-F. Therefore, this chapter shows whether the text-external and text-internal factors that determine the integrity of the US Form 20-F genre according to the Sarbanes-Oxley Act (SOX) (cf. Chapter 7) – and thus together construct the ‘ought’ situation – can be identified in the case-study company’s 2006 Annual Report on Form 20-F. If the ‘is’ situation corresponds fully with the ‘ought’ situation, the case-study company’s 2006 Annual Report on Form 20-F can be considered to demonstrate the integrity of the US Form 20-F genre network, implying that formal transparency has been achieved. If all Dutch cross-listed companies’ Forms 20-F would demonstrate the required integrity, the US ‘good governance’ will have been accepted and thus will ‘good governance’ be institutionalized. This chapter thus covers the following sub question:

- III.2 How do the 2006 Form 20-F’s structure and content reflect the adjustments as required by the Sarbanes-Oxley Act?

The next section describes the structure of the case-study company’s 2006 Annual Report on Form 20-F, and any notable issues with respect to this structure.

Structure of the 2006 Annual Report on Form 20-F

The US annual report differs from the Dutch annual report, as Form 20-F is in fact an extended form that has to be filled in by the corporation concerned. Instructions to the Items, which together specify the structure of Form 20/F, and certain content elements or texts are obligatory, and are printed within the Form. The Form is available from the SEC website under ‘1934 Act – Forms’, ‘20-F Registration statement/Annual report/Transition report’. Rather than printing the Form, companies are required to file it electronically using the Electronic Data Gathering and Retrieval System (EDGAR).

Form 20-F consists of three parts. Of these, the first involves 12 items (with Item 4 having a separate Item 4A), the second contains items 13 to 16E, and the third consists of items 17 to 19 (with the latter including the exhibits). As stated above, the Form includes instructions on how to fill it in¹⁶⁰, and since the case-study company uses the form as its annual report, the following instruction is especially important:

An annual report on this Form must include the information specified in the Parts I, II and III. [...]. In some cases, the instructions may permit you to omit some of the information specified in certain items in Part I. The instructions also may permit you to omit certain information if it was previously reported to us and has not changed. [...]. (Form 20-F, p.5)

Although filling in items 17 and 18 is optional, the instructions to the Financial Statements encourage corporations to indeed complete Item 18:

[...]. We encourage you to provide the financial statements and related information specified in Item 18 of this Form in lieu of Item 17, but the Item 18 statements and information are not required. [...]. Consult those Securities Act forms for the specified requirements and consider the potential advantages of complying with Item 18 instead of Item 17 of this Form. [...]. (Form 20-F, p. 5)

¹⁶⁰ The blank Form 20-F will henceforth be referred to as ‘Form 20-F (original version)’.

Further, the instructions emphasize that the Financial Statements should be audited in accordance with US:

generally accepted auditing standards and the auditor must comply with the U.S. standards for auditor independence. (Form 20-F, p.5)

The case-study company chose to fill in Item 18, as it indicated by checking the item in the first two pages of Form 20-F.

Very broadly speaking, the analysis of the case-study company's 2006 Annual Report on Form 20-F showed some interesting characteristics. The Introduction includes, for example, a cautionary statement concerning "certain forward-looking statements" with respect to the financial condition, results of operations and businesses of the company, and certain plans and objectives with respect to these items, including the following text:

These statements may generally, but not always, be identified by the use of words such as 'anticipate', 'assure', 'intend', 'plan', 'project', 'should', 'expect', 'estimate', 'believe'.

And further:

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future.

The next element concerns Item 3 *Key Information*, specifically D *Risk Factors*. The instruction to part includes that "risk factors should be concise and explain clearly how the risk affects the issuer or the securities". The introduction to part D then refers to the abovementioned cautionary statement. Further, the case-study company stated that:

Risk management is also one of the essential elements of the company's corporate governance

And:

This calls for creating a proper balance between entrepreneurial attitude and risk levels associated with business opportunities

And finally:

We foster a high awareness of business risks and internal control procedures, geared to safeguarding transparency in our operations

The risks have been divided into external risks, strategic decision-making risks, and internal risks. All risks and their consequences have been described in detail, for example Item 11 *Quantitative and Qualitative Disclosures about Market Risk* describes the 'Foreign Currency Exchange Risk Management' and 'Interest Rate Risk Management'.

Item 4 *Information on the Company* covers a full 43 pages. The instructions on Form 20-F (original version) state that the purpose of this item is:

To provide information about the company's business operations, the products it makes or the services it provides, and the factors that affect the business.

Further, this item is:

Intended to provide information regarding the adequacy and suitability of the company's properties, plants and equipment, as well as its plans for future increases or decreases in such capacity.

The case-study company's Form 20-F mentions in the relevant item that correspondence with respect to the Annual Report on Form 20-F should be directed to the Company Secretary, whereas in the US it is the General Counsel who is authorized to receive notices and communications from the SEC. This distinction is remarkable and seems to be based on the distinction between SEC and non-SEC correspondence. Since the SEC's remarks might be considered to be of a more ominous nature, not the Dutch General Counsel but the US General Counsel is considered to be the obvious person to respond adequately to the SEC's communications.

One of the most interesting remarks included in Item 4 *Information on the Company*, 'Government Regulation' is that the case-study company emphasizes that it should comply with rules "both at national and local levels" and that the company "also voluntarily conforms

to a number of international and national codes of conduct". It is unclear whether the latter codes of conduct include the Dutch Corporate Governance Code, but if that were the case, the phrase "voluntary conforms to" is interesting to say the least.

The instruction to Item 5 states that the purpose is to provide information that is necessary for an investor's understanding of the company's financial condition, changes in financial condition, and results of operations.

The next item, Item 6 *Directors, Senior Management and Employees*, should, according to the instructions, provide information about the directors and managers in order to "allow investors to assess such individuals' experience, qualifications, and levels of compensation". This item starts with in-depth information under the title 'Corporate Governance' concerning the nature of the Tabaksblat Code, deviations from the Code, the role and tasks of the supervisory board and the Board of Management (BoM), compensation, board practices (including the content elements of the Rules of Procedure, Code of Conduct, and complaints procedures), and a summary of significant differences between Dutch corporate governance practices and the US stock exchange corporate governance standards. The latter section describes the US requirement that the annual report's audited financial statements should be sent by the corporation to the shareholders. The case-study company explains that because:

Shares in Dutch listed companies are often bearer shares [...], and because these shares are held by securities intermediaries, Dutch listed companies do not always know who their shareholders are [which] prevents the distribution of materials to shareholders.

It is then pointed out that the case-study company was one of the key companies in the establishment of the Shareholders' Communication Channel to enable communication between companies and their shareholders, and among the shareholders themselves (cf. Chapter 8.6.4). Item 6 contains many phrases that also appear in the case-study company's 2006 Dutch annual report. This makes clear just how closely the US annual report and the Dutch annual report are interrelated.

One of the purposes of Item 7 is to provide information to major shareholders and "others that control or may control the company". This formulation could be regarded to be stressing the view that shareholders control the firm. We saw in Chapter 3 (cf. 3.3 and 3.4.2) that the US corporate governance system is an outsider system, and the ideal outsider system is characterized by external control by outside shareholders who are well-informed, which enables the shareholders to monitor and discipline the management. The shareholders are thus to be seen as 'market forces' that may use the 'exit strategy' as a disciplinary measure in the case of mismanagement. The shareholders in the ideal outsider system hold a central position in the values and norms of society, in the legal rules, and in the specific institutional organizations, but they regard the company primarily as a 'product' which can be sold and bought.

Item 10 *Additional Information* mainly concerns the content of the Articles of Association. Sub section E 'Taxation' includes several cautionary statements to investors that they should consult their own tax advisor regarding tax consequences.

One of the most significant items is Item 15 *Controls and Procedures*. This includes 15.A *Disclosure Controls and Procedures*, which explains that the case-study company has established a Disclosure Committee monitoring procedure, and advises the BoM to ensure "adequate and timely disclosure of financial and nonfinancial information". Further, 15.B *Management's Annual Report on Internal Control over Financial Reporting* includes the management's statement on the effectiveness of internal control over financial reporting. Finally, 15.C *Attestation Report of the Registered Public Accounting Firm* includes the auditor's attestation that he/she audited and confirms the accuracy of the management's assessment (cf. 15.B) and the effectiveness of internal control over financial reporting.

Item 16.A includes the disclosure by the audit committee's independent financial expert, and Item 16.B contains the Code of Ethics for senior financial officers. The latter also includes a reference to the Tabaksblat Code (II.1.3) and the US stock exchange corporate governance rules, which require a code of conduct. The case-study company explains that the Business Principles serve as code of conduct.

The figure in Item 16.C *Principal Accountant Fee and Services* shows a significant difference between the accounting fees for 2005 (8.8 million euros) and 2006 (15.5 million euros), which could be considered confirmation of the fact that US listed corporations had to invest a great deal of money in order to implement the SOX.

Another important item is Item 18 *Financial Statements*, which includes the *Report of Independent Registered Public Accounting Firm*. In this report, the auditor approves the consolidated financial statements of 2005 and 2006 and the results of the operations and cash flows for each of the years 2004–2006. Note 27 describes the differences between the IFRS and US GAAP.

The last important item is Item 19, which includes several exhibits; namely, the certifications by the CEO and CFO, and the *Consent of Independent Registered Public Accounting Firm* in which the auditor approves all financial statements.

Chapter outline

This chapter compares the ‘is’ situation with the ‘ought’ situation as described in Chapter 7. In other words, it investigates whether the text-external (cf. 7.6.1) and text-internal factors (cf. 7.6.2) can be found in the case-study company’s 2006 Dutch annual report. The structure of this chapter is based around these text-external and text-internal factors.

The text-external factors consist of (1) discursive procedures, including the annual report contributors (10.2) and the structure of the annual report process (10.3), which includes analysis of the process with respect to the annual report-related A- and B-rules (10.3.1) and the non-annual report-related C- and D-rules (10.3.2). Sub chapter 10.3 is quite extended, as it describes where the relevant rules have been found within the 2006 annual report, and any notable findings, comments, or clarifications provided by the interviewee(s).

The disciplinary culture (2) can be deduced from the analyses in section 10.3.1. The discursive practices (3), including (a) the choice of genre and (b) the communication mode, are described in sub chapter 10.4.

Next, the text-internal factors are described in sub chapter 10.5. Section 10.5.1 examines the situational context (a); 10.5.2 analyzes the findings concerning the communicative purpose (b); 10.5.3 looks at the move structures (c) and relevant themes (d); and 10.5.4 focuses on the intertextual aspects (e). Finally, sub chapter (10.6) provides a summary of the chapter.

The information included in this chapter was obtained partially through the analysis of the case-study company’s 2006 Annual Report on Form 20-F, and partially through the input provided by the accounting firm interviewee (particularly the input regarding the audit process as part of the annual report process). The information provided by the case-study company interviewee is limited in this chapter.

10.2 Discursive procedures – (a) The annual report contributors

The annual report contributors correspond with the contributors mentioned in section 7.6.1. The case-study company interviewee explained that the Annual Report on Form 20-F contributors are the company itself (CCU issuer) and the auditor (CCU RPAF). The auditor assists the company with respect to Form 20-F as the RPAF is involved in the reconciliation

process (cf. 8.5), whereby the entire financial reporting has to be rewritten into the US GAAP. The RPAF also assists with Form 20-F's extended demands with respect to information about the corporation. The auditor's activities concerning both the Tabaksblat Code and the SOX – including the assistance provided by the RPAF in drawing up the Form 20-F – are included in the Engagement Letter. The accounting firm interviewee stated that all SOX-related services are considered to be “high-risk assignments” that should pass through the RPAF's contract unit in order to be approved (cf. 8.6.5).

10.3 Discursive procedures – (b) The structure of the annual report process

This sub chapter concerns the analysis of the 2006 Annual Report on Form 20-F process. It investigates whether the annual report process requirements according to the SOX and AS2 and 3 can be detected within Form 20-F and/or through the information obtained from the case-study company or accounting firm representatives.

Chapter 8 identified the participants, namely:

- The registered public accounting firm (RPAF);
- The Financial Reporting section of the Controlling Department;
- The Communication Department;
- The Disclosure Committee;
- The US General Counsel;
- The Board of Management; and
- The audit committee.

The annual report coordinator is the Financial Reporting section, in contrast to the coordinator of the Dutch annual report, which is the Communication Department supported by the Steering Committee.

We saw in Chapter 7 that the relevant annual report process rules have been divided into certain groups. The rules directly affecting the annual report are the annual report-related A- and B-rules. These rules concern the annual report contributors, i.e. the issuer and the RPAF. To this group also belong the A+ rules, which are only relevant for the annual report in specific circumstances. These rules exclusively concern the RPAF, and can be divided into four separate groups:

- (1) Rules that concern changes/adjustments in the auditor's report after the auditor has identified significant deficiencies or material weaknesses;
- (2) Rules related to the management of the issuer; that is, if the management has added information to its report after its assessment and the auditor finds a material misstatement in the added information, the auditor should adjust his/her report;
- (3) Rules containing content elements for the auditor's report if the information provided to the auditor is inadequate; and
- (4) Rules including additions to the auditor's report for various reasons, for example if the management's report is inappropriate or its process for assessing internal control over financial reporting is inadequate.

The other group of rules relevant for the annual report process involves certain A-rules (which are part of neither group 1 nor the A+ rules) that could be considered as supporting or even forming the basis for a sound annual report process. These are the C-rules. The relevant CCUs are the RPAF, the issuer (including the CEO and CFO), and the audit committee. Finally, the last group consists of those A-rules not belonging to the annual report-related A- and B-rules, A+ rules or C-rules. These are the D-rules, which are directly related to the A+ rules and only apply if the A+ rules apply.

The following sections present the results of the analysis of the Annual Report on Form 20-F process. These sections are structured according to the groups of rules, namely the annual report-related A- and B-rules and A+ rules per CCU (10.2.1); then the C- and D-rules per CCU (10.2.2). Each section per CCU starts by analyzing the relevant rule; these sections are titled ‘Analysis of ...’ If the accounting firm representative and/or the case-study company interviewee has commented or elaborated on the rule, the analysis is followed by a section titled ‘Comment on ...’

10.3.1 Annual report-related A- and B-rules

CCU registered public accounting firm (RPAF)

Analysis of SOX404 and SOX404(b)

According to A-rule SOX404 and in particular B-rule SOX404(b)¹⁶¹, the RPAF should, in the auditor’s attestation report, attest to management’s assessment of the effectiveness of the internal control structure and the issuer’s procedures for financial reporting, and this report must be included in the annual report. The case-study company’s Annual Report on Form 20-F contains the auditor’s report under Item 15 *Controls and Procedures*. The actual report appears in 15.C *Attestation Report of the Registered Public Accounting Firm*, having been announced in 15.B *Management’s Annual Report on Internal Control over Financial Reporting* with the statement:

[...], an independent registered public accounting firm, has audited management’s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, as stated in their report included in Item 15.C.

This report is written in the form of a letter to the case-study company’s BoM and supervisory board. Auditing Standard 2 includes in its Appendices examples or templates of auditor reports containing different contents. It seems that the case-study company chose to use Example A-1, with the prescribed title ‘Report of Independent Registered Public Accounting Firm’ followed by six prescribed paragraphs¹⁶². Between paragraphs 4 and 5, the case-study company added a paragraph stating that the company had acquired several other companies, and that management had excluded in its assessment and the auditor had also excluded an evaluation of the relevant assessment of the internal control over financial reporting of the acquired companies. The case-study company’s BoM explains this as follows:

If adequately disclosed, companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition while integrating the acquired

¹⁶¹ Sec. 404. Management assessment of internal controls. (a) Rules required.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting. (b) Internal control evaluation and reporting.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

¹⁶² The six prescribed paragraphs are: 1) introductory paragraph; (2) scope paragraph; (3) definition paragraph; (4) inherent limitations paragraph; (5) opinion paragraph; and (6) explanatory paragraph.

company under guidelines established by the US Securities and Exchange Commission. (2006 Annual Report on Form 20-F, p. 127)

Finally, the letter form of the attestation report includes the city, country, date and name of the accounting firm concerned, in accordance with Example A-1 included in AS2.

Compliance with SOX404(b) has also been found in Item 18 *Financial Statements*, in the *Report of Independent Registered Public Accounting Firm*, which is – also – a letter to the case-study company’s BoM and its supervisory board. This letter is primarily a statement about the auditor’s audit of the consolidated financial statements, and includes the auditor’s opinion that these consolidated financial statements “present fairly, in all material aspects, the financial position”, the “results of their operations and their cash flows”, and the financial statement schedule. The letter, however, ends with a paragraph about the audit of the effectiveness of the case-study company’s internal control over financial reporting and that the auditor’s report of June 13, 2007:

Expressed an unqualified opinion on management’s assessment of, and the effective operation of internal control over financial reporting.

Furthermore, Exhibit 15.a *Consent of Independent Registered Public Accounting Firm*, again contains an auditor’s report in the form of a letter to the case-study company’s BoM, in which the RPAF consents to all required auditor’s approvals, including on the effectiveness of internal control over financial reporting, and the management’s assessment thereof.

Analysis of AS2-167

Content for the report should be established in accordance with B-rule AS2-167, which includes 16 compulsory content elements that correspond with the paragraphs (a)–(p) as described in Example A-1.

The first element (a) could not be detected in the title, as required by rule AS2-167, but does appear in the announcement/statement of the case-study company’s BoM in 15.B (see above). The elements (b)–(e) correspond with the ‘Introductory paragraph’ of Example A-1, and have been captured in the first paragraph of the report. The example in (b) about the control criteria has been reproduced exactly. Element (f), too, reproduces exactly the ‘Definition paragraph’ of Example A-1 and includes a reference to AS2-7, which defines internal control over financial reporting. This is captured in the third paragraph of the report. In paragraph 2, the report again reproduces exactly the elements (g)–(j), which also correspond with the ‘Scope paragraph’ of Example A-1. Element (k) corresponds with the ‘Inherent limitation paragraph’ of Example A-1, and is included in paragraph 4 as a single long sentence, although there are two sentences leading to an almost exact copy of the obligatory content. The content elements (l) and (m) about the auditor’s opinions correspond with Example A-1’s ‘Opinion paragraph’ and are both included in paragraph 6, which again exactly reproduces the content. The elements (n)–(p) can be found in the report as well.

Besides the obligatory elements, the auditor’s attestation report contains two extra paragraphs. The first of these, paragraph 5, concerns the fact that – as has been stated previously – the case-study company acquired several companies but excludes them from its assessment of the effectiveness of internal control over financial reporting, and likewise the auditor excludes the evaluation of the acquired companies’ internal control over financial reporting from the audit. In the second additional paragraph, paragraph 7, the auditor states that he/she also audited the consolidated balance sheets of the case-study company and its subsidiaries of 2005 and 2006, and the related consolidated statements of income, changes in equity, and cash flows for each of the years 2004, 2005, and 2006, and that the auditor’s report of June 13, 2007 “expressed an unqualified opinion on those consolidated financial statements.”

Comment on AS2-167

The accounting firm interviewee confirmed that the texts used in an auditor's attestation report are 'prescribed', with standard templates varying from (1) an approval statement, and (2) an approval statement with a limitation. These statements can be obtained through the AICPA.org¹⁶³ website.

Analysis of AS2-4

The next A-rule concerns the fact that the RPAF performs an audit of internal control over financial reporting in order to be able to express an opinion on management's assessment of the effectiveness of the company's internal control over financial reporting. The RPAF is only able to express such an opinion if it (1) plans and performs the audit in such a way that it obtains reasonable assurance about whether the company indeed maintained effective internal control over financial reporting, which means that "no material weaknesses exist", and (2) the auditor must audit the company's financial statements. Reference to this rule is included in 15.C *Attestation Report of the Registered Public Accounting Firm* (cf. Analysis AS2-167), paragraph 2, concerning the fact that the auditor should plan and perform the audit to obtain reasonable assurance, and in the additional paragraph 7 (cf. analysis AS2-167), concerning the audit of the consolidated balance sheets, the consolidated statements of income, changes in equity, and cash flows, on which the auditor expressed an unqualified opinion. The auditor's opinions on the management's assessment and the effectiveness of internal control over financial reporting can also be found in the last paragraph of Item 18 *Financial Statements, Report of the Independent Registered Public Accounting Firm* (cf. Analysis SOX404(b)).

Analysis of SOX103(a)(2)(A)

B-rule SOX103(a)(2)(A) contains certain content elements with respect to "each audit report" of an RPAF. These elements concern the description of the scope of the auditor's testing of the issuer's internal control structure and procedures (cf. Analysis SOX404(b)) and of the testing itself. This rule can be identified in the second paragraph of Item 15.C *Attestation Report of the Registered Public Accounting Firm*, although it only concerns a reference to rule SOX103(a)(2)(A):

Our audit included [...] testing and evaluating the design and operating effectiveness of internal control.

Item 18 *Financial Statements*, however, also includes the *Report of the Independent Registered Public Accounting Firm*, which includes the following text in paragraph 2 corresponding (partially) with the content of the relevant rule:

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.

Item 15.C refers to compliance with the content of the relevant rule, with the auditor expressing the opinion that the company "maintained, in all material aspects, effective internal control over financial reporting", and that the management's assessment that the company maintained effective internal control over financial reporting is "fairly stated, in all material aspects".

Since the definition of 'internal control' is included in Item 15.C, paragraph 3, the auditor's opinions are thus expected to cover the content of the relevant SOX rule. SOX404 and SOX103(a)(2)(A) are considered very significant requirements, given that the huge

¹⁶³ AICPA: American Institute of Certified Public Accountants (comparable to the Dutch NIVRA).

number of rules included in Auditing Standards 2 and 3 are elaborations of these SOX rules (cf. 5.5.1).

Analysis of AS2-169

The next B-rule concerns AS2-169, *Separate or Combined Reports*, and involves the fact that the auditor may issue a separate or combined report (the latter being a single report containing an opinion on both the financial statements and internal control over financial reporting). The case-study company's RPAF states in Item 15.C *Attestation Report of the Registered Public Accounting Firm*, paragraph 1, that it is:

Our responsibility to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

And in paragraph 2:

We believe that our audit provides a reasonable basis for our opinion.

And finally, both opinions appear again in paragraph 6.

The auditor also mentions in paragraph 1 of the *Report of Independent Registered Public Accounting Firm* (in Item 18 *Financial Statements*) that it is the auditor's responsibility to express an opinion on the consolidated financial statements and the financial statement schedule based on the audit. Further, in paragraph 2 the RPAF asserts that its audits provide reasonable basis for its opinion. The third paragraph then includes both opinions:

In our opinion, the consolidated financial statements referred to above present fairly, in all material aspects, the financial position of [the case-study company] and subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with IFRS as adopted by the EU. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material aspects, the information set forth therein.

Although the reports included in Item 15.C and Item 18 contain two auditor's opinions, these opinions differ. The opinions in 15.C, the attestation report, concern management's assessment of, and the effectiveness of, internal control over financial reporting, whereas the opinions in Item 18 concern all financial statements.

The case-study company's auditor thus used two different reports to express two opinions on different topics. Further, the case-study company's RPAF states in Exhibit 15.a *Consent of Independent Registered Public Accounting Firm*, that:

We consent to incorporation by reference in the Registration Statements on Form S-8 [...] of AN N.V. of our reports dated June 13, 2007, relating to the consolidated balance sheets of AN N.V. and subsidiaries of December 31, 2006 and 2005, and the related consolidated statements of income, cash flows, and changes in equity for each of the years in the three-year period ended December 31, 2006, the related financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, which reports appears in the 2006 Annual Report on Form 20-F of AN N.V.

It is clear, at least as a consequence of the latter quote, that the case-study company's auditor used three combined reports, the last of which combines all elements that the auditor is required to approve according to the RPAF-related SOX and AS2 requirements. The 'official' term 'combined report' (cf. Footnote to Analysis AS2-169) concerns the auditor's opinion on both the financial statements and the internal control over financial reporting in one report. As we have seen above, the case-study company's Annual Report on Form 20-F does not include such a combined report, but separate reports.

Comment on AS2-169

The accounting firm representative stated that the auditor usually discusses with the client whether separate reports or a combined report is preferred, but that separate reports have a

clear advantage. The interviewee explained that the annual accounts may be needed not only at the end of the year, but also more often throughout the year, for example if the company conducts an issuance in May and then refers to the audited accounts of 31-12 and to the accompanying auditor's statement. If the auditor had combined the reports, the company would need to refer to the statement about the internal controls, which is undesirable because the auditor would then have to make the statement again in April, and thus state that it was still satisfactory. The interviewee referred to the AS2 requirements with respect to the auditor's annual report-related activities:

- (1) Auditor's statement on the annual accounts;
- (2) Auditor's statement on the internal controls concerning management's activities; and
- (3) Auditor's approval of the management's assessment.

One reason for providing a combined report is that some companies have the opinion that two reports would take up too many pages in the annual report. The interviewee stated that the auditor could provide binding advice as the auditor has his/her own responsibility.

Analysis of AS2-171 and 172

The next B-rules are related to AS2-4. The first rule concerns the report date, as the auditor cannot audit internal control over financial reporting without also auditing the financial statements. Therefore, the reports should have the same date. The case-study company's Form 20-F includes the auditor's attestation report in Item 15.C dated June 13, 2007, the *Report of Independent Registered Public Accounting Firm* in Item 18 also dated June 13, 2007, and finally the *Consent of Independent Registered Public Accounting Firm* in Item 19, Exhibit 15.a, dated June 13, 2007 as well. The second rule does not apply, since the case-study company did not use a combined report.

Analysis of AS3-4

AS3-4 (B-rule) refers to the audit documentation, and requires that the auditor prepare the documentation "in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached", and further that the documentation be "appropriately organized to provide a clear link to significant findings or issues". This rule can be considered a basic assumption for the RPAF's audits in general. In Item 15.C *Attestation Report of the Registered Public Accounting Firm*, paragraph 2, the case-study company's auditor refers states that the audit has been conducted in accordance with PCAOB standards, which require that the audit is planned and performed in such a way that the auditor obtains:

Reasonable assurance about whether effective control over financial reporting was maintained in all material aspects.

The auditor then (indirectly) confirms that he/she adhered to AS3-4 by stating that:

We believe that our audit provides a reasonable basis for our opinion.

The RPAF also states in its report under Item 18, concerning the consolidated financial statements, that the auditor conducted the audits in accordance with the PCAOB standards and that they "provide a reasonable basis for our opinion". Thus, the auditor – albeit indirectly – complies with rule AS3-4. The accounting firm representative stated that all requirements are included in the auditor's statement, which also refers to the PCAOB standards, which in turn means that the auditor complies with all relevant rules.

Comment on AS3-4

The accounting firm representative pointed out that the auditor can comply with AS3-4 by using the accounting firm's audit methodology (cf. 8.6.5) to conduct the audit. This methodology is the 'theory' translated into the firm's approach, and set down concretely in work papers which the accountants simply need to fill in. The 'planning memorandum'

includes all requirements with which the auditor must comply. The interviewee explained that it indicates that the auditor should obtain information about any governmental controls executed. The auditor should then ask the client about what controls took place; for example, ‘the Income Tax Department’ conducted an investigation, and the ‘European trust police’ carried out an investigation in Spain, and so on. This means that, for each control, separate work papers have to be used and supported by electronic tools/files. Since the work papers are derived from the general accounting rules, they include:

- (1) The controlling goal;
- (2) What is controlling?
- (3) What to do in the interim period?
- (4) What to do in the final period, for example, if a control has been tested in September, how does the auditor know that it still functions in December: what is the auditor’s roll-forward procedure?

The interviewee stated that it is not overly important what form the audit documentation takes (electronic or hard copy); rather, it is about *having* the work papers (cf. 8.6.5). As the interviewee emphasized:

Everything is formal, because if it has not been documented it has not been performed.

Analysis of AS3-5

B-rule AS3-5 also concerns requirements with respect to audit documentation. The accounting firm representative stated that compliance with all requirements is covered by the auditor’s statement. This statement includes a reference to the PCAOB standards; thus, the elaboration of rule AS3-4 applies here.

Analysis of AS3-10

B-rule AS3-10 can also be seen as including basic assumptions about the auditor’s work, as mentioned in the comment to AS3-4. AS3-10 includes general requirements with respect to the documentation of specific auditing procedures. Neither the 2006 Annual Report on Form 20-F nor the information provided by the accounting firm interviewee refer to this rule. However, the auditor’s statement covers the auditor’s compliance with all relevant auditor requirements.

CCU issuer, including CEO and CFO

Analysis of SOX404(a)

B-rule SOX404(a), which is considered the core rule of the SOX (cf. 5.4.1), requires the issuer to include in each annual report an internal control report. The 2006 Annual Report on Form 20-F contains a kind of introduction to the required management’s internal control report in Item 15.A *Disclosure Controls and Procedures*. This introduction announces that the case-study company indeed has a Disclosure Committee which monitors procedures established by the company and advises the BoM to ensure adequate and timely disclosure of financial and nonfinancial information. The second paragraph indicates that the management (or parties under the management’s supervision), including the CEO and CFO, has evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The CEO and CFO have concluded – based on that evaluation – that the disclosure controls and procedures are effective at the reasonable assurance level. The last paragraph stresses the inherent limitations of the disclosure controls and procedures, which can only lead to reasonable assurance and not absolute assurance that all control issues and instances of fraud have been detected. The actual internal control report is included in 15.B *Management’s Annual Report on Internal Control over Financial Reporting*.

Analysis of AS2-2 and AS2-162

A-rule AS2-2 is an elaboration of SOX404(a), and stipulates that the issuer is required to include in the internal control report management's assessment of and statement about the effectiveness of the company's internal control over financial reporting. The content requirements with respect to this report have been formulated in B-rule AS2-162, and are included in Form 20-F (original version).

Compliance with AS2-2 can be identified in Item 15.B *Management's Annual Report on Internal Control over Financial Reporting*. The content of the first paragraph corresponds with content requirement 1. The second paragraph includes both the content requirements 2 and 3. The third paragraph refers to AS2-7, which defines what 'internal control' is. In the fourth paragraph, the case-study company states that it has excluded the internal control over financial reporting – and management's assessment of the effectiveness thereof – concerning the acquired companies. Finally, the fifth paragraph corresponds with content requirement 4, that the RPAF's attestation report on its audit of the management's assessment of the effectiveness of internal control over financial reporting is included in the Annual Report on Form 20-F.

Analysis 1, AS2-20

A-rule AS2-20 is directly related to AS2-2, and concerns the management's responsibility to carry out certain activities¹⁶⁴ in order to enable the auditor to complete the audit of internal control over financial reporting.

Comment on AS2-20

The accounting firm representative states that these requirements are the most significant, because an auditor may not give approval in the auditor's statement if one of the four requirements has not been fulfilled. The interviewee explained the process, which consists of four stages corresponding with the four content requirements (cf. Analysis AS2-20).

First, the management, including the CEO and CFO, have the final responsibility, which has to be confirmed. Their responsibility must 'be visible' not only through its sound foundation in the statement that they sign, but also in the documents and the project. The CEO and CFO should be involved from beginning to end, and this has to be 'made visible'. For example, they could be expected to be present at the project 'kick-off, namely the start of the audit, and at the meetings of a steering group or at conferences. In other words, they have to show that they are genuinely involved.

Second, suitable control criteria should be used; for example, the COSO framework. Third, there has to be sufficient evidence of a sound foundation for the management's statement. The auditor has to check whether there is indeed a sound basis and sufficient documentation of it; if not, the auditor cannot provide his/her statement (*c* thus includes *a* and *b*).

Fourth, the management has to include its written assessment in Form 20-F. The accounting firm representative emphasized that "management must go first", which means that first the conclusions, namely the management's 'in control statement', has to be provided before the auditor can start working. The interviewee explained that the 'in control' statement is usually provided "late", but that this is not a problem since other processes are already

¹⁶⁴ AS2-20: (a) Accept responsibility for the effectiveness of the company's internal control over financial reporting; (b) Evaluate the effectiveness of the company's internal control over financial reporting using suitable control criteria; (c) Support its evaluation with sufficient evidence, including documentation; and (d) Present a written statement of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year.

underway. First, the auditor checks the design of the controls, and if the management declares that the design is adequate, this has to be documented in writing and verified by the auditor¹⁶⁵. To this end, the auditor checks whether controls indeed exist, and whether they are functioning. Partial statements will be provided after certain checks, and the final statement will be provided at the last moment. The interviewee pointed out that larger organizations have anywhere between 2000 and 8000 controls, each of which:

- (1) Has to be designed;
- (2) The design has to be tested; and
- (3) The control has to be declared to have functioned.

The controls take place throughout the whole year, and statements about their functioning take the form of ‘as of’ reports or a statement ‘as of 31-12’; in other words, from the end of the year but with a view to the year’s progress. Besides the year conclusion – the auditor’s statement in the Annual Report – monthly and quarterly conclusions are also made.

Analysis 2, AS2-20

Compliance with this rule and its requirements can be found in several sections throughout the 2006 Annual Report on Form 20-F. Item 15.A *Disclosure Controls and Procedures*, paragraph 2, states that “under the supervision and with the participation of the company’s management”, including the CEO and CFO, the company has “evaluated the effectiveness of the design and operation of its disclosure controls and procedures” and, based on that evaluation, “the CEO and CFO have concluded that these disclosure controls and procedures are effective at the reasonable assurance level”.

The next paragraph then explains the fact that only a reasonable assurance level can be achieved because of the “inherent limitations in all control systems”. The management’s report in Item 15.B, however, provides much clearer evidence of compliance with AS2-20, since the first paragraph corresponds with content element (a); the second corresponds with the content elements (b) and (d), whereby reference to (b) can be deduced from the fact that the assessment was based on the COSO framework; and the third paragraph corresponds in general with content element (b) in that it includes the three elements defined in AS2-7 as the core of internal control. The first paragraph of the auditor’s attestation report (15.C) refers to content element (a) as required by AS2-20.

The certifications of the CEO and CFO (cf. Item 19, Exhibit 12.a *Certification CEO* and Exhibit 12.b *Certification CFO*) could be regarded to directly confirm the management’s responsibility for the effectiveness of the company’s internal control over financial reporting and the evaluation thereof, and the certifications include the written statement as mentioned in (d) (cf. footnote to analysis 1, AS2-20). Element (c), however, seems to be only indirectly present in paragraph 4.b:

[The case-study company] Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Analysis of AS2-163

AS2-163 is an A-rule about the management’s statement on the effectiveness of the company’s internal control over financial reporting. This statement is included in Item 15.B *Management’s Annual Report on Internal Control over Financial Reporting*, paragraph 2, and is formulated as follows:

¹⁶⁵ If the auditor detects a deficiency in this stage, it is thus a design deficiency.

As of the end of the 2006 fiscal year, the Board of Management conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* [...]. Based on this assessment, the Board of Management concluded that the company's internal control over financial reporting was effective [...].

Rule AS2-163 includes a cautionary statement that the conclusions should not be so subjective that "people having competence in and using the same or similar criteria would not ordinarily be able to arrive at similar conclusions". The last sentence within the quote above can be considered objective, or at least not subjective.

Analysis of AS2-55

A-rule AS2-55 is about the important role of the audit committee, but it is also stressed that despite the committee's important role, the management remains responsible for maintaining effective internal control over financial reporting. We have seen previously (cf. analyses AS2-20 and – of course – SOX404(a)) that the case-study company's management states that it is ultimately responsible for the effectiveness of internal control over financial reporting.

Analysis of SOX302(a) and (b)

A-rules SOX302(a) and (b) concern the corporate responsibility for financial reports. The content elements are prescribed in Form 20-F (original version) and correspond with the text in SOX302(a), namely that the CEO and CFO must certify each annual report. These certifications can be found in Item 19, Exhibit 12.a *Certification CEO* and Exhibit 12.b *Certification CFO*. All content elements as required in SOX302(a) can be identified, and both certifications are identical except for the signing officers. Although the certification has not been presented as a letter, it ends with the date and the name and position of the person who certified the text.

Also under Item 19, *Signatures and Certifications*, the case-study company's 2006 Annual Report on Form 20-F includes the following text about the certifications by the CEO and the CFO as prescribed in Form 20-F (original version):

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

The text is signed by the case-study company and includes the names and titles of the signing officers, as well as the date of signing.

SOX302(b) stresses that 302(a) above also applies to issuers that have reincorporated or engaged "in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States". The facts that the case-study company complies with SOX302(a) (see above) and that the certifications in Item 19, Exhibit 12.a *Certification CEO* and Exhibit 12.b *Certification CFO* include the following statement:

I have reviewed this Annual Report on Form 20-F of [the case-study company], a company incorporated under the laws of the Netherlands.

prove that the case-study company complies with SOX302(b).

Analysis of SOX906

B-rule SOX906 is in fact related to SOX302(a) as it concerns the corporate responsibility for financial reports, which is again expressed through certification by the CEO and CFO (cf. analysis SOX302(a)). These certifications should include a "written statement" that the annual report containing the financial statements "fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act" of 1934, and that the information contained in the annual report "fairly presents, in all material aspects, the financial condition and results of operations of the issuer". The case-study company's 2006 Form 20-F includes in Item 19, Exhibit 13.a *Certification CEO under Section 906* and Exhibit 13.b *Certification CFO under*

section 906. The content of SOX906 has been reproduced in paragraph 2 of each of these certifications. The certifications end with the date, as well as the name and title of the person who certified them.

Analysis of SOX406

B-rule SOX406 requires the issuer to disclose in the annual report whether or not, “and if not, the reason therefore,” the issuer has adopted a code of ethics for senior financial officers (this has already been indicated in Item 6¹⁶⁶). The text of the Code of Ethics is prescribed in Form 20-F (original version), combined with an explanation of the meaning of a code of ethics. The required Code can be found in the case-study company’s 2006 Annual Report on Form 20-F under Item 16.B *Code of Ethics*, consisting of four paragraphs. The first paragraph refers to the case-study company’s corporate responsibility and mentions the persons to whom the Code applies:

The Chief Executive Officer, the Chief Financial Officer, the Senior Vice President Finance, the Director Corporate Control, the Director Corporate Tax, the Director Corporate Internal Audit, the Group Controllers, the Business Unit Controllers, the country controllers, and certain other senior officers.

The company then mentions that the Code is also available on the corporate website, in accordance with an instruction included in Form 20-F (original version). In a separate sentence, the company states that no changes have been made to the Code since its adoption. The last paragraph refers to the fact that the case-study company should comply with the Tabaksblat Code and the Corporate Governance Rules of the relevant US stock exchange, which requires the company to have a code of conduct. The company points out that the Business Principles are considered to be the corporate code of conduct for the Corporate Governance Rules for both the Dutch and the US stock exchanges. Further, it is stated that the company makes efforts to inform the employees about the Business Principles through company-wide training, and that the company has established procedures to monitor compliance with the Principles (cf. 9.3.1, Comment on analysis 2, rule II.1.4).

Analysis of SOX407

The last B-rule concerns SOX407(a), which includes that the company should disclose whether the audit committee has or has not, “and if not, the reasons therefore,” at least one member who is a financial expert. The prescribed text is included in the instructions to Form 20-F (original version). Compliance with this rule can be found under Item 16.A *Audit Committee Financial Expert*.

We have seen in Chapter 7 that some A-rules only apply in certain circumstances (cf. Figures 7.6.1C-F). These mainly concern the detection of significant deficiencies or material weaknesses, and will be referred to as A+ rules. Since neither the case-study company nor the company’s RPAF have detected such significant deficiencies or material weaknesses, these rules do not apply.

¹⁶⁶ Item 6 *Directors, Senior Management and Employees*, in C *Board Practices*, sub section ‘Rules of Procedure, Code of Conduct, Complaints Procedure’, paragraph 4: “The Board of Management has adopted a Code of Ethics for senior financial officers. The designated persons, including the CEO and the CFO, have to confirm annually in writing that they have adhered to this Code. The Code of Ethics can be found on the company’s corporate website.”

To sum up

The previous sections have shown that the case-study company complies with all A- and B-rules, except for one rule (AS2-172), which did not apply. Further, we have seen with respect to AS2-167 that content element (a) should have been included in the auditor's attestation report, but was found instead in the *Management's Annual Report on Internal Control over Financial Reporting*.

Although compliance with the rules was mostly clear because references to the rules can be found within the case-study company's 2006 Annual Report on Form 20-F, compliance with respect to some rules was inherent to the fact that the case-study company's auditor provided his/her auditor's statement. The accounting firm representative pointed out that the auditor's statement in fact covers the auditor's compliance with all SOX, AS2 and AS3 rules, because these rules have been incorporated in the work papers. Since the auditor performs the audit process according to the audit methodology through the work papers, the auditor's statement is the ultimate confirmation of the auditor's compliance with all relevant rules. Another example of this inherent compliance concerns a requirement for the issuer (AS2-20), whereby the management must take certain steps before the auditor can start performing the audit. The accounting firm representative stressed that the expression "management must go first" – as it must provide its 'in control' statement first – is genuinely applicable. More so, the auditor may not start the auditing process if one of the required actions has not been completed by the management. Thus, compliance with this rule can be deduced from the fact that the auditor provided his/her statement, which he/she only does if the management has fulfilled its obligations.

The A+ rules, as we have seen above, do not apply.

10.3.2 C- and D-rules

This section includes those A-rules that are not annual report-related. They can be divided into rules that support the annual report process directly (C-rules) and rules that only apply when the A+ rules apply (D-rules; cf. 10.3.1). Both groups of rules are important as they constitute or at least support the annual report process.

C-rules

The C-rules have been structured according to the relevant Corporate Communication Units (CCUs), namely the CCU RPAF and the CCU audit committee. To the CCU issuer (including the CEO and CFO), only D-rules apply; the CCU investors plays only a minor role with respect to the annual report process. Since the C-rules are in fact all A-rules, compliance with these rules is described per CCU and its communication partners.

CCU registered public accounting firm

RPAF – Issuer

Analysis of SOX204(k)3

The most important part of SOX204(k)3 with respect to the relationship between the auditor and the issuer concerns the text containing the requirement that the RPAF should report to the company's audit committee in a timely manner, but also that the RPAF should report important "written communications" between the RPAF and issuer to the audit committee.

Although compliance with this rule is not evident within the 2006 Annual Report on Form 20-F, the explanation given by the accounting firm representative could be considered

as confirmation of compliance with this rule. Further, the interviewee pointed out previously (cf. 10.3.1) that the auditor's statement covers compliance with all RPAF rules.

Comment on SOX204(k)3

The accounting firm representative pointed out that the auditor establishes a 'report' to the audit committee according to a template that includes the minimum elements to be mentioned. The audit committee is not obliged to respond to this report, although in practice it always reports being pleased to have received the report, which is documented in its meeting minutes. The interviewee explains that only specific circumstances could lead to a formal response, the response being that the report will be discussed, conclusions drawn from the discussion, and a plan of action formulated, which will also be documented in the meeting minutes.

Analysis of AS2-6

The next rule concerns AS2-6, and compliance with this rule is covered by the auditor's statement. The rule includes a cautionary statement that the auditor should be aware of the fact that external users of financial statements are interested in information on internal control over financial reporting because it enhances the quality of as well as their confidence in financial reporting. Further, information on internal control over financial reporting is also:

Intended to provide an early warning to those inside and outside the company who are in a position to insist on improvements in internal control over financial reporting, such as the audit committee and regulators in specialized industries.

Comment on AS2-6

It could be presumed that the cautionary statement included in the quotation above might influence the auditor's formulation of his/her conclusion, but the accounting firm representative stated that the text of the auditor's statement has a fixed format, and thus cannot be influenced by the content of AS2-6. The interviewee pointed out that AS2 includes certain obligatory sentences that the auditor must use, but if the auditor makes use of a clarifying paragraph, for example in the case of detecting a material weakness, the text of that clarifying paragraph is not fixed. In such a case, the auditor can naturally describe the deficiency in different ways. The interviewee stressed, however, that the formulation itself is very important.

The interviewee pointed out that there seem to be many discussions at the very highest level about wording in general. He shared this view on the importance of formulation (cf. 9.3.1, Comment on analysis 2, II.1.4). The auditor must include the same formulation as the management in the case of a material weakness, and thus the same text appears in the management's assessment and in the auditor's statement. The interviewee stated that "this is where the profession of the auditor ends" because some parts of the texts "are completely unreadable because lawyers have been involved" .. These texts mostly concern authorities and responsibilities, and as the interviewee pointed out "these texts do not succeed at the marketing department". Ultimately, he said, it is lawyers who look at the texts, and auditors are only involved in the case of deviations from the auditor's approval, such as a scope limitation (for example, "the auditor could not perform the control activities in certain subsidiaries in Iran"). The interviewee explained that at that point, the auditor should contact his/her department, which deals with probably 20 or 30 non-approvals, whereas a single auditor perhaps faces a few non-approvals in his/her entire career. In the first 'SOX' year, according to the interviewee, 15–16% of disapprovals under SOX occurred, in the second year 9–10%, and in the third year 7–8%. The decrease depended mostly on the implementation phase in which most problems were related to IT, making them complex and not difficult problems to solve. The interviewee explained that GM had a disapproval statement of over 2006, and GM stated that it simply did not have enough qualified personnel

to adhere to the reporting rules for all activities. Many companies indeed have tax law problems. For example, a large corporation selling medical equipment globally has to deal with a very complicated tax regime for which it needs specialists; in other words, the company has to buy that knowledge. Problems arise when companies do not make use of such specialists. Indeed, the decrease from 15% to 7–8% can be explained by the fact that corporations have finally recognized the importance of hiring specialists.

The accounting firm representative was convinced that the SOX functions, because otherwise such mistakes as those described above would not have become visible. This was exactly what SEC and PCAOB had in mind, according to the interviewee:

We do have a percentage of disapproved statements in our minds; if that percentage is not accomplished, the auditors did not do their job well – they have not been rigorous enough, or the rules are not rigorous enough.

The interviewee pointed out that SEC and PCAOB representatives had never answered questions at seminars about what the percentage should be. The interviewee considered this to be a form of “intimidation”, and stated that it was meant “to scare auditors all over the world”. And these auditors, in turn, will consequently frighten their clients. Mistakes are considered to be criminal violations, and violators may face imprisonment for 25 years and a \$10 million fine. As the interviewee put it: “It is the American style, but it functions.”

There are two reasons, according to the interviewee, for the delisting of more and more non-US corporations: (1) listing is expensive, and (2) corporations have discovered more “overdue maintenance”. The role of the US market as the largest capital market has been taken over by other capital markets, including in Europe, which have become more efficient. It is not necessary for most companies to be listed at the US stock exchanges. The accounting firm representative explained that, a few decades ago, the US listings received a great deal of hype among the CEOs of large Dutch corporations. Likewise, the interviewee considered the takeovers in the US to represent the same kind of hype, and drew the conclusion (concerning CEOs) that “They’re just like people”.

Analysis of AS2-19

Rule AS2-19 is related to AS2-20 and includes a warning for the auditor, namely that the work performed and the assurance obtained are of equal importance for expressing opinions both for the management’s assessment of and for the effectiveness of internal control over financial reporting. Further, the auditor should obtain sufficient evidence for both opinions. Finally, it is stated that the auditor’s report on internal control over financial reporting does not diminish the management’s responsibility for effective internal control over financial reporting. The case-study company’s compliance with AS2-20 can be considered to include compliance with AS2-19 (cf. analysis of and comment on AS2-20).

Analysis of AS2-21

Rule AS2-21 is also related to AS2-20, and requires the management to take certain actions in the case that the issuer does not comply with AS2-20. This rule therefore does not apply to the case-study company, as it did comply.

Analysis of AS2-40

AS2-40 is an essential rule, since it contains the auditor’s obligation to understand and evaluate the management’s process for assessing the effectiveness of internal control over financial reporting. This rule, in fact, includes the entire audit process with respect to the internal control over financial reporting. It means that the auditor should determine whether the management has addressed all elements listed in rule AS2-40. These elements only concern control activities.

Compliance with this rule can only be deduced from the auditor's attestation report (Item 15.C), in which the auditor provides an unqualified opinion on the effectiveness of internal control over financial reporting and on the management's assessment thereof. Reference can be made here to the accounting firm representative's comment on AS3-4 (section 10.3.1), that the auditor's statement covers the auditor's compliance with all relevant rules.

Comment on AS2-40

The accounting firm representative explained that AS2 requires the management to provide a well-founded 'in control statement'. If the management indeed states "we are in control", the accountant's duty is to ask the management on what basis it is making this statement. The management, in turn, should be able to answer this question on the basis of a complete documentation file. The auditor checks this file and may detect deficiencies, such as the following:

- (1) Documentation deficiencies, of which the interviewee stated: "It [the control] could be there, but it hasn't been documented";
- (2) Design deficiencies, which the interviewee described as: "It can be designed incorrectly; a procedure is not watertight"; and
- (3) Effectiveness deficiencies, which according to the interviewee means: "It doesn't work; although it is there and it has been documented, it does not function efficiently because, for example, the person who should do the control has been ill all year and there was no replacement".

The management, thus, provides the auditor with a huge number of documents, and multinational organizations have implemented an electronic system for these documents. Only people with a user ID and a password can enter the system, for example the external auditor. The auditor has to check all the documents, based on two principles: (1) the completeness of the documented elements, and (2) whether what is in the documents really exists.

Analysis of AS2-42

AS2-42 is related to the previous rule, in that it concerns the management's documentation. Both rules are significant in terms of compliance with the entire SOX404, and are therefore needed to ensure a sound annual report process, of which the audit process is an important part. The auditor is required to evaluate whether such documentation – providing reasonable support for the management's assessment – includes certain elements. These elements concern the design of controls, the controls themselves, and transactions. Like the previous rule, compliance with this rule is covered by the actual auditor's statements (cf. 10.3.1 comment on AS3-4).

Analysis of AS2-47 and 79

AS2-47, together with AS2-40 and 42 (and AS2-19/20; cf. 10.3.1), ensures a sound audit process as part of the general annual report process. This rule specifically focuses on the auditor's obligation to obtain a sound understanding of the design of specific controls by:

- (a) Inquiring management, supervisory, and other personnel; and/or
- (b) Inspecting company documents; and/or
- (c) Observing the application of specific controls; and finally
- (d) Tracing transactions through the information system relevant to financial reporting.

Rule AS2-79 entails that the auditor should perform at least one walkthrough for each major class of transactions, as part of obtaining an understanding of the design of specific controls.

Comment on AS2-47

The accounting firm representative explained at length what the auditor does in order to comply with AS2-47. The inquiries as referred to in (a) make up one just control technique which the auditor may choose to use. The control techniques partially cover the techniques mentioned previously, namely (a) inquiry, (b) inspection, cooperation, and assessment, (c) observation, and (d) re-performance. These techniques each provide a different quality of evidence.

The inquiries are ‘real’ inquiries in the sense that, for example, an auditor must have a conversation with the audit committee, the supervisory personnel, and the managers concerning fraud and fraud prevention (this is a legal obligation). The auditor’s file should include a document confirming that the auditor has in fact had this conversation. An ‘inquiry’ involves an individual asking a question, and the other person answering. Sometimes standard questions have been used, for example, with respect to fraud. Auditors take part in internal training to help them ask the right questions. However, an inquiry provides less evidence than an inspection, which enhances the PCAOB’s view (cf. 5.5.1) that audit documentation must demonstrate that the work was done, and such evidence does not include oral explanations, since oral evidence only may be used to clarify other written evidence. Besides inquiries, the auditor also uses ‘walkthroughs’ (i.e. ‘probing’ or challenging questions). These questions help the auditor to understand how an organization functions. The auditor asks management and other personnel such questions, and again, everything must be documented.

The inspection of company documents (b) is a control technique for providing more evidence, and the interviewee pointed out that a confirmation by a third party in fact provides the highest degree of certainty. Such a confirmation could, for example, be the inspection report of an external party who is independently involved in supervising certain issues.

Element (c), ‘observation’ is another technique that the auditor may use, along with element (d), ‘tracing transactions’. For the latter, the auditor again performs a ‘walkthrough’, this time meaning that he/she ‘follows’ a transaction from its very beginning to final processing in the annual accounts. In some organizations, this is a very complex procedure.

As we have seen previously, the control audit consists of three phases:

- (1) The design should be good;
- (2) The control must exist; and
- (3) The control must function.

Walkthroughs (cf. AS2-79) allow auditors to test the design of the control. If the auditor can ‘follow’ the transaction into the annual accounts, the second phase is complete, since the auditor can conclude that the control exists. The third step – that the control must function – can be tested by the auditor selecting several transactions and then testing them personally.

Like compliance with the previous two rules, compliance with rules AS2-47 and 79 is covered by the fact that the case-study company complies with SOX404(a) and (b). Further, the accounting firm representative pointed out (cf. 10.3.1, Comment AS3-4) that the auditor’s statement included in the 2006 Annual Report on Form 20-F proves compliance with these rules.

Analysis of AS2-49

The next rule concerns AS2-49, and specifically focuses on the auditor obtaining an understanding of the design of the controls related to each of the five components¹⁶⁷ of internal control over financial reporting. This rule is related to AS2-40, which, similarly, states that the auditor should obtain an understanding of and evaluate the management’s

¹⁶⁷ (1) Control environment; (2) risk assessment; (3) control activities; (4) information/communication; and (5) monitoring.

process for the effectiveness of internal control over financial reporting. However, AS2-40 – in contrast with AS2-49 – is mainly focused on the testing, design, and operation of the actual controls.

Compliance with AS2-49 is again considered to be captured in the case-study company's compliance with SOX404, and the accounting firm representative pointed out that the auditor's statement being included in the annual report signifies that the auditor complied with all auditing requirements (cf. 10.3.1, Comment on AS3-4).

Comment on AS2-49

The accounting firm representative explained that these five components correspond with the five COSO aspects, which are all included in the work papers. He pointed out that financial reporting is to be seen as a “satay test”, meaning that it consists of several tests that have to be carried out correspondingly with these five components:

- (1) The control environment entails that people should have the right qualities and integrity. To this end, a code of conduct is important; the interviewee in fact saw this as a ‘hygiene factor’, suggesting that if there is no such code, the risk is higher;
- (2) Risk assessment entails that some risks should be included;
- (3) Control activities;
- (4) Information and communication concerns the fact that the auditor must be well instructed so that he/she knows what to do; and
- (5) Monitoring concerns the fact that auditors occasionally reflect on their work, especially on whether the right aspects have been checked.

Analysis of AS2-127, 128, and 148

These rules concern the fact that the auditor has to form an evidence-based opinion on the company's effectiveness of internal control over financial reporting (AS2-148). This means that the auditor must obtain evidence on all assertions related to all significant accounts and disclosures in the financial statements, evaluate all evidence obtained from all sources (AS2-127), and review all reports issued during the year by internal audit (AS2-128).

Compliance with these rules can be deduced from the fact that the RPAF expressed unqualified opinions on the management's assessment of and the effectiveness of the case-study company's internal control over financial reporting, as included in Item 15.C *Attestation Report of the Registered Public Accounting Firm*.

Comment on AS2-127, 128 and 148

The accounting firm representative stated that testing and evaluating sources can be considered to be interrelated. He illustrated this using the example of an auditor testing the functioning of a control by comparing lists from a system, in order to find out whether that system, including the lists, is reliable. Thus, if the auditor uses lists from a given source (an information system) – in other words, “system-regenerated reports” – it is important to know whether the source is reliable.

Further, the auditor automatically receives all internal audit reports, and the external auditor meets the internal auditor and the audit committee periodically. During these meetings, it is often an informal rule that the external auditor also comments on the internal auditor's audit plan and sometimes gives advice – whether or not on request – about the quality of the internal audit department. The interviewee stressed that the internal auditor's quality reflects the extent to which the external auditor might make use of the internal auditor's work.

The interviewee stated that the informal conversations are mainly intended to maintain a good relationship. He considered this informal aspect to be just as important as the formal aspect. Both the internal and external auditors are working on the same project, but each have their own specific responsibility (the formal aspect). The formal communication consists of

letters and reports, and oral communication consists of discussions about these reports. The informal communication concerns socializing, which, according to the accounting firm representative, is an important factor as well.

Analysis of AS2-142-143

The rules AS2-142 and 143 both relate to AS2-20 (which itself is related to AS2-2), on the management's responsibility to carry out certain activities in order to enable the auditor to do his/her work. These rules also relate to the fact that the auditor should obtain written representations¹⁶⁸ (a–h) from the management in order to perform the audit of internal control over financial reporting.

Content element (a) can be found in paragraph 1, Item 15.B *Management's Annual Report on Internal Control over Financial Reporting*. Elements (b) and (d) can be found in the second paragraph of this report. Element (c), however, could not be detected within the Annual Report on Form 20-F. Element (e) was identified in Item 19, Exhibit 12.a *Certification CEO* and Exhibit 12.b *Certification CFO*, within point 5. Finally, elements (f)–(h) do not apply, since there were no material fraud or control deficiencies and no changes in internal control over financial reporting.

Rule AS2-143 does not apply either, as there was no limitation on the scope of the audit.

Analysis of AS2-202 and 203

Although AS2-202 and 203 are very important with respect to the annual report and the annual report process, since these rules describe the procedures to be performed by the auditor relating to the management's quarterly certifications on internal control over financial reporting, they do not apply, because foreign issuers are not required to provide quarterly certifications.

Analysis of AS2-204 and 206

These rules concern issues regarding compliance with SOX302 about the certifications of the annual accounts by the CEO and CFO. The auditor is required to ensure that the annual certifications are accurate, and is thus also responsible if matters arise that could lead to changes in internal control over financial reporting. Compliance with these rules can only be deduced from the fact that the certifications according to SOX302 can be found in the Annual Report on Form 20-F, Item 19, Exhibits 12.a and 12.b.

Analysis of AS3-2

AS3-2 includes the definition of audit documentation¹⁶⁹. The note to this rule (cf. Analysis AS2-47) refers to the minor relevance of oral evidence/representations as opposite to written representations. It can only be assumed that the case-study company's auditor complies with this rule, because it can surely be expected that this rule about what audit documentation is

¹⁶⁸ Examples: Providing a statement about management's responsibility to establish and maintain effective internal control over financial reporting, and providing a statement about management's assessment.

¹⁶⁹ Audit documentation is: "The written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as work papers or working papers."

would be one of the most significant basic assumptions within a public accounting firm that is registered with the PCAOB. The auditor's statement covers, according to the accounting firm representative (cf. 10.3.1, Comment on AS3-4), the auditor's compliance with all relevant requirements.

RPAF – Audit Committee

Analysis of SOX204(k)3

Although SOX204(k)3 has been mentioned before – in the relationship between the accounting firm and the issuer – mainly the (k) part is relevant when it comes to the auditor's relationship with the audit committee. Specifically, the accounting firm should report to the issuer's audit committee in a timely manner. This part of the rule is one of the new elements introduced by the SOX, namely that the external auditor should report directly to the audit committee and not to the management board, in order to ensure the auditor's independence (cf. 5.4.1). Previously, the accounting firm representative explained that there is a template for what the auditor should at least include in his/her report to the audit committee (cf. 10.3.1, CCU RPAF). Since the case-study company has mentioned in several parts¹⁷⁰ of the 2006 Annual Report on Form 20-F that the accounting firm did several audits, this implies compliance with SOX204(k)3. The audit firm representative's comment is worth noting here again (cf. 10.3.1, comment AS3-4), namely that the auditor's statement equals the auditor's compliance with all relevant requirements.

Analysis of SOX301(m)2

SOX301(m)2 is directly related to the previous rule, and is highly significant in that it concerns the audit committee's responsibilities towards the external auditor. Item 16.C *Principal Accountant Fee and Services* explains the appointment procedure for the external auditor, including:

- A statement that the audit committee advises the supervisory board;
- A description of the responsibilities of the audit committee; and
- A figure indicating the auditor's fees.

From the figure, it might be concluded that the audit committee is demonstrating its responsibility concerning the auditor's compensation. Further, Item 6.A *Directors and Senior Management*, sub sections 'Corporate Governance', and 'Committees', indicates that "One area of particular focus in corporate governance is the independence of the auditors", and that the audit committee has been "delegated direct responsibility for the compensation and oversight of the auditors and the services they provide". This provides evidence of compliance with this rule, on the responsibilities of the audit committee. The final sentence, too, could be regarded as further proof of compliance with SOX301(m)2, as it states: "All services rendered by [the case-study company's auditor] have been approved by the Audit Committee".

Analysis of AS2-6

Rule AS2-6 also occurs in the communication lines between the RPAF and the issuer, and between the RPAF and the investors.

¹⁷⁰ Item 3 *Key Information*, A *Selected Consolidated Financial Data*; Item 15 *Controls and Procedures*, B *Management's Annual Report on Internal Control over Financial Reporting* and C *Attestation Report of the Registered Public Accounting Firm*; Item 18 *Financial statements*, *Report of the Independent Registered Public Accounting Firm*; Item 19 Exhibit 15.a *Consent of Independent Registered Public Accounting Firm*

Comment on AS2-6

The accounting firm representative stressed the importance of formulation with respect to this rule. We saw in 9.3.1 (Comment on analysis 2, II.1.4) that the case-study company interviewee is very much aware of using the right wording, and he stressed the importance of the Communication Department in this regard. AS2-6 can therefore be considered significant, as it involves the auditor being aware that people who rely on the information concerning internal control over financial reporting include investors, creditors, the board of directors, and audit committee, as well as regulators in specialized industries, such as banking or insurance. It also involves the auditor being aware that external users of financial statements are interested in information on internal control over financial reporting, because the auditor's awareness enhances the quality of financial reporting as well as external users' confidence in financial information, including financial information issued between annual reports (e.g. quarterly information). The case-study company complies with this rule (cf. C-rules, 10.3.2 RPAF – Issuer).

Analysis of AS2-56

Rule AS2-56 is an annual report-related A-rule, but its second sentence is considered to be a C-rule (applying to the relationship between the RPAF and the audit committee), as it states:

However, because of the role of the audit committee within the control environment and monitoring components of internal control over financial reporting, the auditor should assess the effectiveness of the audit committee as part of understanding and evaluating those components.”

Comment on AS2-56

The accounting firm representative considered the last sentence of this rule to be quite strange, since the audit committee is also the auditor's client. At the same time, however, he indicated that the confirmation of the audit committee's effectiveness is very important, because if the audit committee does not function properly this is, according to AS2, a significant deficiency or perhaps a material weakness. In that case, the company would have a serious problem.

The interviewee stated that whether the audit committee has taken into account certain general principles (e.g. the SOX and Tabaksblat Code) can be evaluated. So, too, can:

- (1) The number of audit committee members;
- (2) International experience;
- (3) Understanding of the business; and
- (4) Independence important formal assessable aspects.

In addition, the interviewee called other aspects that can be evaluated “substance” aspects. These are more subjective, like “appearance”. The interviewee stated that an audit committee member can be tested, for example, with respect to the kind of questions that member asks. Further, questionnaires are used to assess the audit committee.

Further, the audit committee assesses itself, and that – according to the interviewee – is the best assessment. He explained that accounting firms often provide listed companies with documentation about the audit committee. This documentation includes, for instance, an example of an annual ‘Audit Committee Meeting Agenda’, but also a complete example ‘Audit Committee Self-assessment’. The latter has been included in the Appendix I, and it shows that all included assessment elements correspond with the relevant rules in the Tabaksblat Code and SOX rules. A reference to the audit committee's self-assessment appears in Item 6.A *Directors and Senior Management*, section ‘Supervisory Board Activities’, sub section ‘Audit Committee’, second paragraph, as follows:

In addition, the Audit Committee met once without management being present to conduct self-evaluation and appraise performance.

The ‘danger’ concerning the auditor assessing the audit committee is that there will be never a negative result. The interviewee confirmed this, and explained that if some kind of problem were to arise, it should have been notified much earlier to the interviewee’s department. This never happened, according to the interviewee, but it had happened that a certain corporation did not want the auditor to be present at the General Meeting of Shareholders, despite this being a Tabaksblat Code principle¹⁷¹ (and listed companies may deviate from best practice provisions if they explain why, but should not deviate from principles). Further, the interviewee stressed the necessity of all rules included in AS2 and 3 (which are largely extensions of SOX404) concerning what should be done in the case of a significant deficiency or material weakness. The interviewee stated that he is proud to be an accountant and that external checking of the financial reporting increases the quality of that reporting. He concluded that:

It costs a huge amount of money, but it has brought a lot too, since the number of restatements has decreased.

The interviewee felt that companies that want to be listed in the US should deal with the consequences, and that they should invest extra money to structure the organization in such a way that it complies with the rules. The case-study company interviewee appeared to agree with this point of view (cf. 9.3.1 CCU MB, Comment on II.1.5).

CCU audit committee

Analysis of SOX201(h), 202(i)(1)(A) and (B), 202/2, and 202/3

The first four rules – SOX201(h), 202(i)(1)(A) and (B), 202/2, and 202/3 – concern the auditor’s independence, which prohibits the auditor from performing certain non-audit services unless they have been approved by the audit committee (SOX202/3 stipulates that one or more members should be delegated to grant the preapprovals). The audit committee should disclose any non-audit service (SOX202/2) performed by the auditor to the investors (in periodic reports). Further, the audit committee should preapprove all auditing and non-audit services. The case-study company’s Annual Report on Form 20-F refers to both rules in Item 6.A *Directors and Senior Management*, sub sections ‘Corporate Governance’ and ‘Committees’. Further, sub section ‘Audit Committee’ under Item 6.A notes that the audit committee discussed the external auditor’s independence, and it can thus be assumed that the audit committee complies with SOX201(h) as well as 202(i)(1)(A) and (B).

Compliance with these rules can also be deduced from the texts¹⁷² included in Item 16.C *Principal Accountant Fee and Services*.

Analysis of SOX301(m)1B2

This rule was elaborated in the communication line between the RPAF and the Audit Committee.

¹⁷¹ V.4: “The external auditor shall, in any event, attend the meeting of the supervisory board, at which the annual accounts are to be adopted or approved.”

¹⁷² The Committee formally evaluates the independence of the external auditor and preapproves the fees for all audit, audit-related, and permitted nonaudit services rendered by the external auditor. The external auditors are prohibited from providing certain nonaudit services to the company. In order to anchor this in the procedures of the company, the Audit Committee adopted the [case-study company’s] “Auditors Independence Policy” and the related [case-study company’s] “Audit Committee Preapproval Policy on Audit, Audit-Related, and Nonaudit Services”; and further “The Audit Committee has adopted a policy on auditor independence which governs the external auditor’s appointment, rotation, responsibilities, services rendered, compensation, and oversight.”

Analysis of SOX301(m)(1)(4)(A)

SOX301(m)(1)(4)(A) includes the requirement that each audit committee shall establish procedures for (a) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (b) the confidential, anonymous submission by the issuer's employees of concerns regarding questionable accounting or auditing matters. Compliance with this rule can be found in Item 6 *Directors, Senior Management and Employees, C Board Practices*, sub section 'Rules of Procedure, Codes of Conduct, Complaints Procedures':

Pursuant to SOX, the Audit Committee is directly responsible for receiving and handling complaints based on this financial complaints procedure and for providing confidentiality for whistleblowers on such matters. These procedures are posted on the company's corporate website.

D-rules

The D-rules have been structured according to the relevant CCUs, namely the RPAF, issuer, and audit committee. However, the rules only apply if the A+ rules apply (cf. 10.3.1), and since the A+ rules do not apply in the case study, the D-rules do not apply either.

To sum up

The case-study company complies with all C-rules except for four¹⁷³ that are not applicable. Further, one rule (AS2-142) comprised one aspect (c) with which the company does not comply, and three aspects that do not apply. We saw in 10.3.1 that the accounting firm representative explained that if the auditor has provided his/her auditor's statement, this in effect means that the auditor complies with all SOX, AS2 and AS3 rules. Moreover, given the fact that the company complies with SOX404 by providing its management's statement, it can be assumed that it complies with all AS2- and AS3-rules (as they are extensions of SOX404).

The foregoing has made clear that some of the C-rules are very strongly interrelated, namely AS2-19, 40, and 142 with AS2-20 (A-rule), and AS2-42 and 49 with AS2-40. One of the C-rules is in fact an A-rule and thus an annual report norm, but it consists of several parts, one of which concerns the requirement that the auditor should assess the effectiveness of the audit committee (this is not the annual report-related A-rule part). We have seen that both the accounting firm representative and the case-study company prefer the self-assessment of the audit committee. The accounting firm interviewee stressed that any audit committee assessment by the auditor can only be based on formal aspects.

The accounting firm representative also emphasized that although the SOX, AS2 and AS3, and Form 20-F prescribe many texts, the formulation of statements that have not already been determined is of great importance for both the auditor and the case-study company (cf. 9.3.1, Comment on analysis 2, II.1.4). Both stressed that "formulation" in itself has virtually become a legal matter.

The D-rules do not apply, because these are directly related to the A+ rules (cf. 10.3.1), which do not apply either. Compliance with the A+ rules only applies if the auditor or management have detected a significant deficiency or material misstatement.

¹⁷³ AS2-21; AS2-143; AS2-202; AS2-203

10.4 Discursive practices – Choice of genre/Communication mode

Choice of genre

The choice of the genre is the annual report genre – more specifically, the Annual Report on Form 20-F, which is a genre network. The annual report, according to the SOX (cf. Chapter 7), should contain two separate reports, namely the auditor's report and management's internal control report. Other obligatory texts are the certifications by the CEO and CFO (according to SOX302 and 906), the Code of Ethics for the CEO and CFO, and a statement that the audit committee has (at least) one financial expert.

All SOX texts as described in the previous section are included in the 2006 Annual Report on Form 20-F, including four reports:

- (1) Item 15.B *Management's Report on Internal Control over Financial Reporting*;
- (2) Item 15.C *Attestation Report of the Registered Public Accounting Firm*;
- (3) Item 18 *Report of the Independent Registered Public Accounting Firm*; and
- (4) Item 19 Exhibit 15.a *Consent of Independent Registered Public Accounting Firm*.

The auditor's reports (2–4) are all in the form of a letter. Although the scope of this study does not include a genre-based analysis of the separate reports and texts included in the 2006 Annual Report on Form 20-F, it is clear that the auditor's reports could be considered to be letter genres, as they start with a salutation and end with the date, the place, and the author's name (i.e. the name of the auditing firm). The salutation in auditor's reports (2) and (3) concern the BoM and the supervisory board of the case-study company, while the salutation in the last letter concerns only the BoM. The salutations have not been prescribed; the endings of all reports, however, are prescribed in Form 20-F (original version). Also, the title of the auditor's attestation report is required to contain the word 'independent'.

With respect to the auditor's attestation report included in 15.C, the case-study company seems to have chosen to use Example A-1¹⁷⁴, which includes the prescribed title *Report of Independent Registered Public Accounting Firm*, followed by six prescribed paragraphs:

- (1) Introductory paragraph;
- (2) Scope paragraph;
- (3) Definition paragraph;
- (4) Inherent limitations paragraph;
- (5) Opinion paragraph; and
- (6) Explanatory paragraph.

Between paragraphs 4 and 5, the case-study company added a paragraph stating that it had acquired several companies, and that management had excluded in its assessment and the auditor had also excluded an evaluation of the relevant assessment of the internal control over financial reporting of the acquired companies. The content of the report should be established in accordance with B-rule AS2-167, which includes 16 compulsory content elements that correspond with the paragraphs as described in Example A-1, and which can also be found in the report. Besides the obligatory elements, the auditor's attestation report also contains two extra paragraphs, namely paragraphs 5 and 7 (cf. 10.3.1).

The second auditor's report, under Item 18 *Financial Statements, Report of Independent Registered Public Accounting Firm*, is primarily a statement about the auditor's audit of and opinion on the consolidated financial statements. It ends, however, with a paragraph about the audit of the effectiveness of the case-study company's internal control over financial reporting, and the fact that the auditor's report of June 13, 2007 "expressed an unqualified opinion on management's assessment of, and the effective operation of internal

¹⁷⁴ AS2, p. 224

control over financial reporting". The content is determined to a certain extent by the rules SOX404(b), AS2-4, and SOX103(a)(2)(A). Both auditor reports should carry the same date (AS2-171).

The letter form of the third auditor's report included in Item 19 is not stipulated in the SOX or AS2 and 3; its content, however, is set down – at least indirectly – in SOX404(b) and 103(a)(2)(A).

The management's report has not been established in the form of a letter, but its content is defined by AS2-162 and is also part of the instructions for Item 15.B.

Certifications 302a

The content elements of the CEO and CFO certifications are prescribed in Form 20-F (original version) and correspond with the text in SOX302(a), namely that the CEO and CFO must certify each annual report. The certifications can be found in Item 19, Exhibit 12.a *Certification CEO* and Exhibit 12.b *Certification CFO*, and all content elements are included. Both certifications are identical except for the persons signing. Although they are not presented as letters, the certifications end with the date and the name and title of the certifying officer.

Certifications 906

The CEO and CFO certifications as required in SOX906 are in fact related to those in SOX302(a). They are included in the case-study company's 2006 Form 20-F, Item 19, Exhibit 13.a *Certification CEO under Section 906* and Exhibit 13.b *Certification CFO under section 906*. The content of SOX906 has been reproduced in paragraph 2 of each of the certifications, which end with the date, the name of the certifying officer, and the name and title of the CEO or CFO.

Code of Ethics

The text of the Code of Ethics has been prescribed in Form 20-F (original version), combined with an explanation of the meaning of a code of ethics. The required Code can be found under Item 16.B *Code of Ethics*. It consists of four paragraphs including the case-study company's statement – as instructed by Form 20-F (original version) – that the Code is also available on the corporate website and has not been changed since its adoption.

Disclosure by audit committee's financial expert

A prescribed text is included in the instructions to Form 20-F (original version) for the disclosure by the audit committee's financial expert (SOX407(a)), which is included in Item 16A. *Audit Committee Financial Expert*.

The Annual Report on Form 20-F as a genre – and certainly as a genre network – not only includes the SOX-required reports and texts as mentioned previously, but also has a relatively fixed structure (cf. sub chapter 10.1, 'Structure of the 2006 Annual Report on Form 20-F'). This pertains to the overall structure, but also to a certain extent to the structure at lower levels, as the Form 20-F (original version) includes clear instructions about what should be filled in, particularly certain content elements. For example, the instructions to Item 4 *Information on the Company* prescribe seven content elements for the fixed section 'History and development of the company'. Moreover, specific instructions can be found for each section¹⁷⁵.

¹⁷⁵ "If you are giving reserve estimates in the registration statement or report: (i) consult the staff of the Office of International Corporate Finance of the Division of Corporation Finance. That office may request that you

Communication mode

The communication mode of Form 20-F should be characterized by the use of legal language (since the SOX is a law), and should be formal, official, and neutral (cf. 7.6.1). The case-study company's 2006 Annual Report on Form 20-F does adhere to this. We have seen above that the structure and content of the texts included in Form 20-F are fixed. Moreover, the entire Form is a fixed document that the case-study company has to complete in accordance with the instructions and requirements included in the SOX and AS2 and 3. The overall structure and the structure per item is fixed as well, which also means that certain content elements are fixed. The content elements and instructions, however, do not usually include fixed phrases that companies need to reproduce. Only the management's internal control report (15.B), auditor's attestation report (Item 15.C), and auditor's report under Item 18 – the report under Item 19 is not included – should contain prescribed phrases.

The Annual Report on Form 20-F leaves the case-study company little space for its own formulated texts. Item 6, however, about the directors, senior management, compensation, board practices, employees, and share ownership, shows a significant mixture of (a) prescribed sub structure, (b) prescribed content elements, and (c) the case-study company's own texts. The majority of the latter, though, are texts concerning corporate governance, which have been (almost verbatim) copied from the company's Dutch 2006 annual report. The texts in the Dutch annual report, as we saw in Chapter 9, are themselves merely texts established in accordance with the Tabaksblat Code, and thus include almost verbatim content phrasing. This means that both the case-study company's US Form 20-F and the Dutch annual report are clearly interrelated.

Finally, another feature of the communication mode is the use of references. The most significant references – starting with the most frequent and ending with the least frequent – concern the following:

- The IFRS
- The case-study company's Business Principles;
- The case-study company's 2006 Form 20-F;
- The Risk Management – Integrated Framework of the COSO;
- The Dutch Corporate Governance Code;
- The US GAAP;
- The Code of Ethics;
- Section 1350;
- Chapter 63 of Title 18 US Code; and
- The PCAOB standards

The references are discussed in section 10.5.4 on intertextual elements.

10.5 Text-internal factors

10.5.1 Situational context

Bhatia (cf. 2.3) distinguishes between the situational or immediate context and the wider context, which both influence the genre. The immediate context influences the genre directly, whereas the wider context has a more indirect influence. We saw in sub chapter 8.5 that the annual report process with respect to the case-study company's 2006 Dutch annual report is

provide supplementally a copy of the full report of the engineer or other expert who estimated the reserves. [...]. (ii) [...], and (iii) [...]."'

considered to be the basis for the process of the 2006 Annual Report on Form 20-F. This would mean that the immediate and wider contexts of the Dutch annual report process are in fact the basis for the US annual report.

The immediate context, according to the case-study company interviewee, consists of two circles (cf. 9.2). The small circle includes the people responsible for annual report contributions, and the contributions themselves (the annual report norms). The large circle includes the annual report process coordinators, participants, and C- and D-rules. In sub chapter 10.3, we saw that the case-study company uses ‘supporting elements’ such as procedures, documents, persons, and so on, in order to be able to comply with the SOX and AS2 and 3 rules.

Concretely, this means that the small circle consists of the annual report contributors, namely the CCU RPAF/auditor and the CCU issuer (specifically the BoM, including the CEO and CFO). The contributions of the RPAF concern the *Attestation Report of the Registered Public Accounting Firm* (Item 15.C), the *Report of the Independent Registered Public Accounting Firm* (included in Item 18), and the *Consent of Independent Registered Public Accounting Firm* (Item 19, Exhibit 15.a). The contributions of the issuer consist of the *Management’s Annual Report on Internal Control over Financial Reporting* (Item 15.B), the *Certification CEO* and *Certification CFO* concerning SOX302(a) and (b) (Item 19, Exhibits 12.a and 12.b), *Certification CEO under Section 906* and *Certification CFO under Section 906* (Item 19, Exhibits 13.a and 13.b), the *Code of Ethics* (Item 16.B), and finally the *Audit Committee Financial Expert* (Item 16.A). These contributions cover the annual report-related A- and B-rules and, together with certain supporting elements, constitute the context of the small circle.

Supporting elements

The auditor (RPAF) is only able to provide his/her reports if there is, first of all, an Engagement Letter containing the contractual agreements with respect to the auditor and his/her client (cf. 8.6.5). This can be seen as the starting point of the audit process. We saw in Chapter 8 that the auditor performs the audit process on the basis of the audit plan, which itself is based on the Integrated Audit Manual. The Manual includes work papers and certain procedures, for example formal and more informal reporting moments (emails or phone calls, which have to be reported in written form afterwards).

Further, supporting elements can be distinguished with respect to each of the three auditor’s reports, as mentioned above. The establishment of the *Attestation Report of the Registered Public Accounting Firm* needs the use of the Internal Control – Integrated Framework (COSO), PCAOB standards, and finally ‘prescribed’ texts or standard templates for the auditor’s statements, which can be obtained through the website of the American Institute of Certified Public Accountants (AICPA). The auditor should make use of the IFRS and PCAOB standards in order to establish the *Report of the Independent Registered Public Accounting Firm* (Item 18), and the Registration Statements on Form S-8 to establish the *Consent of Independent Registered Public Accounting Firm*.

The contributions are presented in the following figures, with a distinction made between the general supporting elements and the supporting elements specifically related to the RPAF reports.

Contributor: RPAF			
Engagement Letter	Integrated Audit Manual		
	Work papers	Procedures	
		Formal reporting moments	Informal reporting E.g. emails, phone calls

Figure 10.1: Small circle context for RPAF (general)

Figure 10.1 shows that the general supporting elements for the CCU RPAF's contributions concern the audit process, as described previously.

The next figure shows the specific supporting elements per auditor's report, most of which concern external rules (the Internal Control – Integrated Framework, PCAOB standards, AICPA templates, and IFRS). Only the case-study company's Form S-8 can be considered to be an 'internal' aspect as the company itself filled in the Form, but as the Form itself is a product of US legislation, it has both an internal and an external aspect (cf. 9.3.1).

Contributor: RPAF				
RPAF Attestation Report		RPAF Independent Report		RPAF Independent Consent
Internal Control – Integrated Framework (COSO)	PCAOB standards	IFRS	PCAOB standards	Form S-8 Registration Statements
AICPA templates				

Figure 10.2: Small circle context for RPAF (specific)

The CCU issuer, in particular the management board, should make use of the Internal Control – Integrated Framework (COSO) in order to establish the internal control report. The CEO and CFO should establish their certifications under SOX906, in accordance with section 13(a) or 15(d) of the Securities and Exchange Act of 1934. Furthermore, the CEO's and CFO's responsibilities should be 'visible' (cf. 10.3.2), as they are expected to attend the meetings and conferences of the RPAF. At the same time, the issuer's obligation to include a Code of Ethics in its annual report means that certain supporting elements are involved. These elements concern the company's procedures to monitor compliance with the Business Principles; and the company's compliance with the Tabaksblat Code, the corporate governance rules of Euronext Amsterdam, and the relevant US stock exchange. The Code applies to certain financial officers¹⁷⁶, who thus also belong to the small circle.

The last contribution by the issuer concerns the *Audit Committee Financial Expert* disclosure, whereby the independence of the financial expert has been defined in accordance with the listing requirements of the relevant US stock exchange.

The figure below shows the supporting elements with respect to the issuer's contributions to the case-study company's 2006 Annual Report on Form 20-F.

¹⁷⁶ CEO; CFO; Senior Vice President Finance; Director Corporate Control; Director Corporate Tax; Director Corporate Internal Audit; Group Controllers; Business Unit Controllers; Country Controllers; and certain "Other senior officers"

Contributor: Issuer							
Management's Internal Control report	CEO and CFO certifications			Code of Ethics			Audit Committee Financial Expert
Internal Control – Integrated Framework (COSO)	Certification under SOX302 (a) and (b)	Certification under SOX906 In accordance with Section 13(a) or 15 (d), SEA 1934	CEO's and CFO's responsibility 'visible' through attendance at RPAF meetings	Company's monitoring procedures for BP compliance	Company's compliance with Tabaksblat Code	Company's compliance with Dutch CG rules and US stock exchanges	US stock exchange listing requirements

Figure 10.3: Small circle context for issuer

Figure 10.3 shows that the supporting elements with regard to the contributions of the issuer again mostly concern external rules, namely:

- The Internal Control – Integrated Framework;
- A section of the Securities and Exchange Act (1934);
- The Tabaksblat Code;
- The corporate governance rules of the Dutch and US stock exchanges; and
- The listing requirements of the relevant US stock exchange.

The only internal aspect concerns the company's procedures with respect to the monitoring of compliance with the Business Principles. The supporting elements with both an 'internal' and an 'external' aspect concern the CEO's and CFO's attendance at RPAF meetings, which could be considered an 'internal' matter with an 'external' aspect in the sense that these meetings take place outside the company; and the financial officers are considered to be 'internal' but the 'country controllers' can be seen as 'external'.

The large circle in the immediate context consists firstly of the annual report process participants (cf. 8.5), namely:

- The Financial Reporting section (annual report process coordinator; part of the Controlling Department);
- The Communication Department;
- The Disclosure Committee;
- The US General Counsel;
- The Board of Management; and
- The audit committee.

The case-study company interviewee pointed out that the Disclosure Committee¹⁷⁷ and the Steering Committee¹⁷⁸ also play an important role within the annual report process. According to the interviewee (cf. 8.5), the Form 20-F process mainly includes the 'reconciliation' process in which the annual accounts in line with the IFRS are adjusted to the US GAAP, whereby the Dutch annual report is available as a guideline. The Annual Report on Form 20-F process consists of the Financial Reporting section filling in the Form and sending it to the Disclosure Committee, which sends it to the BoM for approval. Finally, the BoM sends it to the audit committee for final approval. As the interviewee put it, the process concerns the fact that:

¹⁷⁷ Disclosure Committee: General Counsel (chair), Director Investor Relations (secretary), Internal Auditor and Director Communication Department (members).

¹⁷⁸ Steering Committee: General Counsel (chair), Investor Relations officer (secretary), Financial Reporting, CFO, CEO, external auditors, Director Communication Department, secretary to the BoM, Communication Department (one employee responsible for implementation and realization).

You have to write the letter in fact with a new dictionary. A dictionary in another language.

Besides the annual report process participants and the coordinator, the C- and D-rules (and the case-study company's compliance therewith) also make up the large circle. However, since the D-rules do not apply, only the C-rules are taken into account here. The company's compliance with the C-rules is supported by certain elements, the most important of these concerning the establishing of a sound audit process. The accounting firm representative explained that the audit committee is of great importance for the company's external auditor, since the committee supervises and assesses the auditor. We saw in 5.4.1 that Cox (2007) views the auditor as an independent accountant who should be the guardian of financial disclosure, and that US legislation over the past decades has determined to a large extent the role and tasks of the external auditor, which ultimately finally in the SOX (officially the Accounting Industry Reform Act 2002; cf. 5.2).

This means that the audit committee's task to assess the auditor's performance is of major importance. In 8.5, we saw that the company collects information from the entire company about the external auditor's performance. Further, the audit committee¹⁷⁹ questions the external auditor through the use of an 'assessment document' in the form of a template. The external auditor, in turn, collects information about his/her own audit activities using a 'performance measuring system' or 'customer satisfaction research'. This is a standard procedure in which the auditor asks the client's staff questions about his/her performance and about formal issues like remuneration as well as non-audit and audit-related services.

The relationship between the audit committee and the external auditor is of general importance for the audit process. This relationship consists of formal communication, since the auditor must report – in the form of letters and reports – to the audit committee, but the auditor also attends all audit committee meetings (cf. 8.5). The formal communication, as stated, is mainly in written form, while the committee's meetings naturally involve oral communication, as do the discussions between the auditor and the committee. We saw in 8.5 that the relationship between the external auditor and the audit committee is bipartite. The accounting firm supports the audit committee with respect to its tasks regarding the auditor in very concrete form, for example by way of information and templates provided by the Audit Committee Institute.

A sound audit process further entails that the external auditor establishes correct audit documentation which proves that he/she did the auditing work. Another significant aspect of the auditor's work is obtaining an understanding of the design of specific controls, for example, by inquiring certain personnel (i.e. management, supervisory and other staff). The accounting firm representative (cf. 10.3.2) mentioned that internal training takes place for the auditors to ask the right questions. Further, the auditor can obtain evidence from other sources, including the internal audit reports and 'system-generated reports'. From the case-study company's side, the company's procedures 'Auditors Independence Policy' and 'Audit Committee Pre-Approval Policy on Audit, Audit-Related, and Non-Audit Services' are also relevant here.

Furthermore, the case-study company's complaints procedures are regarded to be supporting elements as well. Finally, three out of the four SOX Corporate Communication Units¹⁸⁰ in this study play an important role in the annual report process. The CCU investors is the addressee for the entire Form 20-F, as the Form is established primarily on behalf of the

¹⁷⁹ The RPAF supports the client's Audit Committee (as we have seen previously) as it provides the Audit Committee with relevant documents, among them a template called 'Example Evaluation of External Auditors', which is included in the Appendix K: Audit Committee's Assessment: External Auditor.

¹⁸⁰ CCU RPAF, CCU issuer, and CCU audit committee. The CCU investors plays only a passive role, since the 2006 Annual Report on Form 20-F is mainly established on behalf of the investors.

investors. The CCU investors thus plays a passive, but significant role. The BoM as part of the CCUs issuer and audit committee have been mentioned above as annual report process participant and one of the three key committees within the annual report process, respectively.

The large circle is presented in the next figure, while the audit process (including the relationship between the audit committee and the external auditor) is elaborated in Figure 10.5 in more detail.

Large circle				
Committees	Processes	Procedures	AR process participants	AR process coordinator
1. Disclosure Committee	1. Audit process	Complaints procedure	Financial Reporting section	Financial Reporting section
2. Steering Committee	2. Cf. Figure 10.5		Communication Department	
3. Audit Committee (cf. Figure 10.5)			US lawyer	
			BoM	

Figure 10.4: Large circle (general)

The large circle of the immediate context as shown in Figure 10.4 includes the complaints procedures with respect to financial issues, which are in accordance with external requirements (i.e. the SOX).

Figure 10.5 shows that the supporting elements are in fact all internal aspects, whereby the audit process is mainly based on external rules (SOX and AS2 and 3). Since the audit process itself is an extended process, the supporting elements are presented separately below:

Audit process					
Training	Committees	Documentation		Department	Assessment External auditor
Auditor training on inquiring client's personnel	Audit Committee	Audit documentation	Company's documents	Legal Department (legal correctness of formulations)	1. EA performance measuring system
	<ul style="list-style-type: none"> • Auditor's reports to AC • Auditor's letters to AC • Discussions between auditor and AC on auditor's reports 	<ul style="list-style-type: none"> System-generated reports 	<ul style="list-style-type: none"> • Internal audit reports • Auditors Independence Policy • AC Pre-Approval Policy on Audit, Audit-Related, and Non-Audit Services 		2. AC assessment document

Figure 10.5: Large circle (audit process)

As will be clear, the audit process is quite complicated, and Figure 10.5 mentions only the most significant supporting elements. Although the RPAF is an independent company, it is in

the service of the case-study company and, therefore, all RPAF documents, procedures, etc. concerning the audit process can be considered ‘internal’ aspects. The supporting elements are thus also considered to be internal aspects, whereby the audit documentation is determined (almost) entirely by the external rules included in Audit Standard 3. Further, the auditor’s reports to the audit committee are an internal issue although they are mainly based on external rules. In addition, the company’s policies with respect to the auditor’s independence and services are internally influenced and established documents, but based on external requirements. Finally, the ‘Audit Committee assessment document’ is a document used internally but is again based on external requirements. This, too, shows that each context element can have an internal and an external aspect.

Although the immediate context with respect to the case-study company’s 2006 Annual Report on Form 20-F seems to be less complicated than the immediate context with respect to the company’s 2006 Dutch annual report (Chapter 9), one should keep in mind that the audit process according to the SOX and AS2 and 3 is highly complicated, and based on a huge number of rules. For example, SOX404 contains 171 words, whereas the clarifying elaborations published by the SEC and PCAOB consist of 10,000 words, and each accounting firm needed 100,000 words to cover these elaborations in their instructions, manuals, and work papers (cf. 8.6.5). Further, the annual report process for the Dutch annual report is considered to be the basis for the Form 20-F process. This would mean that the immediate context of the Annual Report on Form 20-F is more than double the immediate context of the Dutch annual report.

The conclusion about the Dutch annual report context drawn in section 9.5.1 also applies to the Annual Report on Form 20-F context, namely that the context is highly complicated as the immediate context encompasses the small and large circles, and the wider context consists of the relevant external rules. Further, we have seen that the internal and external rules are in fact interrelated, and thus the boundary between the immediate and the wider context is not particularly clear.

10.5.2 Communicative purpose

Section 7.6.2 showed that the communicative purpose according to the SOX is transparency. The emphasis is on financial disclosure, which can be seen as the core of the US view on transparency. The US corporate governance system is an outsider system (cf. 3.4), and in the ideal outsider system the shareholders hold a central position in the values and norms of society, in the legal rules, and in the specific institutional organizations. Chapter 3 showed that financial information enables the shareholders to act in accordance with the expected value of the firm, which means that they may buy or sell their shares based on the information obtained. This explains why the SOX is meant to ‘protect the investors’, as stated in its first sentence, and also explains certain instructions included in Form 20-F. For example, the instruction to Item 3.D *Risk Factors* contains the following text:

Risk factors should be concise and explain clearly how the risk affects the issuer or the securities.

More specific text that highlights the importance of the investors is included in the instructions to Item 5:

[...] provide the information specified below as well as such other information that is necessary for an investor’s understanding of the company’s financial condition, changes in financial condition and results of operations.

Most instructions describe the purpose of the items concerned, namely “to provide information” about various subjects, such as the business operations and the company’s plants and equipment. These examples show that information disclosure is of significant importance,

and that each company should provide information concerning different elements per item included in Form 20-F.

The case-study company also refers to transparency, stating in Item 3 *Key Information*, D *Risk Factors*, second paragraph that:

Risk management is also one of the essential elements of the company's corporate governance. This calls for creating a proper balance between entrepreneurial attitude and risk levels associated with business opportunities. We foster a big awareness of business risks and internal control procedures, geared to safeguarding transparency in our operations.

The company's view of transparency is directly focused on "our operations", which are considered to be related to "a big awareness of business risks and internal control procedures" and thus also strongly linked with financial disclosure. However, the company puts risk management into the larger framework of "the company's corporate governance", which is explained in Item 6 to be based on the requirements of the:

Dutch Civil Code, the company's Articles of Association, and the rules and regulations applicable to companies listed on Euronext Amsterdam and [a US listing], complemented by several internal procedures.

The Dutch Civil Code requires, for example, the two-tier board system, which the Tabaksblat Code also stresses, and both the Civil Code and the Tabaksblat Code are reflected in the Articles of Association. This means that the case-study company is indirectly referring to the transparency goal of the Tabaksblat Code, which requires a sound system of 'checks' and 'balances' (cf. 4.4) – contrary to the US transparency goal, which relates only to financial disclosure (cf. 5.4).

The separate obligatory reports – the auditor's report, management's report, and auditor's attestation report – are expected to have their own communicative purpose, since the communicative purpose of the management's report could be assumed to be the confirmation of the correctness of the financial statements, of the management's assessment of the effectiveness of internal control over financial reporting, and the actual effectiveness of this internal control. As we have seen previously, "management should go first", followed by the auditor's audit, and then the auditor's reports. The communicative purpose of these reports could be the confirmation of the correctness of all the elements mentioned above, from the external auditor's perspective. However, this study did not allow scope for an investigation of the communicative purpose of the separate reports included in the Annual Report on Form 20-F.

10.5.3 Move structures/Themes

Move structures

The first move structure as described in 7.6.2 concerns SOX302, and all elements can be detected (cf. 10.3.1). The second move structure concerns AS2-167 and consists of the elements (a)–(p). The first element, (a) "A title that includes the word *independent*", could not be detected within the auditor's attestation report (Item 15.C), but is mentioned in the management's internal control report (Item 15.B) within the reference to the auditor's attestation report. The third move structure included in AS2-162 can be found in Item 15.B. Finally, the fourth and fifth move structures (AS2-159 and AS2-190) concern A+ rules which do not apply to the case-study company's 2006 Annual Report on Form 20-F.

Besides the above, phrases have also been considered to be a special kind of move structure (cf. 7.6.2). The phrases included in AS2-163 have been captured in Item 15.B. The other phrases (concerning AS2-191, 194, and 196) have not been identified, since the rules concerned do not apply to the 2006 Form 20-F.

Themes

Each of the annual report-related A- and B-rules (cf. 7.6.1) has been linked with a specific corporate governance theme. The case-study company in fact complies with all annual report norms, which means that the annual report-related A- and B-rules have the corresponding themes as revealed in Chapter 7.

10.5.4 Intertextual elements

Sub chapter 10.7, on the annual report context, showed that the Annual Report on Form 20-F is a complex genre network. The references to compliance with the required annual report norms could be found in different chapters and sections of the case-study company's 2006 Form 20-F.

The complexity of the genre network is a result of three different levels of interrelations, varying from (1) a more general level, where references to the case-study company's compliance with the annual report norms appear in different items, to (2) the detection of norms in different sections of the items; and (3) the most detailed level, where the description of compliance with a norm includes a further reference.

The first and second levels of intertextual aspects are shown in the following overviews:

Section	Item	15 Controls and Procedures	16.A Audit Committee Financial Expert
15.A Disclosure controls and procedures		SOX404(a), AS2-20, AS2-55	
15.B Management's AR on Internal Control over Financial Reporting		SOX404(a), SOX404(b), AS2-167 element (a), AS2-2, AS2-20, AS2-55, AS2-163	
15.C Attestation Report of the RPAF		SOX404, SOX404(b), AS2-167, AS2-4, SOX103(a)(2)(A), AS2-169, AS2-171, AS3-4, AS3-5, AS3-10, AS2-20, AS2-55	
			SOX407(a)

Figure 10.6: Intertextual elements: levels 1 and 2A

Section	Item	16.B Code of Ethics	18. Financial Statements	19. Exhibits
	SOX406			
Report of Independent RPAF			SOX404(b), AS2-4, SOX103(a)(2)(A), AS2-169, AS2-171, AS3-4, AS3-5, AS3-10	
Signatures				SOX302(a) and (b)
Exhibit 12.a: CEO certification				AS2-20, AS2-55, SOX302(a) and (b)
Exhibit 12.b: CFO certification				AS2-20, AS2-55, SOX302(a) and (b)
Exhibit 13.a: CEO Certification under Section 906				SOX906
Exhibit 13.b: CFO Certification under section 906				SOX906
Exhibit 15.a: Consent of Independent RPAF				SOX404(b), AS2-169, AS2-171

Figure 10.7: Intertextual elements: levels 1 and 2B

Figures 10.6 and 10.7 show that Item 15.C *Attestation Report of the Registered Public Accounting Firm* includes the majority of the references to certain annual report-related A- and B-rules. This emphasizes the fact that the SOX (and related Accounting Standards 2 and 3) is officially the Accounting Industry Reform Act 2002 (cf. 5.2). The auditor clearly plays a very important role. The *Report of the Independent Registered Public Accounting Firm* in Item 18 takes second place with respect to the number of references, followed by *Management's Annual Report on Internal Control over Financial Reporting* (15.B). It is clear that these three reports form the core of the case-study company's 2006 Annual Report on Form 20-F, which is enhanced by the fact that they contain references to the most significant rule of the US corporate governance code (i.e. SOX404).

Further, Figure 10.7 shows that many references to the case-study company's compliance with the annual report norms are included in Item 19 *Exhibits*, since the signatures of the CEO and CFO are considered to be the company's confirmation that the financial statements, the internal control procedures, and the management's assessment of these procedures are correct. It is clear that both the CCU RPAF and the CCU issuer (including the CEO and CFO) are of major importance with regard to the US corporate governance code.

Most references to compliance with the annual report norms occur not only in one item but in several items. SOX404(a) and (b) appear in items 15.A, B, and C, Item 18, and finally in Item 19 (Exhibit 15.a). AS2-20 and AS2-55 are regarded to be interrelated, and this is confirmed by the fact that they are included in items 15.A, B, and C, and Item 19 (Exhibit 12.a and 12.b). Four references¹⁸¹ occur three times; some¹⁸² twice; and four¹⁸³ only once.

The most detailed level of intertextual aspects concerns references to annual report-related A- and B-rules that themselves also include references. These can be sub divided into internal and external references. The internal references concern the case-study company, while the external references concern US, Dutch, and European legislation and regulations, as well as global rules and regulations.

Since most annual report norms are visible in the abovementioned reports plus in the exhibits in Item 19, the next figure presents the references per report or item:

¹⁸¹ AS2-169, AS2-171 and SOX302(a) and (b)

¹⁸² AS2-167; AS2-4; SOX103(a)(2)(A); AS3-4; AS3-5; AS3-10

¹⁸³ AS2-2; AS2-163; SOX407(a); SOX406

Internal/external Item	Internal references	External references – US	External references – NL	External references – Europe	External references – global
15.B <i>Management's Annual Report on Internal Control over Financial Reporting</i>	Case-study company's policies and procedures concerning internal control over financial reporting	Rule 13-15(f) under Securities and Exchange Act 1934		IFRS	Internal Control – Integrated Framework (COSO)
	Reference to auditor's report included in Item 15.C	US GAAP			
		Guidelines established by US SEC			
15.C <i>Attestation Report of the RPAF</i>	Reference to 1.A, "management's assessment included in the accompanying Management's Annual Report on Internal Control over Financial Reporting"	Audit "in accordance with the standards of the PCAOB"	Financial reporting and preparation of financial statements for external purposes "in accordance with generally accepted accounting principles"	IFRS	Internal Control – Integrated Framework (COSO)
16.A <i>Audit Committee Financial Expert</i>	Requirements as defined in Item 16.A	"Independent for purposes of the [stock exchange] listing requirements"			
16B. Code of Ethics	Company's website	Corporate governance rules (stock exchange)	Tabaksblat Code		

Figure 10.8: Intertextual aspects A: level 3

Internal/external Item	Internal references	External references – US	External references – Europe	External references – global
(16.B <i>Code of Ethics</i>)	Business Principles			
	Company's procedures to arrange for dissemination of the Business Principles			
	Company's procedures to monitor compliance with the Business Principles			
16.C <i>Principal Accountant Fee and Services</i>	Company's Auditors Independence Policy			
	Company's Audit Committee Pre-Approval Policy on Audit, Audit-Related, and Non-Audit Services			
	Company's website			
18 <i>Financial Statements – Report of Independent RPAF</i>	Reference to Note 27 (incl. description of differences between IFRS and US GAAP)	Audits "in accordance with the standards of the PCAOB"	IFRS	Internal Control – Integrated Framework (COSO)
		US GAAP		

Figure 10.9: Intertextual aspects B: level 3

Internal/external Item	Internal references	External references – US	External references - NL
19 Exhibits – (b) Exhibits	Articles of Association (incorporated by reference from Form 6-K furnished to the US SEC)	Form 6-K SEC Form 20-F 12.a Rule 13a-14(a) Certification CEO 12.b Rule 13a-14(a) Certification CFO 13.a Rule 13a-14(b) Certification CEO 13.b Rule 13a-14(b) Certification CFO	
19 Exhibits – Exhibits 12.a and 12.b (CEO and CFO certifications)		Disclosure controls and procedures as defined in Exchange Act rules 13a-15(e) and 15d-15(e) Exchange Act rules 13a-15(f) and 15d-15(f)	

Figure 10.10: Intertextual aspects C: level 3

Internal/ external Item	External references – US	External references – NL
19 Exhibits – Exhibits 13.a and 13.b (CEO and CFO certifications)	Section 1350, chapter 63 of title 18, United States Code	Dutch legislation
	Requirements of section 13(a) or 15(d) of the Securities and Exchange Act of 1934	

Figure 10.11: Intertextual aspects D: level 3

Figures 10.8–10.11 show that the internal references mainly concern the company's policies and procedures, namely:

- (1) Internal control over financial reporting;
- (2) Dissemination of the Business Principles;
- (3) Monitoring of compliance with the Business Principles;
- (4) The Auditors Independence Policy; and finally
- (5) The Audit Committee Pre-Approval Policy on Audit, Audit-Related, and Non-Audit Services.

Further, the internal references also point to the company's corporate website and the Articles of Association.

Text-internal references within the 2006 Annual Report on Form 20-F include a reference to the auditor's report (15.C), to 1.A, to 16.A, and finally to Item 18 Note 27.

As seen above, the external references have been sub divided, and, concerning the US, relate to:

- The SEA of 1934¹⁸⁴;
- The US GAAP;
- The PCAOB standards;
- The listing requirements of a US stock exchange concerning independence;
- The corporate governance rules of the US stock exchange;
- Form 6-K;
- Form 20-F;
- Section 1350 chapter 63 title 18 United States Code; and finally

¹⁸⁴ Securities and Exchange Act 1934: rules 13a-14(a) and (b); 13a-15(e) and (f); and 15d-15(f).

- The SEC.

The external references with respect to the Netherlands concern the Tabaksblat Code, Dutch legislation, and finally the generally accepted accounting principles. The external references with regard to Europe as a whole concern the IFRS, and with respect to global rules and regulations, the Internal Control – Integrated Framework of the COSO.

Broadly speaking, this sub chapter once again demonstrates the complexity of the Annual Report on Form 20-F genre network.

10.6 Summary

This chapter has shown the ‘is’ situation concerning the case-study company’s 2006 Annual Report on Form 20-F as compared to the ‘ought’ situation of the US Form 20-F genre according to the SOX and AS2 and 3 (cf. 7.6.1 and 7.6.2), in order to answer sub question III.2: How do the 2006 annual report’s (Form 20-F’s) structure and content reflect the adjustments as required by the Sarbanes-Oxley Act?

This chapter started by examining the structure of the Form 20-F, which is essentially a template that the concerned company has to fill in, with instructions for the different items and prescribed content elements that the company should take into account. The analysis of the ‘is’ situation consisted of investigating whether the text-external and text-internal factors of the annual report’s generic integrity could be identified.

Text-external factors

The discursive procedures concern the annual report contributors, namely the CCU RPAF and the CCU issuer, which corresponds with the ‘ought’ situation as described in 10.5.1. The participants in the complex annual report process are the RPAF, the Financial Reporting section (part of the Controlling Department), the Communication Department, the Disclosure Committee, the US General Counsel, the BoM, and the audit committee. The Financial Reporting section is also the coordinator of the annual report process. The process is further significantly influenced by the annual report A- and B-rules (cf. 7.6.1), and supported and constructed by the C-rules. The A+ rules, which are A-rules that only come into existence if a significant deficiency or a material weakness is identified, did not apply (nor did the D-rules that are related to the A+ rules).

The case-study company complies with all A- and B-rules except for one content element¹⁸⁵ that could not be detected in the auditor’s report, as required by AS2. However, since AS2 and AS3 are extended additions to SOX404(b) and SOX103(a)(2)(A)(iii)¹⁸⁶, it might be stated that the company’s compliance with both these rules entails compliance with all AS2 and AS3 rules. Further, the accounting firm representative explained that the fact that the auditor provided his/her auditor’s statement in fact means the auditor complies with all

¹⁸⁵ AS2-167 content element (a) should have been included in the auditor’s attestation report (Item 15.C), but was found instead in the *Management’s Annual Report on Internal Control over Financial Reporting* (Item 15.B).

¹⁸⁶ AS2, 3. These are the standards on attestation engagements referred to in Section 404(b) the section Public Company Accounting Oversight Board Bylaws and Rules – Standards – AS2 154 As of August 25, 2009 103(a)(2)(A)(iii) of the SOX. Throughout this standard, the auditor’s attestation of management’s assessment of the effectiveness of internal control over financial reporting required by Section 404(b) is referred to as the audit of internal control over financial reporting. In other words, the two terms (“audit of internal control over financial reporting” and “attestation of management’s assessment of the effectiveness of internal control over financial reporting”) refer to the same professional service. The first refers to the process; and the second refers to the result of that process.

SOX, AS2 and AS3 rules (cf. 10.3.1), thus implying that the case-study company complies with all annual report-related A- and B-rules.

The case-study company also complies with the majority of the C-rules. However, it does not comply with one aspect (c) of one rule (AS2-142), and three aspects of this rule as well as four other rules¹⁸⁷ are not applicable. One of the C-rules is an annual report-related A-rule (AS2-56) consisting of several parts, one part of which (the C-rule) requires that the auditor assess the effectiveness of the audit committee.

With regard to choice of genre, the case-study company has no real choice given that the Annual Report on Form 20-F is a legal obligation. The US Form 20-F genre is a genre network in that it includes four separate reports, namely (1) *Management's Annual Report on Internal Control over Financial Reporting*; (2) *Attestation Report of the Registered Public Accounting Firm*; (3) *Report of Independent Registered Public Accounting Firm*; and (4) *Consent of Independent Registered Public Accounting Firm*. The auditor's reports might be considered letter genres because they start with a salutation and end with the date, place, and author's name. Chapter 7 showed that the US annual report should at least include two reports, namely the auditor's report and management's internal control report. Further, Form 20-F is a genre network as it includes the required CEO and CFO certifications (cf. 7.6.1), the *Code of Ethics*, and the disclosure of the *Audit Committee Financial Expert*. The structure of Form 20-F is entirely fixed, as are many of the content elements.

The communication mode is formal and official, as described in Chapter 7. Most texts are also neutral, especially the fixed texts; since Form 20-F includes many instructions and prescribed elements, the case-study company has little opportunity to use its own formulations. The use of references is part of the communication mode.

Text-internal factors

The situational context does not seem – at first glance – to be overly complex, but as the context of the Dutch report is the basis for the 2006 Form 20-F, the context of the latter is in fact extremely complex.

The small circle of the situational context consists of the annual report contributors CCU RPAF and CCU issuer and the contributions themselves, which corresponds with the annual report norms. Compliance is supported by certain elements. With respect to the auditor's reports, these are mainly external rules; only one element (Form S-8) has both an internal and an external aspect, in that it was established by the case-study company but is based on an external rule. The majority of the supporting elements concerning the CCU issuer are also external rules, plus one internal rule (certain company procedures), and finally two elements that have both an internal and an external aspect.

The large circle consists of the annual report process coordinator and the participants (see above), as well as the references to the case-study company's compliance with the C-rules. The supporting elements of the large circle are internal aspects only. This is because the relationship between the CCU issuer and CCU RPAF is particularly strong as they are the only annual report contributors, and thus the RPAF is considered to 'belong' to the case-study company (and as such regarded to be 'internal').

The external rules together construct the wider context, but most rules are considered to have both an internal and an external aspect, which gives rise to an unclear boundary between the immediate and wider context.

The communicative purpose of the case-study company's Annual Report on Form 20-F is transparency, with an emphasis on financial disclosure (cf. 7.6.2). The other separate,

¹⁸⁷ AS2-21; AS2-143; AS2-202; AS2-203

obligatory texts included in Form 20-F might be considered to be genres as well. However, a genre-based analysis of these texts does not fit into the scope of this dissertation.

The move structures 1 and 3 could be identified as determined in section 7.6.2, while the move structures 4 and 5 could not, as the corresponding rules did not apply. Move structure 2 was detected, except for content element (a) of AS2-167.

The themes described in section 7.6.2 are related to the annual report-related A- and B-rules. Since the case-study company complies with all annual report-related A- and B-rules, all themes were also relevant.

The intertextual aspects are of major importance for the US Form 20-F as a genre network. The fact that the 2006 US annual report includes one management report, three auditor's reports, two CEO and CFO certifications, the disclosure text of the Audit Committee Financial Expert, and the Code of Ethics clearly demonstrates that the 2006 Form 20-F is a genre network. The intertextual aspects, however, are much more profound, given that three levels of interrelation can be identified¹⁸⁸. The core of the first level consists of the *Management's Annual Report on Internal Control over Financial Reporting*, the *Attestation Report of the Registered Public Accounting Firm*, the *Report of the Independent Registered Public Accounting Firm*, and the certifications in Item 19. The second level involves the fact that some references occurred in several text parts. Finally, the references as part of the third level of intertextuality have been sub divided into internal and external references, most of them being external.

This analysis of the 2006 Annual Report on Form 20-F has shown that the case-study company does comply with all prescriptive communication rules of the SOX and AS2 and 3 with respect to the US Form 20-F genre according to the SOX. This means that the 'is' situation corresponds fully with the 'ought' situation, and thus the case-study company's 2006 Annual Report on Form 20-F can be classified as belonging to the US Form 20-F genre.

¹⁸⁸ The references concern all compliance with the A- and B-rules. Level 1: References to compliance with the items. Level 2: References to compliance with sections of the items. Level 3: References to compliance with references.

Conclusions

11.1 Introduction

This dissertation included a single-case study investigation, typified as an ‘illuminative’ case (cf. 2.4.2) as it shed light on how the ‘game’ of ‘good governance’ is played in a corporation. The case study had two goals (cf. 2.4.1). The first was to analyze how the prescriptive constitutive rules of ‘good governance’ as formulated in the Tabaksblat Code and the Sarbanes-Oxley Act (SOX) are used to clarify ‘good governance’ within a company. Specifically, the ‘ideal’ annual report genre was compared with the ‘actual’ annual report (i.e. comparison of the ‘ought’ situation with the ‘is’ situation). The second goal was to demonstrate whether the codes’ attempts to institutionalize ‘good governance’ succeeded, namely Searle’s descriptive theory of institutions. In other words, this study shed light on the implications of Searle’s theory for a specific corporation, in that it investigated how the game of ‘good governance’ was played in this particular case.

The aim – in accordance with Searle’s theory and the communication perspective of this study – was to examine whether the norms of the corporate governance codes could be formulated as rules for communication actions. If so, it should be possible to investigate whether a company complies with these rules in its annual report. The study showed that it was indeed possible to investigate compliance via the annual report: Analysis step 1 (chapters 6 and 7) showed that the Tabaksblat Code’s and SOX’s norms include communication actions, while analysis step 2 (chapters 9 and 10) showed that the case-study company’s 2006 Dutch annual report and the 2006 US Annual Report on Form 20-F revealed whether or not the company had complied with the norms (A- and B- rules). This means that the communication perspective has been confirmed within the study.

Using genre theory as instrument, the case study included two comparisons in order to shed light from the communication perspective on how the constitutive communication rules have been put into practice. To this end, the ‘ought’ situation of the communication actions required by both the Dutch (Chapter 6) and the US (Chapter 7) corporate governance codes was compared with the ‘is’ situation of the case-study company’s 2006 Dutch annual report (Chapter 9) and its 2006 Annual Report on Form 20-F (Chapter 10).

The next sub chapter describes the Tabaksblat Code in the company’s practice. Sub chapter 11.3 does the same for the Form 20-F. Subsequently, the Dutch and US corporate governance are compared in 11.4, while Searle’s theory of institutions forms the core of 11.5. Finally, sub chapter 11.6 describes the topics for further discussion.

11.2 The Tabaksblat Code in the company’s practice

The ‘comply or explain’ rule plays an important role in the comparison of the ‘is’ and ‘ought’ situations with respect to the company’s 2006 Dutch annual report and Annual Report on Form 20-F. It states that while companies should comply with the rules, they may deviate from the best practice provisions (and thus from the annual report A- or B-rules) if they explain why they have done so. Although the ‘comply or explain’ rule seems to be clear, its application often gives rise to the question whether the company does or not comply.

11.2.1 The ‘comply or explain’ rule

The European Commission’s ‘comply or explain’ principle was a requirement for all EU Member States when establishing their own corporate governance codes. We saw earlier that this principle is legally embedded. Schoordijk (2005) stresses that although the Tabaksblat Code was meant as self-regulation, it is a juridical document and incorrect compliance might have considerable consequences. Schoordijk points out that the ‘comply or explain’ rule means that a company is free to express its explanation of the deviation from the relevant best practice provision however it sees fit, but in any event in a transparent manner. The Monitoring Committee, which was established to monitor listed companies’ compliance with the Code, referred in its 2006 report (cf. 4.5.2) to these “transparent explanations”, concluding that 85% of the explanations could be classified as *understandable* and 47% as *verifiable*. In its 2007 report, the Committee observed a more far-reaching, and undesirable development towards standardization (i.e. convergence) with respect to the explanations of deviations. The Committee pointed out that it will consider standard explanations that are not properly elaborated to be insufficient. In the Preamble to the Code, the Tabaksblat Committee emphasizes the importance of the reasons for non-compliance.

The tendency to standardize the formulations might be seen in the light of the “old boys network”; for example, companies discussing controversial items in order to find an acceptable solution. We saw in 3.5.2 that this kind of corporate managers’ network is cohesive, highly powerful, and influential. Heemskerk (2007) regards the existence of such a group to be a feature – in fact, a path dependency factor – within the Dutch corporate governance system. The case-study company interviewee referred to comparable groups with respect to the implementation of the Tabaksblat Code that asked themselves the question “how do other companies deal with the implementation of the Tabaksblat Code?” (cf. 8.3). He pointed out that the larger Dutch listed companies do have contact with one another through several forms of consultation. The secretaries to the management boards have their own meetings, for example, arranged by the Dutch Managers Association (NIVE). Further, the Dutch Association of Business Jurists (NGB) organizes meetings for jurists. The interviewee emphasized that since the Netherlands is such a small country, managers and other employees do come across one another in several different associations. He saw the advantages of such consultative bodies as consistency and better policies. The convergence of the explanations of deviations from Tabaksblat Code rules, thus, is considered to be the consequence of a traditional Dutch corporate governance phenomenon.

The Corporate Governance Insights Centre of the University of Groningen analyzes the answers to the annual questionnaire concerning Dutch listed companies’ compliance with the Code. Their report of these results forms the basis for the yearly report of the Corporate Governance Code Monitoring Committee. The Centre’s 2007 analysis described an experiment by which it investigated the quality of the top 5 most frequently used explanations. Eleven students from the University of Groningen and four members of the Monitoring Committee were to evaluate 30 selected explanations on the basis of four quality dimensions, namely:

1. Understandable: whether the explanation is understandable in the sense that the assessor gains insight into the reasons for the company’s non-compliance;
2. Verifiable: whether the explanation is verifiable with the help of publicly accessible information (e.g. website, annual report);
3. Legitimacy: whether it is regarded to be a legitimate explanation for non-compliance with the provision concerned (without taking the specific features of the corporation into account);
4. Plausibility: to what extent the explanation is considered to be plausible for the corporation concerned when the corporation’s features are taken into account. (Corporate Governance Insights Centre, 2007, p. 13)

The first two quality dimensions indicate whether an explanation is transparent, while the remaining two refer to its suitability. The results showed that the judgments concerning the dimensions ‘understandable’ and ‘verifiable’ scored higher than those for ‘legitimacy’ and ‘plausibility’. Further, the members of the Corporate Governance Code Monitoring Committee were more extreme in their opinions than the students: they were more positive about the ‘understandable’ and ‘verifiable’ dimensions, but more negative concerning ‘legitimacy’ and ‘plausibility’.

The Monitoring Committee’s 2007 report included examples of explanations that had been qualified as ‘good’ and ‘not good’. The ‘good’ explanations seem to be characterized by:

- (1) Concrete formulation of the explanation; and
- (2) Information provision about the company’s policy on the issue.

11.2.2 Non-compliance by the case-study company

The case-study company made use of the ‘comply or explain’ rule with respect to one annual report norm (II.2.7) about severance payment, explaining that it “is not believed to be in the interest of the company to renegotiate existing contracts of the members of the Board of Management appointed before 2004” (cf. 9.3.1: Analysis of rule II.2.10). Further, the company pointed out that the supervisory board has the “intention to take the provisions of the code as guidance for establishing severance payments”. According to the interviewee, this latter remark concerns two aspects. The first is that there are no criteria for determining severance payment, so the company is free to do whatever it considers right. The second concerns the fact that the general meeting of shareholders only approves the remuneration policy and not severance payments.

The 2007 report of the Monitoring Committee includes an example of an explanation for deviation from II.2.7 that was positively assessed, namely:

All present members of the management board were appointed before publication of the Code. Severance payments were agreed upon when entering into these contracts. The duration of the terms of employment with previous employers was taken into account. These regulations could lead to payments that exceed one year’s salary. (Author’s translation) (Monitoring Committee 2007 report¹⁸⁹, p. 33)

The first part of the case-study company’s explanation for deviation from II.2.7 belongs to the top 5 explanations, namely that the company did not want to renegotiate already existing contracts. This may be considered to fit the definition of a ‘good explanation’ if it is (1) the ‘concrete formulation of the explanation’ as mentioned above. Further, the second part of the company’s explanation (i.e. that the company intends to take the provisions of the code as guidance for establishing severance payments) may cover the second part of a ‘good explanation’ – i.e. (2) information provision about the company’s policy on the issue – if the ‘intention’ is regarded as equating to the company’s ‘policy’.

However, the judgments concerning a ‘good’ explanation remain subjective, and can thus be interpreted in different ways. The Committee concluded that altogether the explanations could be considered ‘transparent’, but their ‘suitability’ was insufficient. This conclusion, however, is somewhat vague, because the question arises whether ‘transparent’

¹⁸⁹ The title of the 2007 report is ‘Corporate Governance in Nederland. Een onderzoek naar de stand van zaken in het boekjaar 2006 en de ontwikkelingen ten opzichte van het boekjaar 2005’ [Corporate governance in the Netherlands: A study of the state of affairs in the financial year 2006 and the developments with respect to the financial year 2005].

but not ‘suitable’ explanations have been qualified as ‘good’ explanations. If so, the quality dimensions ‘legitimate’ and ‘plausible’, which constitute ‘suitability’, are apparently of no relevance at all. In this case, what is their consequence?

The case-study company’s explanation for non-compliance with III.2.3 (which, together with III.2.2, forms part of III.2.1) concerned the statements of the supervisory board members’ independence. The company stated outright that it is “formally not in compliance with the Code Provision III.2.3”. At the same time, however, the company appears to be convinced of its compliance with this rule, as it states in its 2006 Annual Report¹⁹⁰ that:

All Supervisory Board members meet the independence requirements as stated in the Code [...], except for [two members]. In this respect, it should be noted that [one of the two members] is a former member of the Board of Management, who retired from this position in 2003. [This member] will step down as member of the Supervisory Board at the 2007 General Meeting of Shareholders.

The deviation has not been explained explicitly, but the fact that the member concerned would step down as supervisory board member in 2007 could be seen as an explanation, since it indicates that the tenure finishes within a short period of time. This means that the first part of a ‘good’ explanation, namely (1) ‘concrete formulation of the explanation’, is not present. However, the information stating that the member will soon retire might be seen as the company’s ‘policy’, covering part (2) of a ‘good’ explanation (information provision on the company’s policy).

The deviation concerning the non-independence of the second member has been explained explicitly: the company has a “long-standing policy” in that it “welcomes the recent knowledge and expertise of the affairs and business of the company” of the member concerned. This individual was a former member of the management board of a bank – the case-study company’s ‘home bank’, in fact – and was still a consultant “on macroeconomic policies” to that same bank, but according to the case-study company he was “in this capacity not involved in its management”. The explanation, in the case-study company’s view, was certainly ‘understandable’ and ‘verifiable’, and also ‘legitimate’ and ‘plausible’. We saw in 9.3.1 that the case-study company interviewee considered the integrity of the supervisory board members a condition *sine qua non*, which seems to relate to the ‘plausible’ aspect of the explanation. However, is this explanation also sound from the Tabaksblat Code’s perspective? All that can be stated here is that it is (1) a ‘concrete formulation of the explanation’ and that (2) information about the company’s policy on the issue is present. The Monitoring Committee’s assessors might therefore indeed evaluate this as a ‘good’ explanation.

This extended elaboration makes clear that non-compliance in the first instance might turn into compliance on further consideration. Since the explanation for the second supervisory board member’s non-independence might be regarded a ‘good’ explanation, leaving only one non-independent supervisory board member, the company may not actually deviate from III.2.3.

Further, the case-study company’s compliance with respect to III.5.3 (reports of the separate supervisory board committees) was not clear. The company explained this and the above deviations to a certain extent, but whether these explanations will be accepted or not remains an open question. Acceptance of these explanations would signify the company’s compliance.

¹⁹⁰ 2006 Annual Report, chapter *Corporate Governance*, section ‘Appointment, Independence and Composition’.

11.2.3 Compliance from the perspective of Searle's theory of institutions

As stated, the case-study company deviated from II.2.7, and the explanation for this may perhaps be considered ‘transparent’ and ‘suitable’ in the Corporate Governance Insight Centre’s and the Monitoring Committee’s view. The company also deviated from III.2.3, and as the explanation may also be considered ‘transparent’ and even ‘suitable’, it is possible that the company may in the end comply with III.2.3. Thus, there remains only the company’s partial compliance with III.5.3.

It is clear that the ‘comply or explain’ rule allows companies to play an ‘open game’ of ‘good governance’. It might be concluded that this ‘open game’ is confusing since it is unclear whether the explanations mentioned previously are actually ‘allowed’ and thus equate to compliance or not. And indeed, the case-study company’s compliance with II.2.7 and III.2.3 is not clear based on the quality dimensions as introduced by the Corporate Governance Insights Centre and used by the Monitoring Committee. If, however, we were to focus exclusively on the company’s deviations, neglecting the notion that the explanations might be ‘good’ explanations, we would have to conclude that the company deviated from both rules.

As stated, it is also unclear whether the company’s partial compliance with III.5 could be considered non-compliance, since neither the Corporate Governance Insights Centre nor the Monitoring Committee provides guidelines with respect to partial compliance. However, if partial compliance indeed entails non-compliance and if the conclusion that the company indeed deviated from II.2.7 and III.2.3 holds, the case-study company’s annual report – the ‘is’ situation – does not correspond with the ‘should’ situation. This set of conclusions would have far-reaching consequences with respect to the following questions:

1. Does the annual report display the integrity of the Dutch annual report genre?
2. Has the company achieved formal transparency?
3. Does Searle’s formula ‘We accept (S has power (S does A))’ apply?
4. Has the Dutch ‘good governance’ been institutionalized?

Question 1: Integrity

If the company did not comply with all rules, the 2006 annual report would not demonstrate the integrity of the Dutch annual report genre according to the Tabaksblat Code. The integrity of a genre is determined by certain text-internal and text-external factors. The factors that determine the Dutch annual report genre according to the Dutch code (cf. 6.9.1 and 6.9.2) could not all be detected within the annual report, meaning that this report does not demonstrate the integrity of the Dutch annual report genre according to the Tabaksblat Code. This generic integrity, in Searle’s view, is the key feature constituting the institution ‘good governance’ (cf. 1.1).

Question 2: Formal transparency

If the conclusions about non-compliance are right, the case-study company did not establish a 2006 Dutch annual report genre network in accordance with the Tabaksblat Code. This leads to the conclusion that the company did not achieve formal transparency. Formal transparency can be achieved if a company complies with all rules, because the constitutive rules included in the Code together construct ‘good governance’, and ‘good governance’ is aimed at transparency. Thus, the Dutch institution ‘good governance’ aims at achieving formal transparency.

Informal transparency, in contrast, is not directly related to compliance with the rules of the Code, although a mutual influence is expected to exist. Rather, informal transparency relates to the explanations of non-compliance. The company considers the explanations to equate to compliance. Thus, it can be stated that the company’s compliance with the rules

aims at formal transparency, whereby informal transparency supports the process towards formal transparency. The case-study company interviewee considered the company to be transparent irrespective of whether it complied with the Code's rules. This transparency, therefore, is informal transparency.

Question 3: 'We accept (S has power (S does A))'

The purpose of having institutions (cf. 2.2), according to Searle, is to create new sorts of power relationships, which he calls "deontic powers". This is the power to bring something into existence by means of applying constitutive rules, such as the rules included in the Tabaksblat Code, which determine who should do what. Searle created a new formula that can be seen as an elaboration of the first formula '*X counts as Y in C*', namely '*We accept (S has power (S does A))*', whereby the link to the first formula lies in the fact that we only accept someone as having power if he/she has that power in virtue of his/her institutional status. Since the case-study company plays its own 'game' of corporate governance – more or less supported by the 'comply or explain' rule – and creates its own version of transparency, whereby it is not clear whether it complies with all rules (as this depends on whether the acceptance of the explanation of non-compliance is in accordance with the Code), Searle's second formula "*We accept (S has power (S does A))*" should not apply. This would mean that the Dutch 'good governance' has not been accepted within the case-study company.

In short, the 'comply or explain' rule leads to uncertainty about compliance, which makes it impossible to draw conclusions about whether the Dutch institution 'good governance' has been constituted or not. The 'comply or explain' rule is a lawful restriction of the institution 'good governance', but it restricts the obligation to comply with the codes' constitutive rules. This implies that this possibility does not promote the institutionalization of 'good governance'. That can certainly be considered an undesirable situation.

11.3 Form 20-F in the company's practice

The comparison of the 'is' and 'ought' situations concerning the case-study company's 2006 Annual Report on Form 20-F (Chapter 10) showed that the 'is' situation of the report corresponds with the 'ought' situation of the US Form 20-F genre according to the SOX. This means that the company's 2006 Annual Report on Form 20-F is a US Form 20-F genre, displaying the text-internal and text-external factors that determine the generic integrity of the genre according to the SOX. In turn, this means that formal transparency has been achieved, Searle's formula '*We accept (S has power (S does A))*' applies to the case-study company, and the US institution 'good governance' has been collectively accepted and thus constituted.

11.3.1 Compliance industry

Since compliance is such an important issue and it is management's responsibility to comply with all relevant rules and regulations for both the SOX and the Tabaksblat Code, some scholars suggest that a 'corporate compliance industry' exists, in particular within the US area. Baer (2009) is one of these. She states that the corporate compliance industry consists of "lawyers, auditors, ethics officers, and other professionals who monitor firms", and that this industry is a consequence of the pressure placed on corporations by mandatory rules and regulations to adopt programs designed to ward off internal misconduct, and by the threat that they will be punished severely if they fail to do so. According to Baer, corporate compliance – which she defines as "the internal programs that corporations adopt in order to

educate employees, improve ethical norms, and detect and prevent violations of law” – has evolved “into a universal corporate governance activity” (2009, p. 4).

We saw in 9.3.1 (Comment on analysis 2, rule II.1.4) that the case-study company has an extended compliance system related to risk management because, as the case-study company interviewee stated, risk management is the condition for transparency, and transparency can be achieved by compliance with the SOX and Tabaksblat Code rules. This compliance system consists of all internal measures concerning risk management, namely:

- The Risk Management framework;
- The Company Statement;
- The Internal Authority Schedules;
- The Corporate Directives; but also
- Risk reporting such as the Business Planning & Review Cycle explained above, or the ‘rolling forecast’ and the contingency plans.

The compliance system also includes the Letters of Representation, the Compliance Committee, and the Code of Conduct, which shows that the company has formal structures to prevent bribery. The Compliance Committee plays a significant role given its task to establish compliance across the entire organization with the Business Principles in particular, and to investigate complaints about non-compliance. Complaints concerning financial disclosure – and thus those that are particularly important for SOX compliance – run via the General Counsel (who also chairs the Compliance Committee). The 2006 Dutch annual report showed that the case-study company regards the practical application of the Business Principles and the law compliance program to be the main means of preventing non-compliance. The latter program concerns, for example, the ‘competition law compliance program’, which includes an interactive program that is obligatory for each new employee. The corresponding ‘competition law compliance manual’ is an additional instrument for achieving compliance with competition law.

Bear defines compliance in general as:

A system of policies and controls that organizations adopt to deter violations of law and to assure external authorities that they are taking steps to deter violations of law. (2009, p. 10)

This seems to be in line with the case-study company interviewee’s statement that the outside world expects more and more from listed companies as a consequence of the Ahold and Enron scandals, and the corporation is expected to ensure firm governance, which is understood as being ‘in control’ (cf. 10.3.1). This means that structures within the company’s organization have to be established that guarantee compliance with the law and with the internal rules (cf. 9.3.1: Comment on II.1.5). The interviewee explained: “It starts at the top and then it can also be seen in the annual report”. It can be concluded that compliance revolves especially around using the prescribed formulations and templates from the SOX. The accounting firm representative (cf. 10.3.2), too, held the view that companies that want to be listed in the US should deal with the consequences, and invest extra money to structure the organization such that it complies with the rules.

Bear (2009) is highly pessimistic about the reasons for establishing compliance programs, as in her view they concern:

‘Cosmetic compliance’, whereby corporations implement programs solely for the sake of appearing, but not actually being, compliant.

Moreover, she states that:

The sheer size of the compliance industry, which includes multiple American Lawyer 100 firms who proudly trumpet their assistance on their websites, severely undercuts the notion that corporations and compliance providers are engaged in a concerted bad-faith attempt at intentional window-dressing. (2009, p.4)

The business sector itself, however, appears to disagree. The case-study company interviewee pointed out that compliance with competition legislation in particular has

nothing to do with “window dressing”. The Compliance Committee is the ‘home’ of compliance within the organization, but there is also a very strong legal component. The chairs have all been General Counsel. Thus, it is all about external expectations, but also about internal expectations, since the management board wants to prevent problems – and not only because it is accountable for mismanagement – like the penalties it has received for competition issues in the past. The company wants to prevent any decrease in its value that could occur as a consequence of paying penalties or making prohibited agreements. The company must be able to detect and prevent such problems, and therefore has to establish a certain structure and reporting procedure in order to do so.

Still, as the constitutive rules can never guarantee the sincerity of the approach to these rules, the independence of the external auditor is a key issue.

11.3.2 Compliance from the perspective of Searle’s theory of institutions

The case-study company complies with all SOX and Auditing Standards 2 and 3 (AS2 and AS3) rules, give or take a few small issues. It was mentioned in 10.3.1 and 10.3.2 that one B-rule (AS2-172), the A+ rules – which are only relevant in the case of material weaknesses – and finally four C-rules (AS2-21; AS2-143; AS2-202; AS2-203) did not apply. Further, it was indicated that content element (a) of B-rule AS2-167 could not be detected in the ‘right’ place, and the company did not comply with one aspect (c) of one C-rule (AS2-142). Finally, three aspects of C-rule AS2-142 do not apply and nor do any of the D-rules, because they are directly related to the A+ rules that also do not apply.

The accounting firm representative explained that an RPAF only provides his/her statements if the client’s ‘in control’ statement is verifiable, and these statements confirm that the auditor complies with all relevant rules. This means that the inclusion of the auditor’s reports in the case-study company’s 2006 Annual Report on Form 20-F automatically entail that the auditor met all relevant SOX and AS2 and 3 requirements, and the management’s ‘in control’ statement also confirms the case-study company’s compliance with all relevant requirements. In other words, both the management’s statement and the auditor’s statements can be seen as confirmations of compliance.

This means that the company reviewed in this dissertation is considered to comply with all rules, and thus that the ‘is’ situation of the case-study company’s Annual Report on Form 20-F corresponds completely with the ‘ought’ situation of the US Form 20-F genre according to the SOX (and AS2 and 3). This report is therefore a US Form 20-F genre network. With respect to Searle’s theory of institutions, this means that formal transparency has been achieved, and US ‘good governance’ has been accepted within the case-study company.

In turn, this also means that the purpose of the institution according to Searle – namely, the creation of new sorts of power relationships (“deontic powers”) – has been accomplished, and thus the formula ‘*We accept (S has power (S does A))*’ applies. This entails that the case-study company accepts that the SOX and related AS2 and 3 include constitutive rules that determine who should do what. The conclusion is that, according to Searle’s theory of institutions, the SOX’s attempt to institutionalize ‘good governance’ could succeed if all listed companies that should comply with SOX do so, as in the case-study company.

However, compliance with most constitutive communication rules with respect to the auditor (the registered public accounting firm, or RPAF) could be identified neither in the case-study company’s 2006 Annual Report on Form 20-F nor in other documents (its audit documents are not made available to ‘outsiders’).

According to the accounting firm representative, the indirect compliance lies in the fact that if the auditor has provided his/her obligatory statements (SOX404(b)), he/she complies with all other SOX and AS2 and 3 rules. This means that the auditor's compliance with the vast majority of the constitutive communication rules depends on compliance with one rule, and 'outsiders' (as well as the client) are forced to trust the auditor's statements, which are based on the management's statement.

In short, it can be concluded based on Searle's theory of institutions that formal transparency in particular has been achieved, although it is barely traceable.

11.4 Dutch and US corporate governance compared

The second comparison concerns the comparison of both 'ought' situations and both 'is' situations, one result being that the Dutch code's 'comply or explain' rule leaves space for an 'open game' of corporate governance. This, in fact, was the intention of the Tabaksblat Committee, which was eager to avoid a 'one size fits all' set of rules. Such an 'open game', however, motivates companies to create their own version of 'transparency' (cf. 9.11.1). The 'comply or explain' rule thus ultimately leads to uncertainty about whether the company complies or not.

As stated, the 'comply or explain' rule entails that companies either comply with the constitutive rules or deviate from the best practice provisions, provided that they explain their reasons for deviating. This equates compliance and explanations for deviations, as long as those explanations are transparent. To be transparent, according to the Monitoring Committee, the explanations need to be understandable, verifiable, and suitable.

Although the quality of the explanations remains a concern for the Monitoring Committee, the case-study company was convinced that it had created a much more transparent company. However, if companies in the Dutch context show a tendency more towards 'explain' – whereby the quality of the explanations is under discussion – and less towards 'compliance', this has consequences for transparency and thus for the collective acceptance of the Dutch institution 'good governance'.

The second result of the comparison between the 'is' and 'ought' situations is that the case-study company did achieve formal transparency with respect to the SOX, according to Searle's theory of institutions. However, this formal transparency, which has been formulated within the constitutive rules of the SOX and AS2 and 3, and thus the case-study company's compliance, is almost exclusively based on the management's 'in control' statement and the auditor's statements. In essence, therefore, the compliance with practically all rules is connected in a kind of chain. If just one link is weak or even broken, the whole chain falls apart. Whereas the company's compliance with the constitutive communication rules of the Tabaksblat Code might be considered reasonably visible for an 'outsider', compliance with the SOX rules is hardly traceable at all, mainly because the audit investigation is unavailable or inaccessible. The SOX was primarily meant for the protection of investors – who are also 'outsiders' – by ensuring reliable financial information. However, it is unclear to outsiders whether the financial information is correct and reliable, and whether the investors are thus protected effectively. Only the regular inspections by the Public Company Accounting Oversight Board (PCAOB) of RPAFs and issuers (cf. 5.2 footnote 1, on the PCAOB's duties) might be seen as a safeguard for correct and reliable financial disclosures and the protection of investors. The conclusion can be drawn that compliance adds up on paper, but is in fact untraceable by an 'outsider'.

It is also worth referring to the accounting firm representative's claim (cf. 10.3.2: Comment on AS2-6) that the SOX indeed functions because otherwise mistakes would not

become visible, and that in order to intimidate auditors all over the world, the SEC and PCAOB had in mind a percentage of disapproved statements that auditors ought to achieve. The PCAOB's inspections of audit firms are rigorous – hence the auditors' nickname for it: 'Piekaboo' – and the penalties for non-compliance are very high. The interviewee's view was that "It is the American style, but it functions".

The conclusion of both comparisons is that the case-study company plays the 'open game' of Dutch 'good governance', which is supported by the 'comply or explain' rule, but which is also a consequence of the company's own ideas of transparency. At the same time, the company plays the 'not-open game' of US 'good governance'.

11.5 Searle's theory of institutions

11.5.1 Relevance of Searle's theory

The case study also used Searle's theory of institutions. Specifically, the case study ought to show to what extent the codes' attempts to institutionalize the quality of corporate governance succeeded within the case-study company.

We have seen that this theory was a useful method to describe how the 'game' of 'good governance' has been played in practice, and the previous sub chapter showed that the case-study company played the US 'game' according to the rules, whereas the Dutch 'game' was an 'open game', meaning it is unclear whether the company complied or not.

Although the expression 'you can put anything on paper, paper won't blush' still applies, the quality of US corporate governance can be considered to be institutionalized. Consequently, this means that the existence of 'good governance' has been made logically dependent on the SOX rules. The conclusion with respect to the Dutch 'game' includes that it is not clear whether the quality of Dutch corporate governance has been institutionalized. The Tabaksblat Committee's attempt to institutionalize 'good governance' by means of the company's obligation to comply with the Tabaksblat Code's rules seems to have succeeded only partially. It could be stated that the Code's rules did function as regulative rules. Searle (1969 (1978)), however, pointed out with respect to constitutive rules that (1) they have the form '*X counts as Y in C*', (2) they come in systems, and (3) that "it may be the whole system which exemplifies this form and not individual rules within the system" (1969 (1978), p. 36). The 'comply or explain' rule is not one of the actual rules of the Tabaksblat Code. Searle's concept of constitutive rules, therefore, does not include or take into account the 'comply or explain' rule as an 'escape' or 'tailor-made' rule. It might even be assumed that because of this rule the Tabaksblat Code's attempt to institutionalize the quality of corporate governance has failed from Searle's point of view.

The conclusion that the case-study company accepted US 'good governance' is based on the fact that the company's 2006 Annual Report on Form 20-F is a US Form 20-F genre network, as it has the integrity – the text-internal and text-external factors – of the US Form 20-F genre according to the SOX. This means that if all listed companies' Forms 20-F demonstrate the required integrity, 'good governance' will have been accepted and thus the US institution 'good governance' will have been constituted, since Searle views generic integrity as the key feature constituting the institution 'good governance' (cf. 1.1).

This conclusion implies that formal transparency has been achieved. The previous sub chapter showed that Searle's theory of institutions has been used with a focus on formal transparency, which arises if the annual report displays the integrity of the annual report genre according to the constitutive communication rules included in the relevant code.

The case-study company interviewee, however, held the view that his company had become transparent due to its compliance with both the SOX and the Tabaksblat Code. This transparency had been established through a huge number of established procedures, policies, committees, etc. (cf. 9.6) as part of the context of the annual reports. It also consists of a clear division of responsibilities, though this seems to be a merit of the Tabaksblat Code only, as the consequence of the legally obligatory two-tier board.

The (partially) formal transparency achieved by the company is a consequence of the rules included in the Dutch Code and the US SOX, and makes it easier to track weaknesses.

11.5.2 Internal communication

The case-study company interviewee emphasized that the internal communication processes have led to changes, one of the biggest being better communication, as an indirect consequence of the Tabaksblat Code and the SOX. However, better communication is particularly a consequence of a parallel development, namely that society – in both the Netherlands and the US – is becoming more bound up in legal matters, and developing more of a ‘claims culture’. In other words, society requires more from corporations, which in turn requires more caution regarding communication. The company representative explained that due to caution with respect to external communication in particular, but also to internal communication, the company is very careful in terms of how it communicates. For example, the US may claim all documentation (including internal communication) in the event of a lawsuit, and an investigation by the EU in the case of a competition law violation might also include internal communication, such as emails. The interviewee explained that communication has become very important:

- (a) In order to *communicate* the message;
- (b) Because miscommunication may have disastrous consequences (i.e. for shares); and
- (c) As a sort of “damage control”, in the sense of “being careful with communication” from a legal perspective.

The case-study company interviewee indicated that the internal communication has been strongly improved. Further, he explained that because the company is highly decentralized and operates in many countries, different approaches emerge, which consequently leads to different ways of communicating. The consequence is that all kinds of misunderstandings could arise. He mentioned the example of the definition of ‘risk’, which had been discussed intensively in the case-study company until an agreement was reached on an accepted definition. The company interviewee thus concluded: “It’s about agreeing on how to communicate with one another”. Although it had been quite a process, the company had become much more unified, with everyone using the same language, vocabulary, and templates, as a result of which accuracy was increased.

Both the transparency of communication and communication as a major unity-constructing factor can be observed in the decision-making process. The company interviewee explained that the three-stage rocket in the decision-making process at corporate level has become a two-stage rocket, whereby a BU proposal goes to a group (the Business Area Board) before it arrives at the management board. The communication lines have thus become shorter, resulting in time savings but also improved quality because the people involved have direct contact with one another. The quality of the documentation has also improved, as the company representative explained, because of:

- (1) more transparency within the concerned group;
- (2) tighter hierarchy and structure; and
- (3) communication between smaller groups, which leads to better decision-making because people are better informed.

The organization and processes within the organization have become more simplified, which the company representative saw as directly relating to compliance with the SOX and the Tabaksblat Code. He considered this to be a global process. Interestingly, he also stated that the two codes “affect the people’s psyches”; that is, in the way people work, and through the choices made by the management board. The board too, had decided on a more focused organization, which led to an increase in internal communication quality. This implies that both the SOX and the Tabaksblat Code are experienced as having the same influence on the company internally, although the outcomes with respect to the constitution of the ‘good governance’ institutions differ.

The case-study company interviewee, however, held the view that the corporate communication had not become more transparent for society at large, because it was the corporation that would ultimately decide “who should know what” to ensure an appropriate and well-organized decision-making process.

The case-study company put in a great deal of effort and spent a huge amount of money to structure the organization such that it complies with both the Tabaksblat Code and the SOX. Its compliance system and entire organizational structure are meant to optimize transparency.

The case study has shown how ‘*X* becomes *Y* (“good governance”)’ within the case-study company. This process concerning the US institution ‘good governance’ resulted in formal transparency. With respect to the Dutch institution ‘good governance’, however, the process did not unequivocally lead to formal transparency.

The processes of developing ‘*X* into *Y*’ within the case-study company necessitated the company-internal process that led to the company’s ‘own’ transparency, which can be seen not only as an improvement for the case-study company itself, but also as a process that supports the process leading to formal transparency. The internal corporate communication with respect to the annual report forms the immediate context, and this combined with the wider context (e.g. external regulation) forms part of all factors that influence the annual report. All these factors together determine whether formal transparency has or has not been achieved.

The case-study company improved its internal communication structure, which implies a more – at least internally – transparent organization and at the same time a (formally) transparent organization according to the SOX.

Is Searle’s theory of institutions useful only for detecting formal transparency, or also for mapping and detecting informal transparency? That is, can we view all the case-study company’s efforts – the entire communication structure consisting of procedures, decision-making processes, meetings, etc. – to play its ‘own game’ and establish its ‘own transparency’ as the informal transparency that supports formal transparency? It is important to keep in mind that Searle conceptualizes ‘good governance’ as compliance with the constitutive rules that include communication actions. Abuse cannot be revealed by compliance, and thus it remains up to judicial judgments to reveal abuse (at least with respect to SOX rules).

11.6 Discussion

The scope of this investigation constrained further research on certain topics that emerged during the course of the study. These topics are described in the following sections.

Tabaksblat Code

The ‘comply or explain’ rule is one of the key elements of the Dutch corporate governance code. This rule offered the case-study company the possibility to play its own ‘game’ of ‘good governance’, but is this still an option within the new Code? As of January 1, 2009, the Tabaksblat Code 2003 has been replaced by the Code 2008. This is the result of the Committee’s June 4, 2008 publication of its proposals for updating the Code. Interested parties could comment on the proposals, and these comments have led to:

Amendments to the wording of the principles and best practice provisions, thereby helping to improve the Corporate Governance Code and, as the Committee expects, to further broaden the base of support for the Code. (Tabaksblat Code 2008, Account of the Committee’s work, 6, p. 48)

The Committee places strong emphasis on “influencing behaviour of management board members, supervisory board members and shareholders”, in contrast with the “accountability and transparency” emphasis in the Code 2003. The rules have been designed in such a way that they encourage the desired behavior, with the Committee aiming to promote “real discussion within and between the different organs of a company”. The Committee mentions in the Preamble that:

5. The Code is not an isolated set of rules, but part of a larger system, together with Dutch and European legislation and case law on corporate governance, which must be viewed in its entirety. The particular merit of the Code as an instrument of self-regulation lies above all in its influence on the behaviour of management board members, supervisory board members and shareholders. The strength of the Code is proportionate to the extent to which the company’s stakeholders endorse it and try to comply with it.

This indicates that the new Committee does not intend to turn the Code 2008 into a rule-based regulation. However, the Committee chair, Jos Streppel, initiated a ‘broader’ monitoring of compliance with the Code, in which the former Committee’s concern about the quality of explanations plays an important role. This monitoring consists of:

- (1) Calling individual corporations to account for non-compliance;
- (2) Organizing meetings with management and supervisory board members and shareholders; and
- (3) Increasing the quality of explanations for deviations, for example, referring to the company’s own regulations will be not accepted as an ‘explanation’¹⁹¹.

Further, the Committee decided with respect to the ‘comply or explain’ rule that:

In so far as a principle or best practice provision corresponds with a statutory rule, this may mean that a company or shareholder is not allowed to depart from the relevant provision, not even when reasons are given.

This means that the Committee prohibits explanations for non-compliance with certain rules. This new approach is the Committee’s way of dealing with the overlap between the Code and existing and future legislation¹⁹². At the same time, it is a first, cautious attempt to accept that even adequate ‘explanation’ is not always equal to ‘compliance’.

However, it would be valuable to investigate whether the principle-based regulation should be turned into rule-based regulation like the SOX, since the case-study company did in fact play the US ‘game’ of ‘good governance’ according to the rules (in contrast with the Dutch ‘game’). It could also be investigated whether some kind of ranking with respect to compliance with best practice provisions based on higher and lesser priority might lead to better compliance.

¹⁹¹ As has been mentioned previously, the Corporate Governance Insights Centre established quality dimensions that determine whether an explanation is ‘transparent’ ('understandable' and 'verifiable') and ‘suitable’ ('legitimate' and 'plausible'). The Centre also included examples of ‘good’ and ‘not good’ examples in its 2007 report (pp. 31-34), though neither the Centre nor the Monitoring Committee mention any consequence for ‘not good’ explanations. The Committee merely calls for better explanations.

¹⁹² Cf. Tabaksblat Code 2008, Account of the Committee’s work, p. 50.

The SOX and AS2 and 3

The case-study company has decided to delist from the US stock exchange and deregister from the SEC. The company interviewee pointed out that the SOX is a very in-depth and aggravating legal process. He conceded that monitoring and being ‘in control’ are important, but the company prefers less concrete monitoring than provided for by the SOX, and prefers to let the management board act at its own discretion. The delisting and deregistration also represented huge cost savings. Further, being listed only in Amsterdam, according to the interviewee, is more efficient in “this global financial market” in which “everyone is finding his way to the Amsterdam stock exchange”. The company does not need the US listing to have US investors.

Many non-US (and particularly European) companies have made the same decision, and perhaps as a consequence of so many delistings, AS5 has superseded AS2 since August 6, 2007. The content of AS5 remains, according to the accounting firm representative, but the obligatory procedures have been simplified. Still, the question arises: has the dominance of the US context been jeopardized by the constitutive rules of its own collectively accepted institution ‘good governance’?

Multinational/transnational companies

Although numerous delistings have indeed taken place, many companies such as the case-study company have created a certain communication structure in which the system of Letters of Representation has a central function, and which leads to better control and more transparency. With respect to the case-study company, this structure has mainly been influenced by compliance with the SOX and AS2 and 3, which again emphasizes the dominance of the Anglo-Saxon context over the Dutch context. This dominance can be seen in the light of the discussion about multinational/transnational enterprises, in which multinational enterprises are domiciled in a certain country (the Netherlands for the case-study company). A multinational enterprise that controls the assets of other entities in economies other than its home economy, usually by owning a certain equity capital stake, is a transnational corporation. The threshold for the control of assets is normally considered to be an equity capital stake of 10% or more of the ordinary shares or voting power for an incorporated enterprise, or the equivalent for an unincorporated enterprise¹⁹³. In this regard, it could be worth investigating what consequences might arise from the developments towards transnational companies for the corporate governance systems involved and the related regulation and legislation.

Stakeholder/shareholder system

The case-study company interviewee held the view that the stakeholder focus in the Netherlands is still important, despite the Anglo-Saxon dominance as mentioned above. He also pointed out that the Dutch still, “at least in theory”, believe in having a healthy balance between different groups of stakeholders. He explained that the Tabaksblat Code was primarily meant to strengthen shareholders’ powers, and by doing so, a potential imbalance was established in the relationships between the stakeholders. This primarily concerns the corporation’s relationship with the shareholders, according to the interviewee, but by turning over this relationship slightly, an imbalance among the stakeholders might have occurred as a consequence.

¹⁹³ UNCTAD, 2004. Development and Globalization: Facts and Figures, p. 40.

This also seems to be reflected in the new Code 2008, in which the Committee explicitly mentions that it has included two sections in the Preamble concerning the:

inherent tension in the stakeholder model between, on the one hand, the rule that when taking decisions the management and supervisory boards should be guided by the interests of the company and its stakeholders and, on the other, the fact that these boards are accountable for their actions to shareholders, who are themselves entitled to put their own interests first.

The relevant sections in the Preamble are the following:

10. The above principles can cause tension between on the one hand the management and supervisory boards, which have to serve the interests of the company and are accountable for this to the general meeting and, on the other, the shareholders, who are, in principle, free to put their own interests first. How this tension should be resolved will differ from case to case. The Code contains general rules of conduct designed to ensure the careful handling of the processes involving the management board, the supervisory board and the shareholders (in particular, the general meeting of shareholders) and to help the management board and the supervisory board weigh up the different interests correctly. Good relations between the various stakeholders are of great importance in this connection, particularly through a continuous and constructive dialogue.

11. The tension described above may become especially pronounced in takeover situations. It has been seen in practice that when various alternatives have to be compared during takeover negotiations, the highest price for the shares is often a major factor. However, decision-making should also take account of other relevant interests. Partly in view of the risk that particular interests may gain the upper hand in takeover situations, the special involvement of the supervisory board is required in cases where, for example, the shares are acquired by means of a public bid or where a company makes a substantial acquisition.

Section 11 above refers explicitly to takeover situations, which the Committee directly relates to section 10 and which are one of the new themes¹⁹⁴ covered by the amendments. The Committee points out that since the original Code came into force in 2004, Dutch listed companies have increasingly come under the influence of the market for corporate control (mergers and acquisitions), and the shares of large Dutch listed companies in particular are to a great extent in the hands of foreign shareholders. It might therefore be interesting to investigate whether – despite the Committee's efforts to maintain the stakeholder model and the fact that a quite 'typical' Anglo-Saxon market for corporate control is emerging – the stakeholder model will indeed remain in the future. The question whether the stakeholders are represented sufficiently within the Code's rules could also be taken into account here.

Genre-based investigations

An annual report – and in particular the Dutch annual report genre network according to the Tabaksblat Code, as its separate texts are not as fixed as those included in the US Form 20-F genre – consists of separate chapters and other text parts. Although genre-based analyses of annual reports have been performed¹⁹⁵, these have mainly concerned the CEO's letter/Chairman's statement and not the other text parts. This dissertation has shown that many more separate chapters and texts are included, which might be considered as constituting specific genres in themselves. However, no genre-based analysis of the majority

¹⁹⁴ The main new themes are: (1) diversity/position of women; (2) corporate social responsibility; (3) levels of executive pay; and (4) takeover situations.

¹⁹⁵ (1) The communicative purpose of the entire annual report (Yuthas et al. 2002; Garzone 2004; Hundt 1998); (2) The non-financial texts contributing to the general promotional potential of the annual report have been selected by British and Dutch interviewees and, in the British and Dutch-English annual reports, concern the CEO's Statement, the corporate profile description, and the operational review; and in the British annual report additionally the Chairman's Statement (De Groot 2006); (3) The addressees of the annual report (Garzone 2004; De Groot 2006; Hundt 1998); (4) The obligatory components of the annual report genre (Garzone 2004; De Groot et al. 2006); and (5) Move structures within the CEO's Letter/Chairman's Statement (Garzone 2004; Nickerson and De Groot 2006; De Groot 2008).

of the texts has yet been conducted. Such genre investigations might shed light on the different text-external and text-internal factors, and the annual report genre in general, even more clearly. They could also contribute to the discussion on intercultural communication. Likewise, very few investigations with respect to actual business texts and in particular complete annual reports have been conducted, though such studies could reveal how the integrity of the different annual reports from different countries corresponds or differs. Investigations into the annual reports of businesses in different EU Member States could, for example, shed light on how these countries deal with the ‘comply or explain’ rule. In short, much still remains to be explored in the field of actual business texts from different countries.

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Appendix A

Structure of the Tabaksblat Code

The Code consists of principles and best practice provisions. The Code includes five chapters and the structure is as follows:

Chapter	Principle	Best practice provisions
I. Compliance with and enforcement of the code	I	I.1 – I.2
II. Management board	II.1 Role and procedure	II.1.1-II.1.7
	II.2 Remuneration Amount and composition of the remuneration	II.2.1-II.2.8
	Determination and disclosure remuneration	II.2.9-II.2.14
	II.3 Conflicts of interest	II.3.1-II.3.4
III. Supervisory board	III.1 Role and procedure	III.1.1-III.1.9
	III.2	III.2.1-III.2.3
	III.3 Expertise and composition	III.3.1-III.3.6
	III.4 Role of the chairman of the supervisory board and the company secretary	III.4.1-III.4.3
	III.5 Composition and role of three key committees of the supervisory board	III.5.1-III.5.13
	III.6 Conflicts of interest	III.6.1-III.6.7
	III.7 Remuneration	III.7.1-III.7.4
	III.8 One-tier board structure	III.8.1-III.8.4
IV. The shareholders and the general meeting of shareholders	IV.1 Powers	IV.1.1-IV.1.7
	IV.2 Depositary receipts for shares	IV.2.1-IV.2.8
	IV.3 Provision of information to and logistics of the general meeting of shareholders	IV.3.1-IV.3.9
	IV.4. Responsibility of institutional investors	IV.4.1-IV.4.3
V. The audit of the financial reporting and the position of the internal auditor function and of the external auditor	V.1 Financial reporting	V.1.1 – V.1.3
	V.2 Role, appointment, remuneration, and assessment of the functioning of the external auditor	V.2.1-V.2.3
	V.3 Internal auditor function	V.3.1
	V.4 Relationship and communication of the external auditor with the organs of the company	V.4.1-V.4.3

Appendix B

Structure of the SOX

Section 1. Short title; table of contents.	Sections 1-3
TITLE I—Public company accounting oversight board	Sections 101-109
TITLE II—Auditor independence	Sections 201-209
TITLE III—Corporate responsibility	Sections 301-308
TITLE IV—Enhanced financial disclosures	Sections 401-409
TITLE V—Analyst conflicts of interest	Section 501
TITLE VI—Commission resources and authority	Sections 601-604
TITLE VII—Studies and reports	Sections 701-705
TITLE VIII—Corporate and criminal fraud accountability	Sections 801-807
TITLE IX—White-collar penalty enhancements	Sections 901-906
TITLE X—Corporate tax returns	Section 1001
TITLE XI—Corporate fraud and accountability	Sections 1101-1107

Appendix C

Communication lines of the Tabaksblat Code CCUs

Supervisory Board's communication lines

Supervisory board members -> supervisory board

Content:

III.6.3: Transactions of supervisory board members that lead to conflicts of interest should be approved by the supervisory board and published in the annual report. Content Theme: information conflict of interest.

Supervisory board -> chairman of the supervisory board

Content:

III.6.1. shall immediately report any (potential) conflict of interest to the chairman of the supervisory board and shall provide all relevant information¹⁹⁶. Content Theme: information conflict of interest.

Supervisory board -> audit committee/ Remuneration committee/selection and appointment committee

Content:

The supervisory board should communicate with the audit committee/remuneration committee/ selection and appointment committee about/with regard to principle and provisions: III.5; III.5.1; III.5.2.

In principle III.5 if SB consists of more than four members, it shall appoint from among its members an audit committee, a remuneration committee and a selection and appointment committee. Function of the committees is to prepare the decision-making of the supervisory board. The SB report includes how the duties of the committees have been carried out in the financial year. Content Theme: Corporate Governance structure.

Provision III.5.1 SB should draw up a set of regulations (i.e. role, responsibility, composition, manner in which the committee discharges its duties) of each committee and shall contain in any event that a maximum of one member of each committee need not to be independent. Both regulations and compositions will be posted on the company's website. Content Theme: Corporate Governance structure.

In provision III.5.2 has been formulated more detailed as in III.5 and III.5.1 that the SB report shall state the composition of each committee, the number of committee meetings and the main items discussed. Content Theme: Corporate Governance structure.

Supervisory board -> management board¹⁹⁷

Content:

Provision II.2.6: SB shall draw up regulations concerning ownership of and transactions in securities by management board members, other than securities by their 'own' company. Content Theme: CG structure.

Provision II.2.12 if a (former) management board member is paid special remuneration during a given financial year, an explanation of this remuneration shall be included in the remuneration report¹⁹⁸. Content Theme: remuneration.

Principle III.1 the board should supervise the policies of the management board. Content Theme: supervision.

Provision III.1.1 the board shall draw up regulations. One paragraph in these regulations shall include its relations with the management board. Content Theme: Corporate Governance structure.

III.1.6 The supervision of the management board¹⁹⁹. Content Theme: supervision.

Provision III.1.9 the supervisory board and its individual members each have their own responsibility for obtaining all information from the management board (and the external auditor) that the board needs in order to be able to carry out its duties properly. Content Theme: Corporate Governance structure.

Principle III.6 should approve decisions to enter into transactions under which supervisory board members would have conflicts of interest that are of material significance to the company and/or to the relevant

¹⁹⁶ III.6.1, p. 23 for more information

¹⁹⁷ All concerned principles and/or best practice provisions: II (II.1); II.2.6; II.2.12; III.1; III.1.1; III.1.9; III.6; III.6.5; V.1; V.1.1; V.2

¹⁹⁸ of the supervisory board

¹⁹⁹ (i) achievement of the company's objectives; (ii) corporate strategy and the risks inherent in the business activities; (iii) the structure and operation of the internal risk management and control systems; (iv) the financial reporting process; (v) compliance with the legislation and regulations.

supervisory board members. The board is responsible for deciding on how to resolve conflicts of interest between management board members on the one hand and the company on the other²⁰⁰. Content Theme: information disclosure conflicts of interest.

Provision III.6.5 (potential) conflicts of interest between management board members (among other units) and the company: These regulations require approval of SB. Content Theme: information disclosure conflicts of interest.

Principle V.1 to supervise the management board fulfilling this responsibility (for the quality and completeness of publicly disclosed financial reports). Content Theme: supervision.

Provision V.1.1 supervision on compliance with internal procedures with regard to financial information. Content Theme: supervision.

V.1.3: SB shall see to it that the internal procedures²⁰¹ are established and maintained. Content Theme: supervision.

Principle V.2 shall nominate a candidate (external auditor); the remuneration shall be approved by SB. Content Theme: remuneration.

Supervisory board -> general meeting of shareholders²⁰²

Content:

Principle I is responsible for the corporate governance structure of the company and compliance with the code, SB (and MB) are accountable for this to the general meeting of shareholders²⁰³. Content Theme: Corporate Governance structure.

Principle II, p. 12 the determination and disclosure of the remuneration provided by SB to GMS. Content Theme: remuneration.

Provision III.1.1 One paragraph SB regulations shall include its dealings with its relations (among other units) with the general meeting of shareholders. Content Theme: Corporate Governance structure.

Principle III.6 SB responsible for deciding on how to resolve conflicts of interest between (among other corporate units) major shareholders and the company. Content Theme: information disclosure conflicts of interest.

Provision III.6.5 SB shall draw up regulations which include rules on dealing with (potential) conflicts of interest. Content Theme: information disclosure conflicts of interest.

Principle IV.3 SB shall provide all shareholders with equal and simultaneous information about matters that may influence the share price and the board shall provide all necessary information for the exercise of the meeting's powers. Content Theme: info disclosure.

Provision IV.3.5 if by the general meeting of shareholders requested information would be contrary to an overriding interest of the company this information will not be provided by the SB. Content Theme: information disclosure.

Provision IV.3.7 SB shall inform the general meeting of shareholders by means of a 'shareholders circular' of all facts and circumstances relevant to the approval, delegation or authorisation to be granted²⁰⁴. Content Theme: information disclosure.

Provision V.2.3 relates to principle V.2 about the role etc. of the external auditor: the supervisory board (and audit committee) shall at least once every four years, conduct a thorough assessment²⁰⁵ of the functioning of the external auditor; main conclusions shall be communicated to the GMS for the purposes of assessing the nomination for the appointment of the external auditor. Content Theme: Corporate governance structure.

Supervisory board -> external auditor

Content:

In provision III.1.9 SB is responsible for obtaining all necessary information from among other things the external auditor; SB may also require that the external auditor attends its meetings. Content Theme: Corporate governance structure.

²⁰⁰ III.6, p. 22 for more information

²⁰¹ with regard to the MB ensuring that financial information from business divisions and/or subsidiaries is reported directly to it and that the integrity of the information is not compromised

²⁰² All concerned principles and/or best practice provisions: I; II.2; III.1.1; III.6; III.6.5; IV.3; IV.3.5; IV.3.7; V.2.3

²⁰³ I, p. 8 for more information

²⁰⁴ if a right of approval is granted to the general meeting of shareholders by law or under the articles of association of the company, the supervisory board requests a delegation of powers.

²⁰⁵ V.2.3, p. 32 for more information

Principle III.6 (and III.6.5) about conflicts of interest. Content Theme: information disclosure conflicts of interest.

Chair of the Supervisory Board communication lines

Chairman of the supervisory board -> supervisory board

Content

III.4: description relation CSB and SB (CSB determines agenda of SB; monitors proper functioning of SB and its committees; provides information towards SB; arranges training programme for SB members; etc.). Content Theme: Corporate Governance structure.

III.4.1: CSB shall see to it: for example, SB members receive in good time all information which is necessary for the proper performance of their duties; committees function properly; performance SB is assessed; SB has proper contact with MB. Content Theme: Corporate Governance structure.

Chairman of the supervisory board -> management board

Content

The CSB should communicate about principle and best practice provision: III.4 and III.4.1.

Principle III.4 CSB acts on behalf of the SB as main contact for the MB and evaluates the functioning of the MB. Content Theme: Corporate governance structure.

Provision III.4.1 CSB shall see to it, that the performance of the MB members is assessed at least once a year (e)) and that the SB has proper contact with the MB (g)). Content Theme: Corporate Governance structure.

Chairman of the supervisory board ->general meeting of shareholders

Content

CSB should communicate with the GMS about principle: III.4: CSB ensures the orderly and efficient conduct of the general meeting of shareholders. Content Theme: Corporate Governance structure.

Audit Committee communication lines

Audit committee-> supervisory board

Content

III.5.3 AC has to provide the SB a report of its deliberations and findings. Content Theme: Corporate Governance structure.

V.2 the remuneration of the external auditor as well as the instructions to that auditor to provide non-audit services shall be approved by the supervisory board on the recommendation of the audit committee. Content Theme: remuneration.

V.2.2 AC shall report its dealings with the external auditor to the supervisory board on an annual basis, including his independence in particular. Content Theme: information disclosure.

Audit committee -> management board

Content

III.5.4: AC shall supervise the activities of the MB with respect to²⁰⁶: (a) the operation of the risk management and control systems, including supervision of the enforcement of the relevant legislation and regulations, and supervising the operation of codes of conduct; b) the provision of financial information by the company; f) relations with the external auditor, including, in particular, his independence, remuneration and any non-audit services for the

Company. Content Theme: supervision.

Audit committee -> general meeting of shareholders

Content

V.2.3: AC shall conduct a thorough assessment - at least once every four years - of the functioning of the external auditor. The main conclusions shall be communicated to the general meeting of shareholders for the purposes of assessing the nomination for the appointment of the external auditor. Content Theme: Corporate Governance structure.

²⁰⁶ c) compliance with recommendations and observations of internal and external auditors; d) the role and functioning of the internal audit department; e) the policy of the company on tax planning; g) the financing of the company; h) the applications of information and communication technology (ICT).

Audit committee -> external auditor

Content

III.5.5 AC shall act as the principal contact for the external auditor if he discovers irregularities in the content of the financial reports. Content Theme: Corporate Governance structure.

III.5.8 AC shall decide whether and, if so when the external auditor (among other units), should attend its meetings. Content Theme: Corporate governance structure.

V.1.2 AC shall determine how the external auditor should be involved in the content and publication of financial reports other than the annual accounts. Content Theme: Corporate Governance structure.

Remuneration Committee communication lines

Remuneration committee -> supervisory board

Content

Principle Determination and disclosure of remuneration:

RC should prepare a remuneration report which contains among other things the remuneration policy.
Content Theme: remuneration.

III.5.3: RC provides RC report to SB. Content Theme: Corporate Governance structure.

III.5.10: RC duties (i.e. drafting a proposal to the supervisory board for the remuneration policy to be pursued and for the remuneration of the individual members of the management board; this proposal shall include: remuneration structure, amount of the fixed remuneration, shares and/or options to be granted and/or other variable remuneration components, pension rights, redundancy pay and other forms of compensation to be awarded, performance criteria and their application. The committee also shall prepare the remuneration report. Content Theme: Corporate Governance structure.

Remuneration committee -> management board

Content

III.5.10: RC drafts a proposal for the remuneration of the individual members of the MB, for adoption by the SB.
Content Theme: remuneration.

Remuneration committee -> general meeting of shareholders

Content

Principle Determination and disclosure of remuneration :

RC should prepare a remuneration report which contains among other things the remuneration policy. Every material change in the remuneration policy shall be submitted to the general meeting of shareholders for adoption. Further shall schemes (and major changes to such schemes) whereby management board members are remunerated in the form of shares be submitted by the general meeting of shareholders. Content Theme: remuneration.

Selection and Appointment Committee communication lines

Selection and appointment committee-> supervisory board

Content

III.5.3: SAC provides SB with its report. Content Theme: Corporate Governance structure.

III.5.13: SAC duties: drawing up selection criteria and appointment procedures for supervisory and management board members; assesses the size and composition of the supervisory board and proposes a composition profile of the supervisory board; assesses the functioning of individual supervisory and management board members and reports on this to the supervisory board; makes proposals for appointments and reappointments. Content Theme: Corporate Governance structure.

Selection and appointment committee -> management board

Content

III.5.13: SAC shall in any event focus on a) drawing up selection criteria and appointment procedures for supervisory and management board members. Content Theme: Corporate Governance structure.

Management board's communication lines

Management board -> supervisory board

Content: II.1; II.1.2; II.1.4; II.1.7; II.3.4; V.1.3; V.2.2

Principle II.1 MB shall report related developments to and shall discuss the internal risk management and control systems with the SB and the MB shall provide the SB in good time with all information necessary for the exercise of the duties of the SB. MB is accountable for its managing of the company to the SB. Content Theme: Corporate Governance structure.

II.1.2: MB shall submit to the SB for approval: a) operational and financial objectives of the company; b) strategy designed to achieve the objectives; c) parameters to be applied in relation to the strategy: the main elements shall be mentioned in the annual report. Content Theme: Corporate Governance structure.

II.1.4: MB shall declare in the annual report that the internal risk management and control systems are adequate and effective and shall provide clear substantiation of this. In the annual report shall the MB report on the operation of the internal risk management and control system during the year under review; it shall describe any significant changes and any major improvements that are planned, and shall confirm that they have been discussed with the audit committee and the supervisory board. Content Theme: financial disclosure.

II.1.7: If MB member wants to be member of a SB of a listed company, the acceptance requires the approval of the SB. Other important positions held by a MB member shall be notified to the SB. Content Theme: Corporate Governance structure.

II.3.4: Decisions to enter into transactions in which there are conflicts of interest with management board members that are of material significance to the company and/or to the relevant board members require the approval of the supervisory board. Such transactions shall be published in the annual report, together with a statement of the conflict of interest and a declaration that best practice provisions II.3.2 to II.3.4 inclusive have been complied with. Content Theme: information disclosure conflicts of interest.

Provision V.1.3 MB is responsible for establishing and maintaining internal procedures which ensure that all major financial information is known, so that the timeliness, completeness and correctness of the external financial reporting are assured. This will be supervised by the supervisory board. Content Theme: financial disclosure.

Provision V.2.2 contents that the management has to report its dealings with the external auditor to the supervisory board. Content Theme: information disclosure.

Management board -> chairman of the supervisory board

Content II.2.6; II.3.2; III.4.

Provision II.2.6 A MB member shall give periodic notice of any changes in his holding of securities in Dutch listed companies to the CSB (in case of not having an appointed compliance officer). Content Theme: information disclosure.

Provision II.3.2 MB member shall immediately report any (potential) conflict of interest that is of material significance to the company and/or to him, to the chairman of the supervisory board²⁰⁷. Content Theme: information disclosure conflicts of interest.

Management board -> audit committee

Content II.1; II.1.4

Principle II.1 MB reports related developments to and discusses the internal risk management and control systems with the audit committee. Content Theme: Corporate Governance structure.

II.1.4: MB shall declare in the annual report that the internal risk management and control systems are adequate and effective plus in this report shall MB describe any significant changes that have been made and any major improvements that are planned, and shall confirm that they have been discussed with the audit committee. Content Theme: financial disclosure.

Management board -> general meeting of shareholders

Content: I; IV.1; IV.3; IV.3.5; and IV.3.7.

Principle I: MB is responsible for the corporate governance structure, the compliance with and enforcement of the code. The boards are accountable for this to the GMS, who take careful note and make a thorough assessment of the reasons for any non-application. Content Theme: Corporate Governance structure.

IV.1: any decisions of the MB on a major change in the identity or character of the company or the enterprise shall be subject to the approval of the GMS. Content Theme: Corporate Governance structure.

IV.3 MB shall provide all shareholders with equal and simultaneous information about matters that may influence the share price; MB shall provide the GMS with all information that it requires for the exercise of its powers. Content Theme: information disclosure.

IV.3.5 if the requested information by the GMS would be contrary to an overriding interest of the company, the MB must give reasons for that. Content Theme: information disclosure.

IV.3.7: if the MB requests a delegation of powers, the board shall inform the GMS by means of a 'shareholders circular' of all facts and circumstances relevant to the approval, delegation or authorisation to be granted. This circular shall be posted on the company's website. Content Theme (CG): information disclosure.

²⁰⁷ II.3.2, p. 14 more information

General Meeting of Shareholders's communication lines

General meeting of shareholders -> supervisory board²⁰⁸

Content

Principle III.7: GMS determines SB members' remuneration. Content Theme: remuneration.

Principle IV.1: GMS should be able to exert such influence on the policy of the SB that it plays a fully-fledged role in the system of checks and balances in the company. Content Theme: Corporate governance structure.

Provision IV.1.1: GMS of a company which does not have statutory two-tier status may pass a resolution to cancel the binding nature of a nomination for the appointment of a SB member board and/or a resolution to dismiss a SB member by an absolute majority of the votes cast²⁰⁹. Content Theme: Corporate governance structure.

Provision IV.1.6: the resolution to approve the policy of the MB and to approve the supervision exercised by the SB shall be voted on separately in the GMS. Content Theme: Corporate Governance structure.

General meeting of shareholders -> management board

Content: IV.1 ; IV.1.1 ; IV.1.6.

Principle IV.1: any decisions of the management board on a major change in the identity or character of the company or the enterprise shall be subject to the approval of the GMS. Content Theme: Corporate Governance structure.

Provision IV.1.1 the GMS of a company not having statutory two-tier status may pass a resolution to cancel the binding nature of a nomination for the appointment of a MB member board and/or a resolution to dismiss a MB member by an absolute majority of the votes cast²¹⁰. Content Theme: Corporate Governance structure.

Provision IV.1.6: resolutions to approve the policy of the MB shall be voted on separately at the GMS. Content Theme: Corporate Governance structure.

General meeting of shareholders -> external auditor

Content: V.2; V.2.1; V.2.2.

Principle V.2: the external auditor is appointed by the GMS. Content Theme: Corporate governance structure.

Provision V.2.1 the EA may be requested by the GMS in relation to his statement on the fairness of the annual accounts. The auditor shall therefore attend and be entitled to address this meeting. Content Theme: Corporate governance structure.

Provision V.2.2 the SB this²¹¹ into account when deciding its nomination for the appointment of an external auditor which nomination shall be submitted to the general meeting of shareholders. Content Theme: Corporate Governance structure.

External Auditor communication lines

External auditor -> supervisory board

Content: principle V.4 and provision V.4.1.

Principle V.4: the EA shall attend the meeting of the SB, at which the annual accounts are to be adopted or approved; EA has to report his findings in relation to the audit of the annual accounts to the MB and SB simultaneously. Content Theme: financial disclosure.

Provision V.4.1: the EA shall receive the financial information underlying the adoption of the quarterly and/or half yearly figures and other interim financial reports and shall be given the opportunity to respond to all information. Content Theme: financial disclosure.

External auditor -> management board

Content: principle: V.4.

V.4: the EA shall report his findings in relation to the audit of the annual accounts to the management board²¹².

Content Theme: financial disclosure.

External auditor -> audit committee

Content: III.5.5.

²⁰⁸ All concerned principles and/or best practice provisions: III.7; IV.1; IV.1.1; IV.1.6

²⁰⁹ IV.1.1,p.26 for more information

²¹⁰ IV.1.1, p. 26 more detailed information

²¹¹ V.2.2, p.32 for more information.

²¹² V.4, p. 32 more information

III.5.5: the AC shall act as the principal contact for the external auditor if he discovers irregularities in the content of the financial reports. Content Theme: Financial disclosure.

Appendix D

Communication lines of the Sarbanes-Oxley Act, AS2 and AS3

CCU Registered Public Accounting Firm (RPAF)

RPAF -> (management/directors of the) Issuer - Sarbanes-Oxley Act

Sec.204k)3: Other material written communications (i.e. management letter) between the RPAF and management of issuer. CG: information disclosure.

Sec. 404b: Management Assessment of Internal Controls, (b) Internal Control Evaluating and Reporting: With respect to the internal control assessment required by subsection (a), each RPAF that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. Any such attestation shall not be subject of a separate engagement. Content theme: Financial disclosure.

Auditing Standard 2

Auditor's objective in an Audit of Internal Control Over Financial Reporting, AS2 4: RPAF must plan and perform the audit to obtain reasonable assurance about whether the company maintained,[...], effective internal control over financial reporting as of the date specified in management's assessment. The RPAF must audit the company's financial statements as of the date specified in management's assessment. Content theme: Financial disclosure.

AS2 6: The auditor should be aware that external users are interested in information on internal control over financial reporting [...]. Content theme: Financial disclosure.

AS2 19: RPAF must obtain sufficient evidence to provide a reasonable basis for his or her opinion and the use and evaluation of management's assessment is inherent in expressing either opinion. Content theme: Financial disclosure.

AS2 21: RPAF should communicate, in writing, to MB and AC that the audit of internal control over financial reporting cannot be satisfactorily completed and that RPAF is required to disclaim an opinion (in case of management not fulfilling its responsibilities, see 20, p. 158). Content theme: Financial disclosure.

AS2 40: RPAF must obtain an understanding of, and evaluate, management's process for assessing the effectiveness of the company's internal control over financial reporting. RPAF should determine whether management has addressed certain elements. [these elements concern the controls].

Content theme: Financial disclosure.

AS2 42: RPAF should evaluate management's documentation whether it includes particular information. The design of controls over all relevant assertions related to all significant [accounts and disclosures in the financial statements, information about certain transactions, and controls].

Content theme: Financial disclosure.

AS2 47: RPAF should obtain an understanding [...] applying procedures [...]. Content theme: Financial disclosure.

AS2 49: RPAF must obtain understanding of the design of controls related to each component of internal control over financial reporting [...]. Content theme: Financial disclosure.

AS2 79: RPAF should perform at least one walkthrough or each major class of transactions (cf.71). Content theme: Financial disclosure.

AS2 127: RPAF should evaluate all evidence obtained from all sources, including (p.194). Content theme: Financial disclosure.

AS2 128: RPAF should review all reports issued during the year by internal audit. Content theme: Financial disclosure.

AS2 130: RPAF must evaluate identified control deficiencies and determine whether these are significant deficiencies or material weaknesses. Content theme: Financial disclosure.

AS2 133: Several factors affect the *likelihood* that a deficiency [...] could result in a misstatement of an account balance or disclosure. Content theme: Financial disclosure.

AS2 134: When evaluating the likelihood,[...] the auditor should evaluate how the controls interact with other controls. Content theme: Corporate governance structure.

AS2 138: Inadequate documentation of the design of controls and the absence of sufficient documented evidence to support management's assessment of the operating effectiveness of internal control [...] are control deficiencies. [...] the auditor should evaluate these as to their significance. Content theme: Financial disclosure.

AS2 142: In an audit of internal control over financial reporting, the auditor should obtain written representations [a-h] from management.

Content theme: Financial disclosure.

AS2 143: The failure to obtain written representations from management, including management's refusal to furnish them, constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion. (cf.178): when management limits the scope of the audit, the auditor should either withdraw from the

engagement or disclaim an opinion. Further, the auditor should evaluate the effects of management's refusal on his or her ability to rely on other representations [...].

Content theme: Financial disclosure.

AS2 148: The auditor's opinion relates to the effectiveness of the company's internal control [...] as of *a point in time* and *taken as a whole* resp. 148: a sufficient period of time and the auditor must obtain evidence about the effectiveness of controls over all relevant assertions related to all significant accounts and disclosures in the financial statements. Content theme: Financial disclosure.

AS2 160: If, the auditor assesses control risk as other than low for certain assertions or significant accounts, the auditor should document the reasons for that conclusion. Content theme: Financial disclosure.

AS2 186: *Subsequent Events.* Changes in internal control over financial reporting or other factors that might significantly affect internal control over financial reporting might occur subsequent to the date as of which internal control over financial reporting is being audited but before the date of the auditor's report. [auditor's activities]. Content theme: Financial disclosure.

AS2 187: RPAF could inquire about and examine other documents for the subsequent period.

Content theme: Financial disclosure.

AS 2 192: If auditor believes that management's additional information contains a material misstatement of fact, he should discuss the matter with management [...]. RPAF concludes that a material misstatement of fact remains [...] he should notify management and the audit committee, in writing, of the auditor's views concerning the information. Content theme: Financial disclosure.

AS2 197: After the issuance of the report on internal control [...] the auditor may become aware of conditions that existed at the report date that might have affected the auditor's opinions had he or she been aware of them. [...] the auditor must determine whether the information is reliable and whether the facts existed at the date of his report [...]. Content theme: Financial disclosure.

AS2 201: When the reason for a change in internal control over financial reporting is the correction of a material weakness, management has a responsibility to determine and the auditor should evaluate whether the reason [...] and the circumstances are material information necessary to make the disclosure about the change not misleading. Content theme: Financial disclosure.

AS 2 202/203: Auditor's responsibility as it relates to management's annual assessment of internal control [...]. To fulfil this responsibility, the auditor should perform [certain] procedures. Content theme: Financial disclosure.

AS2 204: Auditor should communicate the matter(s) to the appropriate level of management as soon as practicable. Content theme: Financial disclosure.

AS2 206: If matters come to the auditor's attention as a result of the audit of internal control over financial reporting that lead him to believe that modifications to the disclosures about changes in internal control ... are necessary for the annual certifications to be accurate and to comply with the requirements of Section 302 of the Act. The auditor's communication responsibilities (cf. 204/ 205). [...]. Content theme: Financial disclosure.

AS2 207: RPAF must communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit. [...].Content theme: Financial disclosure.

AS 2 208: RPAF must communicate, that specific significant deficiency or material weakness in writing to the board of directors. Content theme: Financial disclosure.

AS 2 209: RPAF should communicate to management, in writing, all deficiencies in internal control [...] the auditor should communicate deficiencies in internal control [...] of which he is aware. Content theme: Financial disclosure.

AS2 210: These written communications (209, p.220) should state that the communication is intended solely for the information and use of the board of directors, audit committee, management, and others within the organization. Content theme: Financial disclosure.

AS2 211: These written communications also should include the definitions of control deficiencies, significant deficiencies, and material weaknesses and should clearly distinguish to which category the deficiencies being communicated relate. Content theme: Financial disclosure.

AS2 213: [...] fraud or possible illegal acts [...] it must be brought to management, the auditor must communicate the matter directly to the audit committee [...]. Content theme: Financial disclosure.

AS2 214: When timely communication is important, the auditor should communicate the preceding matter during the course of the audit rather than at the end of the engagement. [...]. Content theme: Financial disclosure.

Auditing Standard 3

AS3 2: RPAF's representations to a board of directors or other parties are usually included in the auditor's report accompanying the financial statements of the company. [...]. Content theme: Financial disclosure.

AS3 13: RPAF must identify all significant findings or issues in an *engagement completion document*. [...].Content theme: Financial disclosure.

RPAF-> Audit committee - Sarbanes-Oxley Act

Section 204k)3 auditor reports to audit committee: Each RPAF performing any audit shall timely report to the audit committee of the issuer [certain topics]. Content theme: Corporate governance structure.

Sec.301m)2: Responsibilities of RPAs: The RPAF shall report directly to the audit committee. Content theme: Corporate governance structure.

Auditing Standard 2

AS2 6: The auditor should be aware that persons (i.e. audit committee) who rely on the information concerning internal control over financial reporting are interested in information on internal control over financial reporting²¹³. Content theme: Financial disclosure.

AS 2 56: The auditor is responsible for performing a separate and distinct evaluation of the audit committee. However, [...] the auditor should assess the effectiveness of the audit committee as part of understanding and evaluating those components. Content theme: Corporate governance structure

AS 2 192: If RPAF concludes that a material misstatement of fact remains-> he should notify management and the audit committee, in writing, of RPAF's views concerning the information. Content theme: Financial disclosure.

AS2 205: If, in the auditor's judgement, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform the audit committee. If, in the auditor's judgement, the audit committee does not respond appropriately, the auditor should evaluate whether to resign from the engagement. Content theme: Financial disclosure.

AS2 206: If matters come to the auditor's attention as a result of the audit of internal control over financial reporting that lead him to believe that modifications to the disclosures about changes in internal control over financial reporting are necessary [...]. The auditor should follow the same communication responsibilities as described in par. 204/205. [...]. Content theme: Financial disclosure.

AS2 207: RPAF must communicate in writing to audit committee all significant deficiencies and material weaknesses identified during the audit. CG: financial disclosure. Form: written.

AS2 210: These written communications (209) should state that the communication is intended solely for the information and use of the board of directors, audit committee, management, and others within the organization. Content theme: Financial disclosure.

AS2 214: When timely communication is important, the auditor should communicate the proceeding matter during the course of the audit rather than at the end of the engagement. Content theme: Financial disclosure.

RPAF-> investors - Auditing Standard 2

AS2 6: The auditor should be aware that persons who rely on the information concerning internal control over financial reporting include (i.e. CCU Investors). Content theme: Financial disclosure.

CCU Issuer

Issuer -> RPAF - Auditing Standard 2

AS2, 2: Issuer is required to file the auditor's attestation report as part of the annual report. Content theme: Financial disclosure.

AS2 20: For the auditor to satisfactorily complete an audit of internal control over financial reporting, management must do [certain activities].

Content theme: Financial disclosure.

AS2 163: Management should provide, both in its report on internal control over financial reporting and in its representation letter to the auditor, a written conclusion about the effectiveness of the company's internal control over fin reporting. [...] management is required to state a direct conclusion about whether the company's internal control over fin reporting is effective. Content theme: Financial disclosure.

Issuer->CEO/CFO - Sarbanes-Oxley Act

Sec.306/1: In any case in which a director or executive officer is subject to the requirements of this subsection in connection with a blackout period [...] with respect to any equity securities, the issuer of such equity securities shall timely notify such director or officer and the SEC of such blackout period. Content theme: Information disclosure.

Issuer -> Audit committee - Auditing Standard 2

²¹³ Because: 1. It enhances the quality of financial reporting; and 2. Increases their confidence in financial information; 3. intended to provide an early warning to those inside and outside the company who are in a position to insist on improvements in internal control, such as the audit committee [...]; 4. additionally, Section 302 of the Act and Securities Exchange Act Rule 13a-14(a) or 15d-14(a),^{1/} whichever applies, require management, with the participation of the principal executive and financial officers, to make quarterly and annual certifications with respect to the company's internal control over financial reporting

AS2 55/56: 55: Although the audit committee plays an important role [...] management is responsible for maintaining effective internal control over financial reporting. This standard does not suggest that this responsibility has been transferred to the audit committee. 56: The board of directors is responsible for evaluating the performance and effectiveness of the audit committee. Content theme: Corporate governance structure.

CEO/CFO as part of CCU Issuer

CEO/CFO-> RPAF

Sec.302a and b)5: The signing officers have disclosed to the issuer's auditors and the audit committee: a. all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in the internal controls; and b. any fraud, whether or not material that involves management. Content theme: Corporate governance structure.

CEO/CFO ->issuer - Sarbanes-Oxley Act

Sec. 304a): If an issuer is required to prepare an accounting restatement [...], the CEO and CFO of the issuer shall reimburse the issuer for: 1. any bonus or other incentive-based or equity-based compensation [...]; 2. Any profits realized from the sale of securities of the issuer during that 12-month period.). Content theme: Remuneration.

CFO/CEO -> Audit committee - Sarbanes-Oxley Act

Sec.302a)5: The signing officers have disclosed to the issuer's auditors and the audit committee: A. all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in the internal controls; and B. any fraud, whether or not material that involves management. Content theme: Corporate governance structure.

CCU Audit committee

Audit committee-> RPAF - Sarbanes-Oxley Act

Sec. 201: (h) Preapproval required for Non-audit services – a RPAF *may* engage in any non-audit service only if the activity is approved in advance by the audit committee. Content theme: Corporate governance structure.

Sec.202 Preapproval requirements : (i)(1)(A) audit committee action – all auditing services and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee. Content theme: Corporate governance structure.

Sec.301m)1B2: the AC shall be directly responsible for the appointment, compensation, and oversight of the work of any RPAF employed by that issuer. Content theme: Corporate governance structure.

Audit committee -> issuer - Sarbanes-Oxley Act

Sec.202/1A: all auditing services and non-auditing services, provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer. Content: Corporate governance structure.

Sec.301m)A4: AC shall establish procedures for: A: the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matter. Content theme: Corporate governance structure.

Auditing Standard 2

AS2 55: The AC plays an important role within the control environment and monitoring components of internal control over financial reporting. Content theme: Financial disclosure.

Audit committee-> members of the audit committee - Sarbanes-Oxley Act

Sec. 202/3: The AC may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required. Decisions of any member [...] shall be presented to the full audit committee at each of its scheduled meetings. Content theme: Corporate governance structure.

Audit committee -> investors - Sarbanes-Oxley Act

Sec.202/2: Approval by an audit committee of an issuer [...] shall be disclosed to investors in periodic reports required by section 13a. Content theme: Information disclosure.

CCU Investors

Investors-> issuer - Sarbanes-Oxley Act

Section 403 (a)(a): Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any security [...] shall file statements containing the amount of all equity securities of such issuer of which the filing person is the beneficial owner and indicates ownership by the filing person at the date of filing, any changes in ownership, and purchases and sales. The requirements include [certain content elements]. Content theme: Financial disclosure.

Appendix E

Case-study protocol

A. Introduction

This introduction consists of three topics, namely:

- Case-study goals
- Selection of case-study company
- Interviewees

Case-study goals

The first goal is to show how codified rules of ‘good governance’ are used to clarify ‘good governance’ within a company, as the case study allows for comparison of the ‘ideal’ annual report genre the ‘practical’ annual report (i.e. comparison of the ‘ought’ situation with the ‘is’ situation). To this end, the case study actually includes two comparisons: (1) the ‘ought’ situation of the communication actions required by the Dutch and US corporate governance codes will be compared with the ‘is’ situation of the 2006 Dutch annual report and the 2006 US Form 20-F; but also (2) both ‘ought’ and both ‘is’ situations will be compared. The results of the two comparisons will show whether and how formal transparency has been achieved, and thus also whether and how ‘good governance’ has been constituted.

The second goal is to demonstrate the relevance of the constitutive rules of an institution ('good governance'). In other words, this study sheds light on the implications of Searle's theory for a specific corporation, in that it investigates how the game of 'good governance' has been played in this particular case.

Selection of case-study company

The selection of the case-study company was based on two aspects. First, the company should be listed in both the Netherlands and the US. Second, its website should give indications of (1) well-structured corporate communication, (2) mainly transparent and clear texts, and (3) clear references to corporate governance, suggesting that the company is considered a good example of a cross-listed company complying with the Tabaksblat Code and the SOX. Desk research led to a few possible candidates, one of which was immediately willing to participate in the investigation.

Interviewees

Two interviewees will be involved. One interviewee has a good understanding of the Tabaksblat Code and the second of the SOX.

Data from case-study company interviewee

The case-study company interviewee provided the following relevant documents:

- 2006 Annual Report (and included Corporate Social Responsibility Report);
- 2006 Form 20-F;
- 2006 Annual Report for Corporate Governance Code Monitoring Committee;
- Email exchange between the company and a University of Groningen project leader concerning the evaluation of listed companies' compliance with the Tabaksblat Code rules;
- Time Schedule for Annual Report 2006;
- Two juridical articles, one on risk management (Schoordijk 2005) and one on CSR (Eijsbouts 2005);
- Copy of a newspaper text announcing the case-study company's 2006 GMS;
- Correspondence between the company and a bank with respect to the GMS;
- Overview of actions with respect to the GMS;
- 2007 GMS Agenda;
- 2007 letter to shareholders including all voting options concerning the 2006 GMS;
- A document including the overview of the company's compliance topics and definition of 'compliance';
- An email including answers to certain SOX questions;
- A document/template called 'Supervisory board evaluation'.

Further, the interviewee referred to the Articles of Association and the minutes of the 2007 GMS on the corporate website, as well as to the website of the Authority Financial Markets (AFM), which lists the stock options and shares of management board members in listed companies.

Data from accounting firm representative

The accounting firm representative provided a document called 'Shaping the audit committee agenda', which included guidance for implementation of the Dutch corporate governance code, and a CD called 'Audit Committee Toolkit' both provided by the Audit Committee Institute.

This interviewee also referred to the PCAOB's website with respect to inspection reviews and the 4010 report with respect to 'understanding the business/the client'. In addition, he referred to the NIVRA's²¹⁴ website, which includes the standards (COS²¹⁵) established in accordance with Dutch legislation and derived from the International Standards on Auditing (ISA). Further, the interviewee referred to the website of the Audit Committee Institute with respect to rule 56 (Auditing Standard 2) on the relationship between the audit committee and the external auditor. Finally, he mentioned the website of the American Institute of Certified Public Accountants (AICPA), which is comparable to the Dutch NIVRA, with regard to the accountant's statements.

Both interviewees agreed to the interviews being recorded. These records will be destroyed after the dissertation has been approved.

Time schedule of in-depth interviews

<i>Case-study company</i>	<i>Accounting firm</i>
Interview 1: May 16, 2007	Interview 1: October 29, 2007
Interview 2: June 19, 2007	Interview 2: November 9, 2007
Interview 3: July 17, 2007	
Interview 4: November 7, 2007	

C. Case-study questions

INTERVIEW 1 – Case-study company

Date: May 16, 2007

Note: The pages referred to in the questions are from the English version of the case-study company's 2006 Dutch annual report.

Introduction

1. What is your position?
2. Are you a company secretary?

General

A. Tabaksblat Code and SOX

As a Dutch listed company, the company should comply with the rules of the Tabaksblat Code. Since it is also listed at a US stock exchange, it should comply with the Sarbanes-Oxley Act (SOX) as well.

- 1a. Since what date has the company been required to comply with the Tabaksblat Code?
- 1b. Could you shed light on the implementation process of the Code?
2. Does the Tabaksblat Code also apply to the company's subsidiaries?
3. Who or which external institution monitors the company's compliance with the Code?
- 4a. Since what date has the company been required to comply with the SOX?
- 4b. Could you shed light on the implementation process of the implantation of the SOX?
5. Does the SOX also apply to the company's subsidiaries?
6. Who or which external institution monitors the company's compliance with the SOX?

B. The 2006 annual report process

1. What phases can be distinguished with respect to the annual report process?
- 2a. What are the supervisory board's general tasks and responsibilities within the separate phases of the process?
- 2b. What are the communication steps with respect to these phases, i.e. who communicates with whom and about what?
- 2c. Are documents with respect to the communication steps available?
- 3a. What are the management board's general tasks and responsibilities within the separate phases of the process?
- 3b. What are the communication steps with respect to these phases, i.e. who communicates with whom and about what?
- 3c. Are documents with respect to the communication steps available?
- 4a. What are the general tasks and responsibilities of the general meeting of shareholders (GMS) within the

²¹⁴ NIVRA: Koninklijk Nederlands Instituut van Registeraccountants (Netherlands Institute of Registered Accountants), comparable to the US AYECA

²¹⁵ COS: Controle- en overige standaarden (Control and Other Standards), comparable to Accounting Standards

separate phases of the process?
4b. What are the communication steps with respect to these phases, i.e. who communicates with whom and about what?
4c. Are documents with respect to the communication steps available?
5a. What are the external auditor's general tasks and responsibilities within the separate phases of the process?
5b. What are the communication steps with respect to these phases, i.e. who communicates with whom and about what?
5c. Are documents with respect to the communication steps available?
6a. Do the supervisory board, the management board, the GMS, and the external auditor confer within the phases of the annual report process?
6b. Are these meetings documented?
7. Which other company bodies are involved in the annual report process?
8. What are their responsibilities within the process?
9. Do they have any meetings with one another?

INTERVIEW 2 – Case-study company**Date: June 19, 2007****Part 1 The analysis of the obligatory annual report content according to the Tabaksblat Code and the Sarbanes-Oxley Act.****Sarbanes-Oxley Act**

Page 66 of the annual report (*Corporate Governance* chapter) states that the company complies with the requirements of Dutch law, the Tabaksblat Code, and the SOX. Page 122 (*Auditor's Report* chapter) states that the financial statements are in accordance with the requirements of the IFRS and Dutch law.

1. Why has it not been mentioned explicitly that the company also complies with the SOX?**Tabaksblat Code**

The company complies with most Tabaksblat Code rules with respect to the annual report. Nevertheless, a few questions arise. According to the Code, the annual report should include a report of the audit committee. The chapter *Report of the Supervisory Board*, section 'Financial statements and dividend proposal'; the chapter *Report of the Board of Management*, section 'Internal Controls'; and the chapter *Corporate governance*, section 'Committees' all include some relevant information concerning the audit committee

1. Although an audit committee report is not included in the annual report, the most significant tasks of the audit committee are referred to. Do you hold the view that in this way, the company complied with the requirement to include an audit committee report in the annual report?

The Tabaksblat Code also requires a report of the selection and appointment committee to be included in the annual report.

2. Does the company comply with this rule by including a short report of this committee within the chapter *Report of the Supervisory Board*?**Part 2 Analysis of requirements concerning communication lines between the supervisory board, management board, GMS, and external auditor according to the Tabaksblat Code and SOX**

Tabaksblat Code

A Analysis

The company complies with the majority of the Tabaksblat Code rules. The confirmation of the company's compliance was not always found only in the annual report, but also, for example, in the Rules of Procedure. Compliance with certain rules, however, was not clearly traceable. This concerns the following rules:

GMS -> supervisory board:

IV.1 The GMS should be able to exert such an influence on the supervisory board's policy that the GMS plays an important role within the company's system of 'checks' and 'balances'.

How is it shown (e.g. in the annual report) that the company complies with this principle?

IV.1.6 During the GMS, the approval of the management board's and supervisory board's policy will be voted on separately (discharge).

How is it shown in the annual report that the company complies with this rule?

III.4.1 The supervisory board should have proper contact with the works council.

How is it shown in the annual report that the company complies with this rule?

III.5.8 The audit committee shall decide on whether, for example, the internal auditor, or the CFO, or another person may participate in the committee's meetings.

How will it be announced that, for example, the CFO may participate in the meetings?

B. The company

The company describes in its annual report that it deviates from certain rules in accordance with the 'comply or explain' rule. The GMS agreed with these deviations; however, a few questions arise in this regard.

- Best practice provision II.1.1 describes that members of the management board are appointed for four years, and may subsequently be reappointed. The company deviates from this rule to the extent that appointments of members from before 2004 have not been renegotiated. The reason given is that this would not be in the company's interest.

1. Why is this not in the company's interest?

- Best practice provision IV.1.1 states that the GMS should have the possibility to cancel the nomination of a member of the supervisory board or the management board. The company, however, decided in its Articles of Association that the holders of 'priority shares' have the power to make binding nominations that cannot be cancelled by the GMS (cf. p. 67). The company does not clarify this, although it does point out that in normal situations, the company does comply with IV.1 concerning non-binding nominations by the supervisory board, which require a majority of the votes.

2. Is this about the votes of the supervisory board?

- In normal situations, the GMS also has the right to nominate supervisory board and management board members. These nominations require a two-thirds majority, which represents at least 50% of the shares capital.

3. When are the supervisory board members and GMS allowed to make nominations?

- The board of the company's Foundation may only use its binding nomination rights in very special circumstances, for example in the case of a hostile takeover. This has been confirmed by the Board of the Foundation.

4. Who decides what 'very special circumstances' are?

- The board of the company's Foundation consists of members of the supervisory board (cf. p. 67) that are not member of the audit committee. This board is a holder of 'priority shares', and the meeting of holders of priority shares has both nomination rights and the right to approve amendments to the Articles of Association.

5. Does this mean that, ultimately, the supervisory board (or in the case of the Foundation, representatives of the supervisory board) makes nominations – binding or otherwise – for supervisory and management board members both in normal circumstances and in very special situations?

- It has been mentioned in the annual report that despite the company's deviation from IV.1.1, the supervisory board and management board hold the opinion that this rule reinforces the continuity of the company's management and policy.

6. So why deviate, then?

<ul style="list-style-type: none"> Best practice provision II.1.7 includes that management board members may have a maximum of two supervisory board memberships in other listed companies. The company deviates to the extent that its management board members may have more than two supervisory board memberships in the year prior to their retirement (cf. p. 67). The reason is that these memberships enable them to prepare themselves for the time after their retirement, as long as they do not conflict with their current tasks. External membership of a supervisory board should be approved by the chair of the company's supervisory board.
<p>7. Does the supervisory board also determine whether the tasks that should be performed for the other supervisory board memberships are (or are not) in conflict with the tasks to be performed within the company?</p>
<p>8. Have criteria concerning acceptable/non-acceptable tasks been set up?</p>
<ul style="list-style-type: none"> The company also deviates from best practice provision II.2.7. This rule states that the maximum severance payment covers one year's salary for management board members. The company holds the view that it is not in the company's interest to renegotiate the contracts drawn up before 2004. Severance payment will therefore be determined by the supervisory board in line with the remuneration committee's advice.
<p>9. What are the criteria for determining the company's severance payment?</p>
<p>10a. What role does the GMS play here?</p>
<p>10b. What are the communication steps here: who communicates with whom, about what, and in what form?</p>
<p>10c. Are documents concerning the communication steps available?</p>
<ul style="list-style-type: none"> The company also deviates from provision II.2.6. This rule requires that the management board members report all changes in their shares in other Dutch listed companies. The reason for deviation is that it would cause unnecessary administrative burden.
<p>11. The annual report relates the deviation from provision II.2.6 to the Rules on Inside Information (cf. p. 68). What does this relationship mean?</p>
<ul style="list-style-type: none"> The company deviates from provision III.3.5, which states that a supervisory board member is to be appointed for four years with the possibility of being reappointed twice. The company, however, chose to reappoint members more than twice, the reason being that it should be possible to do so in a specific case in the company's interest.
<p>12. What might such a specific case be?</p>
<p>13a. What role does the supervisory board play here?</p>
<p>13b. What are the communication steps: who communicates with whom and about what?</p>
<p>13c. Are documents with respect to the communication steps available?</p>
<p>14a. What role does the management board play here?</p>
<p>14b. What are the communication steps: who communicates with whom and about what?</p>
<p>14c. Are documents with respect to the communication steps available?</p>
<p>15a. What role does the GMS play here?</p>
<p>15b. What are the communication steps: who communicates with whom and about what?</p>
<p>15c. Are documents with respect to the communication steps available?</p>
<ul style="list-style-type: none"> The company deviates from provisions III.2.1, III.2.2, and III.2.3 which describe the independence of the supervisory board members. Two members of the supervisory board do not comply with the independence rules. One is a former member of the company's management board. The second was a member of the management board of one of the company's main banks, and is still an advisor to that bank. In the company's view, he is not involved in the management of that bank, and the company thus considers him to be independent.
<p>16. Will it be checked in any way (for example, each year) whether the individual concerned is indeed not involved in the bank's management?</p>
<p>17. If so, who is responsible for this?</p>

Sarbanes-Oxley Act

The communication lines of the SOX differ from those of the Tabaksblat Code, especially in the sense that they clearly highlight the significant importance of the registered public accounting firm (RPAF).

1. **The chapter *Report of the Supervisory Board* states that the audit committee held discussions with respect to the implementation of SOX404 (p. 21). What were the most important discussion items?**
2. **What is the content of the following three ‘communications’: The auditor’s Engagement Letter, fee, and audit plan?**

Section 401(a)(i) requires that the financial statements be established by the RPAF in accordance with the generally accepted principles and the rules and regulations of the Securities Exchange Commission (SEC). The external auditor, however, states in the chapter *Auditor’s report* (p. 122) that the financial statements have been established in accordance with the IFRS and Dutch law.

3. Do the financial statements comply with SOX401(a)(i)?

The section concerned also requires that the annual report should include an internal control report. The first part of that report (confirming management’s responsibility with respect to the establishment and maintenance of an adequate internal control structure and procedures for financial reporting) is included (p. 17 *Report of the Management Board* and p. 122 *Auditor’s report*).

The second part, however (including an assessment of the effectiveness of the internal control structure and procedures for financial reporting), is only included in the form of a provision that processes and procedures provide a ‘reasonable level of assurance’, that they functioned ‘properly’ in 2006, and that they will do so in 2007 (p.17 *Report of the Management Board*).

The assessment process, however, had not been finished yet when the annual report was published. The certification had been finished but the Annual Report on Form 20-F had not yet been filled in.

4. Do you feel that the annual report now meets the SOX requirements with respect to the assessment of the effectiveness?

Part III *Governance and compliance chapter*

This is an obligatory chapter according to the Tabaksblat Code. Within this chapter, however, the company also complies with the SOX rules. The questions below concern certain noteworthy items within this chapter in the light of both codes.

A. Compliance Committee

The management board indicates in its *Report of the Board of Management* (p. 7) that a Compliance Committee has been established in order to support and monitor the company’s compliance with legislation and regulations.

1. What was the reason for establishing this committee?
2. When was this committee established?
3. How many committee members are involved?
4. What are the requirements for members to be allowed to participate in this committee?
5. What authorities does this committee have?
6. What responsibilities does this committee have?
7. To whom is this committee accountable?
8. What is the legal status of the committee’s announcements or documentation?

- 9a. What is the supervisory board’s role with respect to this committee?
- 9b. What are the communication steps here: who communicates with whom and about what?
- 9c. Are documents concerning the communication steps available?

- 10a. What is the management board’s role with respect to this committee?
- 10b. What are the communication steps here: who communicates with whom and about what?
- 10c. Are documents concerning the communication steps available?

- | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>11. The management board considers the Business Principles (p. 17) to also be part of the relevant legislation and regulation. Why are the Business Principles part of the Compliance Committee's monitoring?</p> <p>12. The company's Business Principles state that management board does not hold management responsible for any business loss resulting from compliance with the Business Principles (p. 131). What are the reasons for this statement?</p> <p>13a. What is the supervisory board's role concerning the Business Principles?</p> <p>13b. What are the communication steps here: who communicates with whom and about what?</p> <p>13c. Are documents available with respect to the communication steps?</p> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

B Articles of Association

The management and supervisory boards have laid down their points of view with respect to corporate governance in the Articles of Association. This was a consequence of discussions with the shareholders in the 2004 and 2005 general meetings, in which corporate governance was a separate agenda item. The adjusted Articles of Association have been approved by the GMS.

1. Why have the Articles of Association been established?
2. What is the aim of the Articles of Association?
3. Do the Articles have legal status?

The Articles describe, for example, the role and authorities of management board, supervisory board, and shareholders (GMS). The shareholders approve the Articles. The Board of the company's Foundation has the ultimate right to approve amendments to the Articles (p. 71).

4. Does the Board of the Foundation ultimately represent all shareholders?

The Board of the Foundation consists of supervisory board members that are not members of the audit committee.

5. Who actually approves the amendments: the shareholders or the supervisory board?

6. What are the communication steps between the shareholders and the supervisory board with respect to the approval of amendments? (Who communicates with whom and about what?)

7. Are documents with respect to the communication steps available?

8. Which corporate body (supervisory board; management board; GMS; external auditor) monitors compliance with the Articles?

9. What is the management board's role with respect to the Articles? What are the communication steps?

10. What is the supervisory board's role with respect to the Articles? What are the communication steps?

11a. Does the GMS have any other role with respect to the Articles, besides approving them?

11b. What are the communication steps between the shareholders and the supervisory board? (Who communicates with whom and about what?)

11c. Are documents available with respect to the communication steps?

12. What is the relationship between the Articles, the Business Principles, and the Company Statement?

INTERVIEW 3 – Case-study company

Date: July 17, 2007

The 2006 annual report

A. Disclosure Committee

The annual report mentions a Disclosure Committee (p. 68). This committee advises the management board and monitors procedures that have been established by the company.

1. What procedures are involved?
2. Why has this committee been established?
3. When was the committee established?
4. Who are the committee's members?
5. What are the committee's authorities?
6. To whom is the committee accountable?
7. What is the relationship between this committee and the Compliance Committee?

- 8a. What is the supervisory board's role with respect to the committee?
- 8b. What are the supervisory board's communication steps? (Who communicates with whom and about what?)
- 8c. Are documents with respect to the communication steps available?

- 9a. What is the GMS's role with respect to the committee?
- 9b. What are the GMS's communication steps? (Who communicates with whom and about what?)
- 9c. Are documents with respect to the communication steps available?

B. Rules of Procedure

The supervisory board should meet the Rules of Procedures (cf. p. 68), but the rules for the supervisory board committees (audit/remuneration/appointment committee) are included in the Rules of Procedure.

1. Who establishes the Rules?
2. Does only the supervisory board approve the Rules?
3. Who monitors the supervisory board's compliance with the Rules?

- 4a. Who monitors the supervisory board committees' compliance with the Rules?
- 4b. What are the communication steps between the monitoring organ and the committees? (Who communicates with whom and about what?)
- 4c. Are documents with respect to the communication steps available?

- 5a. What is the management board's role concerning the Rules?
- 5b. What are the management board's communication steps? (Who communicates with whom and about what?)
- 5c. Are documents with respect to the communication steps available?

6. What is the difference between the Rules of Procedure and the Articles of Association?

C. The company's Rules on Inside Information

The management board should comply with the company's Rules on Inside Information (cf. p. 68). These Rules are part of the Rules of Procedure (article 21, p. 8), and restrict the opportunities for management board members to trade in the company's other companies' shares. They prohibit persons with inside information on transactions in the company's or other companies' securities from performing such transactions. Further, the Rules state that the Compliance Officer may determine when and which other companies' securities transactions are prohibited.

The supervisory board should comply with the Rules too (cf. p.70).

1. The annual report mentions that the Rules apply to the management board members (p. 68). The Rules themselves, however, indicate that they also apply to the supervisory board members (p. 8). How do you explain this?
2. The supervisory board should adhere to the Rules on the one hand, but it should approve the Rules on the other hand. How can both 'roles' be combined?
- 3a. Which company body monitors the Rules on Inside Information?
- 3b. What are the monitoring organ's communication steps? (Who communicates with whom and about what?)
- 3c. Are documents with respect to the communication steps available?
- 4a. What is the GMS's role with respect to the Rules?
- 4b. What are the GMS's communication steps? (Who communicates with whom and about what?)
- 4c. Are documents with respect to the communication steps available?
- 5a. What is the external auditor's role with respect to the Rules?
- 5b. What are the external auditor's communication steps? (Who communicates with whom and about what?)
- 5c. Are documents with respect to the communication steps available?
6. Do the Rules have legal status?
7. What is the relationship between the Articles of Association, the Rules of Procedure, and the Rules on Inside Information?

D. Code of Ethics for senior CFOs

The CEO's and CFO's compliance with the Code of Ethics should be confirmed in writing. (p. 69).

Will this written confirmation be made public?

INTERVIEW 4 – Case-study company

Date: November 7, 2007

1. The 2006 annual report

A. Chair of the supervisory board

The tasks of the chair of the supervisory board are mentioned on p. 70, one of them being to monitor and evaluate the functioning of the supervisory board members and the three committees.

- 1a. How does the chair monitor and evaluate? (What are the communication steps: Who communicates with whom and about what?)
- 1b. Are documents with respect to the communication steps available?

B. Compliance Officer

Does the Compliance Officer participate in a certain committee, for example, the Compliance Committee?

2. CSR and separate CSR report

The chapter *Corporate Social Responsibility* states that the CSR report is a Standard 3410 requirement (p. 62).

1. Is US legislation involved here?
2. If so, why has the CSR report been published together with the Dutch annual report and not with Form 20-F?
3. Does US legislation require that CSR be part of the internal audit?

3. Form 20-F

20-F preparation

1. Is the preparation for the Form 20-F with regard to the communication lines etc. the same as the preparation for the Dutch annual report?
2. Are the same CCUs and departments involved as for the preparation of the Dutch annual report? If not, what are the differences and what are the communication steps per phase?
3. Who oversees the preparation?
4. Who actually fills in Form 20-F?
5. What is the planning concerning the Form 20-F preparation? (Tasks, responsibilities, deadlines, documents?)

4. Questions concerning the chapter *Report of the Board of Management* in the 2006 Dutch annual report

The section ‘Internal Controls’ describes the processes and procedures within the company that have been designed to provide the Board of Management with control over the company’s operations. These include measures with regard to the ‘general control environment’, such as the Business Principles, Corporate Directives, and Authority Schedules.

1. Have the Authority Schedules been established as a consequence of the implementation of the SOX or the Tabaksblat Code?
2. To what extent can the Schedules be used as a control measure?

5. Risk management chapter

The introduction to the chapter *Risk management* mentions that risk management is related to the aim of being a ‘sustainable company’. This means that a direct link is made with the company’s CSR and at the same time with corporate governance, namely the internal control systems and the awareness of business risks that lead to transparency.

1. Is risk management thus a condition to achieve transparency within the company?

This chapter mentions the ‘risk boundaries’. These are the Company Statement; the Business Principles; the Internal Authority Schedules; the Corporate Directives; Insurance; Health, Safety and Environment; Human Resources; Communications; Legal and Intellectual Property.

1. What is the relationship between Communications and risk management?

The last bullet on p. 64 states that risk reporting is an integral part of the company’s ‘Business Planning & Review cycle’.

1. Could you explain what is meant by ‘Business Planning & Review cycle’?
2. Is this cycle the consequence of compliance with the SOX or the Tabaksblat Code?
3. If so, does the management board take other communication steps with respect to this cycle besides monitoring the procedures and results? Is documentation with respect to these communication steps available?
4. Does the supervisory board do more with respect to this cycle than discussing the management board’s control concerning the procedures and the results? Is documentation with respect to these communication steps available?
5. What are the communication steps of the GMS with respect to this cycle? Is documentation with respect to these communication steps available?
6. What are the communication steps of the external auditor with respect to this cycle? Is documentation available?

It has also been mentioned that the company could be exposed to “events of non-compliance with environmental laws, regulatory enforcement, property damage, and possible personal injury and property damage claims resulting there from.” The risks concerned might be prevented by “contingency plans and crisis management”.

6. Are these “contingency plans” a consequence of the implementation of SOX or the Tabaksblat Code?

The company’s steps to prevent non-compliance with legislation and regulation consist of: 1. the practical application of the Business Principles, and 2. A ‘reinforced comprehensive law compliance program’ introduced in 2000.

7. Is the ‘law compliance program’ a consequence of the implementation of the SOX or the Tabaksblat Code?
8. What CCUs are involved here and what are communication steps? Is documentation with respect to these communication steps available?

The next risk concerns the fluctuations of diverse valuta. The company has a “hedge policy” for this which consists of “exchange contracts” (p. 106).

8. Is this policy a consequence of the implementation of the SOX or the Tabaksblat Code?

The company tries to minimize risks with respect to the production by: (1) spreading production; (2) an adequate “inventory policy” together with “contingency planning”; and (3) risk transfer arrangements.

9. Is the “inventory policy” a consequence of the implementation of the SOX or the Tabaksblat Code?

6. Report of the Supervisory Board
The second column on p. 20 mentions that the supervisory board discussed, among other things, the annual financing and investment plan.
1. Is this plan in any way the consequence of the implementation of the SOX or the Tabaksblat Code?
7. Corporate website
The company's website, under Corporate Governance – Procedures – Appendix 2: General pre-approved services states the reason for the inclusion of Appendix 2 (i.e. to ensure that the company's Auditor's Independence Policy is followed).
1. Was there any reason for the inclusion of Appendix 2 resulting from the SOX or Tabaksblat Code rules?
'Risk management' part
This includes the statement, "Our Risk Management Framework encompasses the following elements: A common risk language to facilitate communications and decision-taking on risks".
1. Could you explain this statement?
'HSE' part
This part mentions the "Product Stewardship Management System".
1. Could you explain what this system is?
The company's Financial Code of Ethics
1. Has this Code been established in accordance with a template prescribed by the SOX?
The company's Policy on Auditor Independence
1. Has this Policy been established in accordance with a SOX template?
2007 General Meeting of Shareholders (March 25)
1. The minutes of the 2007 GMS (p. 57) mention the existence of a European Council. Could you clarify that?
Final question
What has the biggest change been with respect to communication within the company as a consequence of compliance with the Tabaksblat Code and the SOX?

ACCOUNTING FIRM
INTERVIEW 1 – Accounting firm

Date: October 29, 2007

Introduction
1. What is your position within the accounting firm and which tasks do you have? 2. Since when has the accounting firm been registered with the PCAOB?
The audit process – the preparation for the final annual report

1. How is the audit process started?
 - a. Who contacts the accountant? In what way?
 - b. What is usually included in an Engagement Letter?
 - c. When is this letter established?
 - d. Who signs the letter?
 - e. Does the letter apply to all SOX and Tabaksblat Code audit activities for a given company?

2. The audit committee appoints the external auditor (cf. SOX301(m)(2)), determines the remuneration, and monitors the audit.
 - a. How is the auditor appointed and how does the committee monitor the auditor?
 - b. Is certain documentation involved?
 - c. Is there any kind of written or oral consultation? If so, is it formal or informal?

3. The audit committee should also approve the audit services (cf. SOX202(i)(1)(A)).
 - a. In what way will they be approved?
 - b. Is the way in which approval is given also part of the Engagement Letter?
 - c. Are all audit services mentioned in the Engagement Letter?

4. How is the audit process planned or structured? Is there a kind of project plan available?
 - a. Has a new project plan been developed after the SOX implementation? If so, how is the plan structured? What documentation is available?
 - b. Which departments and persons are involved in this process? Is documentation available?
 - c. What tasks do the departments and persons involved have? Is documentation available?
 - d. Who is responsible for what?
 - e. In what way and how many times do all involved departments and persons consult with one another? Is this formal or informal? In written or oral form? Is documentation available?

INTERVIEW 2 – Accounting firm

Date: November 9, 2007

1. How does the external auditor deal with ‘audit documentation’ and the auditor’s report, given that AS2 mentions only very generally:

AS3-4 The auditor must prepare audit documentation in connection with each engagement conducted pursuant to the standards of the PCAOB. Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation should be appropriately organized to provide a clear link to the significant findings or issues. 1/ Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

- a. What does the preparation include? Is documentation available?
- b. How does the auditor make clear what the goal, the source, and the conclusions are? Is documentation available?
- c. What does “appropriately organized” mean according to auditors?
- d. Is documentation available with respect to the organization?
- e. What form does ‘audit documentation’ usually take?

2. It has been stated in AS2-40 that the accountant should understand and evaluate the processes for assessing the effectiveness of the internal control over financial reporting. Further, the external auditor should determine whether the management has addressed certain elements.

40. The auditor must obtain an understanding of, and evaluate, management's process for assessing the effectiveness of the company's internal control over financial reporting. When obtaining the understanding, the auditor should determine whether management has addressed the following elements:

- Determining which controls should be tested, including controls over all relevant assertions related to all significant accounts and disclosures in the financial statements. Generally, such controls include:
 - Controls over initiating, authorizing, recording, processing, and reporting significant accounts and disclosures and related assertions embodied in the financial statements.
 - Controls over the selection and application of accounting policies that are in conformity with generally accepted accounting principles.
 - Antifraud programs and controls.
 - Controls, including information technology general controls, on which other controls are dependent.
 - Controls over significant nonroutine and nonsystematic transactions, such as accounts involving judgments and estimates.
 - Company level controls (as described in paragraph 53), including:
 - The control environment and
 - Controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; to initiate, authorize, record, and process journal entries in the general ledger; and to record recurring and nonrecurring adjustments to the financial statements (for example, consolidating adjustments, report combinations, and reclassifications).
- Note: References to the period-end financial reporting process in this standard refer to the preparation of both annual and quarterly financial statements.

- a. How does the external auditor obtain an overview of which control elements management took into account? Is documentation available?
- b. How does the external auditor do this? Does a conversation take place or is the contact in written form only? Is this formal/informal? Is documentation available?

3. Related to question 6, AS-20 stipulates the following:

AS2-20. Management's Responsibilities in an Audit of Internal Control Over Financial Reporting: For the auditor to satisfactorily complete an audit of internal control over financial reporting, management must do the following:

- a. Accept responsibility for the effectiveness of the company's internal control over financial reporting;
- b. Evaluate the effectiveness of the company's internal control over financial reporting using suitable control criteria;
- c. Support its evaluation with sufficient evidence, including documentation; and
- d. Present a written assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year.

- a. How does this process take place? Should the accountant wait for management action before finishing the audit? Is documentation available?
- b. Does management inform the accountant in a certain way that management has met these requirements? How is the auditor informed? Is this formal/informal? Is documentation available?

4. AS2-49 lists the five internal control components with respect to financial reporting:

The auditor must obtain understanding of the design of controls related to each component of internal control over financial reporting:

- Control environment (explanation of why: p. 168);
- Risk assessment (explanation of why: p.168);
- Control activities (explanation of why: p. 168);
- Information and communication (explanation of why: p.168);
- Monitoring.

- a. In what way does the external auditor deal with these components? Do standard procedures or templates exist?
- b. How does point 2, ‘Risk assessment’, relate to the chapter *Risk management* in an annual report?
- c. Do the ‘control activities’ cover any other elements than the ‘control environment’?
- d. What does ‘information and communication’ mean here?
- e. What does ‘monitoring’ mean here?

5. AS2-159 requires the external auditor to understand and evaluate the ‘design’ of the five components of internal control over financial reporting, i.e:

- The process used to determine significant accounts and disclosures and major classes of transactions, including the determination of the locations or business units at which to perform testing;
- The identification of the points at which misstatements related to relevant financial statement assertions could occur within significant accounts and disclosures and major classes of transactions;
- The extent to which the auditor relied upon work performed by others as well as the auditor's assessment of their competence and objectivity;
- The evaluation of any deficiencies noted as a result of the auditor's testing; and
- Other findings that could result in a modification to the auditor's report.

- a. How does the external auditor obtain an understanding of and evaluate the ‘design’ of the five components? Does he/she use certain templates?
- b. Is it common for an external auditor to use the work of other external auditors?
- c. If so, how does this process work? Do the auditors meet? Is this formal/informal? Is there documentation?

6. AS2-47 requires the external auditor to carry out certain procedures, namely:

- making inquiries of appropriate management, supervisory, and staff personnel;
- inspecting company documents;
- observing the application of specific controls; and
- tracing transactions through the information system relevant to financial reporting.

- a. How are these ‘inquiries’ performed? Is use made of certain standard questions? Are the questions in written or oral form? Is documentation available?
- b. What documents are referred to in point 2? Are these standard documents? How does the external auditor obtain these documents? Are there meetings with management or others concerning these documents? If so, are these formal/informal? In oral/written form? Is documentation available?
- c. How does the external auditor deal with point 3? Are standard procedures with standard documents available? If so, which documents are involved?
- d. The last point also has to do with AS2-79:

AS2-79. Performing walkthroughs. The auditor should perform at least one walkthrough for each major class of transactions (as identified in paragraph 71). In a walkthrough, the auditor traces a transaction from origination through the company's information systems until it is reflected in the company's financial reports. Walkthroughs provide the auditor with evidence to:

- confirm the auditor's understanding of the process flow of transactions [...].

Does a certain standard procedure exist for this? If so, what kind of procedure? Is an overview of all transactions made, for example? If so, how? Is documentation available?

7. AS2-127 indicates that the external auditor should evaluate all evidence from all sources.

- | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> a. Does the external auditor use a certain system or certain templates for this? If so, which? Is documentation available? b. How many external auditors are involved in this? c. If two or more auditors are involved, how does consultation take place? Is this formal/informal? In oral/written form? Is documentation available? |
| <p>8. The external auditor is also required to investigate all internal audit financial reports of the relevant year.</p> <ul style="list-style-type: none"> a. With whom in the client's company does the external auditor have contact? The audit committee, the internal auditor, the controlling department, etc? b. What kind of communication takes place between the accountant and the contact person? Is this formal/informal? In written/oral form? Is documentation available? c. Does the external auditor use a certain system or template for this? If so, what documentation is used? |
| <p>9. AS2-6 stipulates that the external auditor should realize that investors will also read the information provided by the auditor within the annual report.</p> <ul style="list-style-type: none"> a. Does this requirement influence how the external auditor expresses his/her findings in the auditor's report? b. If so, how? And how is this influence expressed in the auditor's written statements? c. Could this be a reason for the external auditor to make use of certain templates or other fixed texts? If so, what kind of templates/fixed texts? |

General questions

1. The implementation of the SOX has possibly led to a number of changes within the accounting firm and within your tasks. What kind of changes have been made? For example:
 - a. Did the NIVRA, for instance, provide specific guidelines? If so, what kind of guidelines? Is documentation available?
 - b. Did new departments or positions come into existence? If so, which ones and why? Is documentation available?
 - c. Have new procedures been developed? If so, which ones and why?
 - d. What kind of changes, processes, etc. have been made with respect to audits in general? Is documentation available?

The annual report – Form 20-F

1. Management should provide the external accountant with a Letter of Representation including the conclusion with respect to management's assessment of the effectiveness of the internal control over financial reporting.
 - a. What does such a Letter of Representation include?
 - b. Does the accountant actually receive such a letter, or is the content made available in some other way to the external auditor?
2. The auditor's report should include the auditor's attestation. The content requirements are included in AS3-6, as follows:

The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions. Audit documentation must clearly demonstrate that the work was in fact performed. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

 - a. to understand the nature, timing, extent and results of the procedures performed, evidence obtained, and conclusions reached, and
 - b. to determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.
 - a. Is use made of standard procedures and/or documents?
 - b. If so, what kind of procedures or documents?
 - c. Which parties are involved? How does consultation take place? Is this formal/informal? In written or oral form?
3. AS2-167 (cf. AS2-142: Requirement for Written Representations from management) specifies what content elements should be included in the auditor's report, namely:

- a. A title that includes the word *independent*;
 - b. An identification of management's conclusion about the effectiveness of the company's internal control over financial reporting as of a specified date based on the control criteria [for example, criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)];
 - c. An identification of the title of the management report that includes management's assessment (the auditor should use the same description of the company's internal control over financial reporting as management uses in its report);
 - d. A statement that the assessment is the responsibility of management;
 - e. A statement that the auditor's responsibility is to express an opinion on the assessment and an opinion on the company's internal control over financial reporting based on his or her audit;
 - f. A definition of internal control over financial reporting as stated in paragraph 7;
 - g. A statement that the audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States);
 - h. A statement that the standards of the Public Company Accounting Oversight Board require that the auditor plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects;
 - i. A statement that an audit includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as the auditor considered necessary in the circumstances;
 - j. A statement that the auditor believes the audit provides a reasonable basis for his or her opinions;
 - k. A paragraph stating that, because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements and that projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate;
 - l. The auditor's opinion on whether management's assessment of the effectiveness of the company's internal control over financial reporting as of the specified date is fairly stated, in all material respects, based on the control criteria (See discussion beginning at paragraph 162);
 - m. The auditor's opinion on whether the company maintained, in all material respects, effective internal control over financial reporting as of the specified date, based on the control criteria;
 - n. The manual or printed signature of the auditor's firm;
 - o. The city and state (or city and country, in the case of non-U.S. auditors) from which the auditor's report has been issued; and
 - p. The date of the audit report
4. AS3-5 also mentions the goal of the auditor's report:
- Because audit documentation is the written record that provides the support for the representations in the auditor's report, it should:
- a. Demonstrate that the engagement complied with the standards of the PCAOB,
 - b. Support the basis for the auditor's conclusions concerning every relevant financial statement assertion, and
 - c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.
- a. Have standard documents or fixed texts been developed for the auditor's report?
- b. If so, what kind of documents/texts?
5. The external auditor may choose between a combined report or separate reports (AS2-169). What is chosen within the accounting firm? Why?
6. AS3-18 requires the accounting firm to be responsible for the audit, and the audit documentation to comply with all rules of the SOX and other regulations.
Who exactly is responsible for this? Is there documentation?
7. The accounting firm will be reviewed every three years by the PCAOB/SEC.
- a. Has the accounting firm been reviewed already?
 - b. How does a review proceed?
 - c. Is this only in written form? Are standard letters used, for example? If so, what kind of letters?

- d. Which documents should the accounting firm provide?
- e. Which departments and/or persons within the accounting firm are involved?
- f. Will use be made of a certain procedure? If so, which procedure? Is documentation available? Is this formal/informal?

Report to the audit committee

SOX204(k) and SOX301(m)(2) state that the auditor should report to the audit committee.

- a. Is this a standard procedure? Or does it only apply in certain circumstances?
- b. Are fixed texts or templates used for this? If so, which texts/templates?
- c. What is the content of this report?
- d. Does the audit committee reply to the report? If so, in what way?

Appendix F

2006 annual report

Chapters	Sections	Sub sections
Overview and strategy The company at a glance Key developments Shareholder information Chairman's statement	Company's share price	
Strategy	General [...] ²¹⁶ Financing objectives	
Report of the BoM	General financial overview Economic Value Added (EVA) [...] Internal Controls	Several sub sections Dividend – EUR [...] Positive for 2007
Supervisory Board	Resumee of each SB member	
Report of the Supervisory Board	Financial statements and dividend proposal Supervisory Board activities Composition of the Supervisory Board Board of Management changes Audit Committee Remuneration Committee Nomination Committee	
Business Performance BUs		
People and society Our people Corporate Social Responsibility	Anchoring CSR at the heart of our business Company Art Foundation Inspiring and connecting	Governance Creating sustainable value Recognition
Governance and Compliance Risk management	Unidentified risks are a threat; identified risks are a managerial issue Major risk factors Strategic decision-making risks Internal risks	External risks
Corporate governance	General Board of Management Appointment, conflicts of interest Remuneration Risk management and (financial) reporting Rules of procedure, codes of conduct, complaints procedures Supervisory Board Appointment, independence and composition Remuneration Committees Relations with shareholders and other investors	General Changes to the corporate governance

²¹⁶ [...] indicates that the chapter or section consists of more sections and sub sections respectively. The not mentioned sections and sub sections are either (1) not relevant for this case study, and/or (2) would jeopardize the anonymity of the case-study company.

	Anti takeover provisions and control Auditors	
Remuneration report	General Remuneration policy	Base salary Short-term incentive (annual bonus) Long-term incentives
	Pensions Employment agreements Remuneration in 2006	General Base salary 2006 Short-term incentive (annual bonus) 2006 Long-term incentives 2006
Financial statements	[...]	
Contents Summary of significant accounting policies Consolidated statement of income Consolidated balance sheet Consolidated statement of cash flows Consolidated statement of changes in equity Notes to the consolidated financial statements Statement of income and balance sheet Notes to the statement of income Notes to the balance sheet Auditor's report	[...] Note 26 Related party transactions Report on the Financial Statements	Management's responsibility Auditor's responsibility Opinion with respect to the consolidated Financial Statements Opinion with respect to the Company Financial Statements
Profit allocation and distributions Financial summary	Report on other legal and regulatory requirements [...]	
Additional information Index Financial calender Definitions Business principles Contact details		

Appendix G

GMS AGENDA 2007

1. Opening	
2. Management Board report about financial year 2005	
3. (a) Deciding on the financial statements 2005	<i>(voting point)</i>
(b) Deciding on Dividend	<i>(voting point)</i>
4. Discharge	
(a) Discharge of the Management Board members on behalf of the by them performed tasks in 2005	<i>(voting point)</i>
(b) Discharge of SB members on behalf of the by them performed tasks in 2005	<i>(voting point)</i>
5. Supervisory Board	<i>(voting points)</i>
Appointment and reappointment of Supervisory Board members	<i>(voting points)</i>
6. Remuneration Supervisory Board	<i>(voting point)</i>
7. Proposal for change of remuneration policy for Management Board	<i>(voting point)</i>
8. Deciding on the maximum number of available shares for the long term remuneration plans	<i>(voting point)</i>
9. Proposal to grant authorization for:	
(a) issuance of shares	<i>(voting point)</i>
(b) the restriction or preclude shareholders' preference rights	<i>(voting point)</i>
10. Proposal to grant the MB authorization to obtain shares within the corporation on behalf of the corporation	<i>(voting point)</i>
11. Reports and queries	

Appendix H

ANALYSIS II.2.10

(CHAPTER 9)

A. Content

A statement about relative importance of variable and non-variable remuneration components and explanation

2006 annual report

Statement:

Chapter *Remuneration report*, section ‘General’:

‘[...] a significant proportion of the remuneration package is variable and dependent on short- and long-term performance of the individual Board members and the company.

Explanation:

Chapter *Remuneration report*, section ‘Remuneration policy’:

“The company’s remuneration policy, [...], is in line with the Dutch Corporate Governance Code”.

B. Content

An explanation of any absolute change in the non-variable remuneration component

2006 annual report

Chapter *Remuneration report*, section ‘Employment agreements’:

“The employment contracts allow the Supervisory board to request a Board member to resign between the age of 60 [...].”

C. Content

The composition of the group of companies (peer group) whose remuneration policy determines in part the level and composition of the remuneration of the MB members

2006 annual report

Chapter *Remuneration report*, section ‘Remuneration policy’:

“The peer group included five direct competitors of the company. [...].”

D. Content

A summary of the company’s policy with regard to the term of the contracts with MB members, the applicable periods of notice and redundancy schemes and an explanation of the extent to which best practice provision II.2.7 is endorsed.

2006 annual report

Chapter *Remuneration report*, section ‘Employment agreements’:

“Employment agreements [...] appointed in 2004 and subsequent years are [...] in conformity with the Dutch Corporate Governance Code. [...]. The amount of this severance payment shall in principle not exceed the equivalent of one year of base salary, or in case of termination upon the first term of four years, two years of base salary. The employment agreements [...] before 2004 have not been adjusted in this respect [...]. However, the Supervisory Board has the intention to take the provisions of the Code as guidance for establishing severance payments. [...]”

E. Content

A description of the performance criteria on which any right of the MB members to options, shares or other variable remuneration components is dependent and an explanation thereof.

A summary of the methods applied in order to determine whether the performance criteria have been fulfilled and an explanation of the choice of these methods.

2006 annual report

Chapter *Remuneration report*, section ‘Remuneration policy’, sub section ‘short-term incentive (annual bonus)’:

“The objectives of the short-term incentive are to reward economic value creation (EVA) for our shareholders and other stakeholders, to measure individual and collective performance and to encourage progress in the achievement of long-term strategic objectives.” And “the bonus opportunity is linked to EVA for 70%; the remaining 30% is based on qualitative individual and collective targets. [...]. Targets are set in the context of the medium-term objectives of the company and qualify as commercially sensitive information. The company will not disclose the targets. [...]”

Same Chapter and section, then in sub section ‘Long-term incentives’:

“[...]. The performance measure used to determine the number of options that vest is set by the average of the results of the comparison between planned and realized EVA on Invested Capital (EOI) or economic value created in relation to invested capital during the period of three consecutive years. [...]. The specific targets will not be disclosed as they qualify as commercially sensitive information. [...]”

F. Content

A summary of the factors that will be used to make the comparison (if performance criteria are based on a comparison with external factors); etc.

2006 annual report

Chapter <i>Remuneration report</i> , section ‘Remuneration policy’, sub section ‘Long-term incentives’: “The TSR will be compared with the following peer group [...].”
G. Content
A description of each proposed change to the conditions on which a MB member can acquire rights to options, shares or other variable remuneration components and an explanation of this
2006 annual report
Chapter <i>Remuneration report</i> , section ‘Remuneration policy’, sub section ‘Long-term incentives’: “There will be no shares that vest for a position below the tenth position of the 15 peer companies. [...].”
H. Content
<i>An explanation</i> if any right of a MB member to options, shares, or other variable components is not performance-related, an explanation of why this is the case.
2006 annual report
Not applicable
I. Content
Current pension schemes and the related financing costs
2006 annual report
Chapter <i>Remuneration report</i> , section ‘Pensions’: “The pension plan [...] is based on an income- and age-related defined contribution plan and in line with the pension legislation as from January 1, 2006. [...]. “[They] normally retire in the year that they reach the age of 62.” [...]. And Chapter <i>Remuneration report</i> , section ‘Employment agreements’ [see content element below]
J. Content
Agreed arrangements for the early retirement of management board members.
2006 annual report
Chapter <i>Remuneration report</i> , section ‘Employment agreements’: “[...] allow the Supervisory Board to request a Board member to resign between the age of 60 [...].”

Appendix I

Audit committee's self-assessment (certain elements of the original template)

	Excellent 1	2	3	4	Poor 5
Terms of reference					
Have the audit committee's terms of reference been approved by the board?					
Does the audit committee annually review its terms of reference and recommend any necessary changes to the board?					
Do the terms of reference (audit committee charter) include:					
1. Monitoring the integrity of the financial statements;					
2. Reviewing the company's internal financial control systems;					
3. Unless addressed by another board sub-committee or by the board itself, reviewing the company's risk management systems;					
4. Monitoring and reviewing the effectiveness of the company's internal audit function;					
5. Recommending to the board the appointment of the external auditor and approving their remuneration and terms of engagement following appointment by the shareholders in General Meeting;					
6. Monitoring effectiveness of the external auditor's performance and their independence and objectivity;					
7. Developing and implementing a policy on the engagement of the external auditor to supply non-audit services?					
Membership and appointments					
Does the audit committee consist independent non-executive directors?					
Is the board chairman excluded from audit committee membership?					
Are audit committee members appointed by the board on the recommendation of the nomination committee (where there is one) in consultation with the audit committee chairman?					
Is audit committee membership restricted to a term no longer than three years (extendable by no more than two additional three-year periods)?					
Meetings					
Does the audit committee meet regularly (at least three times a year to coincide with key dates in the financial reporting and audit cycle)?					
Are audit committee meetings well attended?					

Other elements that are part of the audit committee self-assessment template and that included each several questions are:

- Training and resources;
- Financial reporting;
- Internal financial controls and risk management systems;
- Internal audit process.

Appendix K

Audit committee's external auditor assessment

Calibre of external audit firm

What is the reputation of the external audit firm? Are there recent or current litigation cases against the firm?

What is the reputation and presence of the external audit firm in this industry?

Does the external audit firm have the size, resources and geographical coverage required to audit this company?

Quality processes

What are the quality control processes in the external audit firm?

Do the factors to be considered include the level and nature of review procedures, the approach to audit judgements and issues, independent quality control reviews and the external audit firms approach to risk?

How are key audit individuals at the external audit firm compensated and evaluated, and do these compensation and evaluation schemes run the risk of impairing the external auditor's independence?

What is the external audit firm's process for internal review of accounting judgements, including an understanding of the key issues?

What relevant specialists does the external audit firm employ and how are these linked to the audit process?

Audit team

Do the individuals assigned to the external audit team have the requisite expertise, including industry knowledge, to audit this company effectively?

Are sufficient resources allocated to the audit?

What is the scope of the engagement partner's/other senior personnel's involvement in the audit process and is this sufficient?

Does the external audit firm have adequate key team member succession plans in place, which meet the relevant audit partner rotation requirements and facilitate the maintenance of objectivity?

Audit scope

Is the external audit scope adequate to address all of the financial reporting risks facing the company?

Do the factors to be considered include the geographical coverage, the allocated resources, the level of audit testing and the nature of the audit reports issued at each location?

Does the external audit firm agree the audit scope and plan with the audit committee?

Is specialist input to the audit in areas such as taxation, pensions and regulation at an appropriate level?

Are all key operations covered by the external audit?

How are overseas audits controlled and is audit effectiveness regarded as consistent internationally?

Are the reporting processes for subsidiary audit teams effective?

Samenvatting

De huidige kredietcrisis doet vragen rijzen ten aanzien van de betrouwbaarheid van banken, het gemis aan transparantie in hun werkwijze en hun organisatie, en bovendien zijn de torenhoge beloningen van de bestuurders menigeen een doorn in het oog. Dergelijk punten van kritiek werden ook geuit met betrekking tot grote ondernemingen – bijvoorbeeld Enron en Ahold - die zo'n tien jaar geleden verwikkeld waren in accounting schandalen. De financiële schandalen rond 2000 maakten duidelijk, dat goed bestuur geen vanzelfsprekendheid is, meer nog, de roep om regelgeving ten aanzien van goed bestuur, die in Nederland al in de jaren 90 aangewakkerd was, werd steeds sterker. Zowel in de Verenigde Staten als ook in Nederland werd een code met regels ten behoeve van goed bestuur (corporate governance code) opgesteld. De Sarbanes-Oxley Act verscheen in de zomer van 2002 en de Code Tabaksblat werd een jaar later van kracht.

Nederlandse ondernemingen die zowel aan een Nederlandse beurs als ook aan een Amerikaanse beurs genoteerd staan zijn verplicht om zich aan beide codes te houden. Alhoewel transparantie voor beide codes het doel is, verschilt de Amerikaanse kijk op goed bestuur van het Nederlandse perspectief daarop. Waar de Sarbanes-Oxley Act vooral gericht is op financiële verslaglegging staan in de Code Tabaksblat met name de machtsverhoudingen tussen de raad van bestuur, de raad van commissarissen en de (algemene vergadering van) aandeelhouders centraal. Een ander belangrijk verschil betreft het wettelijk karakter. De Code Tabaksblat is een gedragscode, waarbij alleen het ‘pas toe of leg uit’ principe²¹⁷ wettelijk verankerd is. De Sarbanes-Oxley Act daarentegen is een wet. Ondanks deze essentiële verschillen zijn er ook overeenkomsten, namelijk zowel het doel als ook de middelen, die door regelgeving van goed bestuur bereikt kunnen worden, en dat daardoor de problemen zoals te hoge beloningen of accountingschandalen voorkomen kunnen worden.

Door middel van de codes wordt een institutie, namelijk ‘goed bestuur’, in het leven geroepen. De codes formuleren regels die ‘goed bestuur’ constitueren vergelijkbaar met bijvoorbeeld de regel ‘schaakmat’, die bepaalt dat het schaakspel ten einde is en wie de winnaar en wie de verliezer is. Een ander voorbeeld van een dergelijke regel met betrekking tot Nederlandse beursgenoteerde ondernemingen is de regel²¹⁸ dat de leden van de raad van commissarissen onafhankelijk moeten zijn op maximaal één commissaris na, waarbij uitgelegd wordt wat deze onafhankelijkheid inhoudt. Deze regel bepaalt dus dat de commissarissen onafhankelijk moeten zijn en wat die onafhankelijkheid inhoudt. Searle (2005) stelt dat een institutie, dus ook de institutie ‘goed bestuur’, een systeem van constitutieve regels is, waarbij Searle (1978) deze constitutieve regels karakteriseert door middel van twee formules, namelijk (1) constitutieve regels hebben vaak de vorm ‘*X geldt als Y in context C*’; en (2) het creëren van constitutieve regels, creëert als het ware de mogelijkheid tot nieuwe vormen van gedrag. De constitutieve regels hebben de vorm ‘*X geldt als Y in context C*’, waarbij de *X* staat voor bepaalde karakteristieken van een object, persoon of stand van zaken, de *Y* is de *X* met een toegevoegde statusfunctie, en de *C* is de context ofwel de collectieve acceptatie van het feit dat *X* een bepaalde status functie heeft gekregen en

²¹⁷ Het ‘pas toe of leg uit’ principe houdt in dat een onderneming ofwel de regels toepast ofwel afwijkt van een of meerdere regels, maar dan is de onderneming verplicht om in het jaarverslag aan te geven van welke regels het afwijkt en in het jaarverslag moet uitgelegd worden waarom de onderneming van de betreffende regel(s) afwijkt.

²¹⁸ Tabaksblat Code 2003, III.2.1 Alle commissarissen, met uitzondering van maximaal één persoon, zijn onafhankelijk in de zin van best practice bepaling III.2.2.

daardoor telt als Y . De status functie van de Y geeft aan dat er bepaalde consequenties zijn. Bijvoorbeeld schaakmat is de X maar doordat het een deel van het schaakspel is heeft het als consequentie dat de ene partij wint en de andere partij verliest. Zo is de eis van onafhankelijkheid met betrekking tot commissarissen de X , maar doordat het een deel van het ‘spel’ ‘goed bestuur’ is heeft het als consequentie dat leden die niet-onafhankelijk zijn geen lid van de raad van commissarissen mogen zijn.

De constitutieve regels leiden echter volgens Searle niet alleen tot het collectief toekennen van status functies aan X , waardoor X geldt als Y en dus tot bepaalde consequenties, maar deze regels leiden er ook toe dat door het toekennen van status functie Y aan X er een situatie ontstaat, waarin algemeen geaccepteerd wordt dat een persoon S , die in een geschikte verhouding tot X staat zodanig is dat (S heeft macht (S doet A)). Dat betekent dat er een machtsverhouding ontstaan is met een nieuwe vorm van macht, waarbij S ‘deontic power’ heeft, namelijk de macht om rechten en plichten op te leggen.

Het tweede kenmerk van constitutieve regels is dat deze constitutieve regels nieuwe vormen van gedrag ofwel iets tot existentie brengen, iets constitueren. Een voorbeeld van een constitutieve regel is ‘schaakmat is voorhanden als de koning op een zodanige manier aangevallen is dat geen enkele zet de schaakstelling kan opheffen’. Deze regel voor schaakmat definieert ‘schaakmat in het schaakspel’ zoals de schaakregels ‘het schaken’ definiëren. Zulke constitutieve regels brengen het schaakspel tot existentie. Het eerste kenmerk van constitutieve regels, namelijk het creëren van de mogelijkheid tot een nieuwe vorm van gedrag, betekent dus dat gedrag dat in overeenstemming is met de regel specificaties of beschrijvingen kan krijgen die het niet zou krijgen als de regel niet zou bestaan. Bijvoorbeeld schaakregels geven de basis voor specificaties van gedrag, zoals ‘hij zette de koning schaakmat’ een specificatie van gedrag die alleen maar kan bestaan doordat er constitutieve regels, schaakregels, zijn.

De regels in de codes worden gekenmerkt door een bepaalde gelaagdheid. Ze zijn namelijk regulatief met betrekking tot het gedrag en de activiteiten van de institutie ‘beursgenoteerde vennootschap’, maar ze zijn constitutief als het gaat om ‘goed bestuur’. De codes zijn in het leven geroepen om boven de oude institutie ‘beursgenoteerde vennootschap’ de nieuwe institutie ‘goed bestuur’ te constitueren.

De institutie theorie van Searle (2005) is een centraal uitgangspunt van deze dissertatie, waarbij een belangrijk doel van het onderzoek is om in een op microniveau uitgewerkte case studie de adequaatheid van deze theorie op de proef te stellen.

De institutie ‘goed bestuur’ is een systeem van constitutieve regels die de vorm ‘ X geldt als ‘goed bestuur’ in context C ’ hebben. Om problemen met betrekking tot corporate governance op te lossen doen de codes een poging om door het expliciteren van constitutieve regels voor ‘goed bestuur’ de ‘collectieve toekenning van status functies aan X voor alle betrokkenen verplicht op te leggen. De case studie van deze dissertatie moet uitsluitsel geven of dit lukt en dus of deze intentie gerealiseerd kan worden. De Code Tabaksblat bevat de constitutieve regels die expliciet maken waar het in de Nederlandse institutie ‘goed bestuur’ om gaat. Datzelfde geldt ook voor de Sarbanes-Oxley Act, die de constitutieve regels bevat die de kern van de Amerikaanse institutie ‘goed bestuur’ weergeven. Dat betekent dat wanneer een beursgenoteerde onderneming voldoet aan de regels van de code(s), dit bedrijf voldoet aan de kerneisen van ‘goed bestuur’ volgens het betreffende corporate governance systeem, want de context C is in dit geval het corporate governance system. Het begrip ‘goed bestuur’ wordt in Nederland anders ingevuld dan in de VS. Dit is van essentieel belang voor dit onderzoek.

Searle benadrukt in zijn theorie over instituties, dat de status functie zoals die gesymboliseerd is in ‘ X geldt als Y in C ’ door taalgebruik (symbolgebruik) gerepresenteerd moet worden.

Searle formuleert dit als volgt “A status function must be represented as existing in order to exist at all, and language or symbolism of some kind provides the means of representation” (2005, p. 12). Dit is de theoretische reden om in deze dissertatie het communicatie perspectief als uitgangspunt te nemen. De Nederlandse en Amerikaanse corporate governance code zijn op te vatten als regelgeving waarin duidelijk wordt aan welke principes een bedrijf moet voldoen en aan welke communicatie praktijken het moet vast houden. Goed bestuur volgens de Code Tabaksblat en de Sarbanes-Oxley Act wordt bereikt doordat bedrijven zich aan de regels in de codes houden. Deze regels bestaan grotendeels uit communicatieregels en dit onderzoek richt zich dan ook alleen op die communicatieregels.

Searle beschrijft in zijn theorie dat een institutie pas tot existentie gebracht is, wanneer de status functie collectief geaccepteerd wordt. De corporate governance codes zijn in het leven geroepen om iets te doen aan de ‘collective acceptance’ van ‘goed bestuur’. De codes hebben transparantie tot doel en wanneer transparantie bereikt is kan gesproken worden van ‘collective acceptance’ van ‘goed bestuur’. Dat betekent dat de communicatieregels in de codes constitutief zijn voor ‘goed bestuur’ omdat ze expliciteren wat ‘goed bestuur’ is en dat naleving van deze regels door ondernemingen uiteindelijk zou moeten leiden tot het doel van ‘goed bestuur’, namelijk transparantie, waarmee dan de collectieve acceptatie een feit is en de institutie ‘goed bestuur’ tot existentie gebracht is.

Searle benadrukt dat taalgebruik het middel is om de status functie te representeren. Dat betekent dat de constitutieve communicatie regels in de codes de status functie, namelijk ‘goed bestuur’, representeren. Daarom wordt er in dit onderzoek wordt gebruik gemaakt van genre theorie om te verduidelijken hoe door middel van taalgebruik – namelijk communicatie in teksten - ‘goed bestuur’ tot existentie gebracht wordt. Genre theorie wordt daarom gebruikt om Searle’s institutie theorie uit te leggen, namelijk door welke tekstsoorten en communicatie handelingen – die de constitutieve communicatie regels bevatten - ‘goed bestuur’ tot existentie gebracht wordt. Genre theorie wordt dus gebruikt om te laten zien hoe taal, namelijk specifieke genres en communicatie handelingen, de representaties zijn van de status functie en dus representaties zijn van hoe *X* tot *Y* wordt.

In genre theorie wordt een bepaalde tekst een genre als deze tekst bepaalde kenmerken toont die karakteristiek voor een bepaald genre zijn. Een jaarverslag, bijvoorbeeld wordt het genre jaarverslag als het bepaalde kenmerkende elementen laat zien die een tekst tot het jaarverslag genre maken. Volgens Bhatia (2005) vormen deze kenmerken die een tekst tot een genre maken de integriteit van het specifieke genre. Het genre dat in onderliggend onderzoek centraal staat is het jaarverslag. Het jaarverslag genre is een afspiegeling van de bedrijfscommunicatie van een onderneming en het jaarverslag kan dus beschouwd worden als representatief voor de algehele bedrijfscommunicatie van een onderneming. De constitutieve communicatieregels zoals vastgelegd in de Code Tabaksblat en de Sarbanes-Oxley Act kunnen gezien worden als regels van een tekstsoort, bijvoorbeeld een jaarverslag. Dat betekent dat deze communicatieregels bepalen hoe het jaarverslag genre eruit zou moeten zien. Het concept van genre levert een adequaat kader om de regels in de codes voor bedrijfscommunicatie – die goed bestuur constitueren – en ook het voldoen aan deze regels in de praktijk van een bedrijf (het jaarverslag) in kaart te brengen. Als het Nederlandse jaarverslag van een Nederlandse onderneming de kenmerken heeft van het jaarverslag genre volgens de Code Tabaksblat dan heeft dat jaarverslag de integriteit van het jaarverslag genre zoals dat door de constitutieve communicatie regels van de Code bepaald is. Datzelfde geldt voor het Amerikaanse jaarverslag van een onderneming. Als dat jaarverslag de tekst-interne en tekst-externe karakteristieken heeft zoals die door de Sarbanes-Oxley Act bepaald zijn dan heeft het jaarverslag de integriteit van het specifieke Amerikaanse jaarverslag genre. De

integriteit is volgens de opvatting van Searle het kenmerk van het constitueren van de institutie ‘goed bestuur’.

In deze dissertatie wordt onderzocht of zowel het Nederlandse en als ook het Amerikaanse jaarverslag van een Nederlandse onderneming die integriteit toekomen zoals die bepaald is door de constitutieve regels van de codes. Indien beide jaarverslagen inderdaad de integriteit toekomen zoals vastgelegd door de codes en ze dus een voorbeeld van het Nederlandse jaarverslag genre en een voorbeeld van het Amerikaanse jaarverslag genre zijn, dan heeft de onderneming ‘goed bestuur’ bereikt en dat heeft als consequentie dat de onderneming geacht wordt transparant te zijn. Een onderneming zal zijn bedrijfscommunicatie moeten aanpassen als het aan de regels van de codes wil voldoen. De onderzoeksfrage is dan ook:

“Hoe passen beursgenoteerde ondernemingen hun bedrijfscommunicatie aan de constitutieve regels van de Code Tabaksblat en de Sarbanes-Oxley Act aan?”

Opzet van het onderzoek

Om de onderzoeksfrage te kunnen beantwoorden wordt gebruikt gemaakt van de inzichten van Bhatia (2004) over genre analyses en er wordt gebruik gemaakt van inzichten met betrekking tot case studie. De case studie is volgens Yin (2003) geschikt om een bepaalde theorie op de proef te stellen. In deze dissertatie wordt de institutie theorie van Searle en daarin de rol van taal- en symboolgebruik in een case op de proef gesteld. Genre theorie wordt gebruikt als instrument om vanuit het communicatie perspectief de institutie theorie van Searle in een case studie te toetsen. Genre theorie wordt verder gebruikt om de context van de institutie corporate governance te verduidelijken. Dat betekent dat de *C* term in ‘*X geldt als Y in C*’ wordt verduidelijkt aan de hand van genre theorie. De institutie ‘goed bestuur’ is in Nederland een andere dan in de VS wat ook explicet gemaakt wordt door de prescriptieve communicatie regels in de corporate governance codes, waarbij genre theorie gebruikt wordt als instrument om dit duidelijk te maken. Searle beschouwt de *C* term als de context ofwel de collectieve acceptatie van de status functie die *Y* heeft, dat betekent dat een institutie pas een institutie is wanneer *X* tot *Y* geworden is en wanneer dit collectief geaccepteerd wordt en dus is de context bepalend voor het feitelijk tot existentie brengen van een institutie. Het feit dat de institutie ‘goed bestuur’ in Nederland een andere is dan de institutie ‘goed bestuur’ in de VS wordt bepaald doordat de institutie in een andere context tot existentie gebracht is. De case studie in dit onderzoek wordt gebruikt om te laten zien hoe het ‘spel’ corporate governance in de praktijk gespeeld wordt.

Bhatia’s genre analyse

Een tekst kan bepaalde kenmerken laten zien, waardoor het een bepaald specifiek genre realiseert. Voor tekstsoorten zijn verschillende regels constitutief en die zijn bepalend voor een specifiek genre. De Code Tabaksblat en de Sarbanes-Oxley Act formuleren regels die kenmerken van het jaarverslag beschrijven om ‘good governance’ of ‘goed bestuur’ te garanderen in een bedrijf. Een jaarverslag moet voldoen aan de kenmerken van het jaarverslag genre zoals de codes dat in hun regels formuleren, waardoor het jaarverslag de integriteit toekomt die het tot een jaarverslag genre maakt. Door de genre integriteit van een concreet jaarverslag te onderzoeken bepaal je of het jaarverslag aan de door de Tabaksblat Code en Sarbanes-Oxley Act geconstitueerde regels voldoet.

De constitutieve regels voor het jaarverslag genre die bepalen hoe de integriteit eruit zou moeten zien bestaat zoals iedere genre integriteit volgens Bhatia (2004) uit tekst-interne factoren en tekst-externe factoren.

De tekst-externe factoren zijn erg omvangrijk. De eerste groep tekst-externe factoren bestaat uit ‘discursive procedures’. Deze procedures bestaan uit de structuur van het proces dat leidt tot de totstandkoming van de tekstsoort. Bijvoorbeeld bij het genre zakelijke brief hoort een bepaald tijdspad, bepaalde mensen die betrokken zijn, nagaan van informatie, e.d. wat samen het proces uitmaakt. De ‘discursive procedures’ bestaan ook uit de persoon (/personen) die de brief schrijft. De tweede groep van tekst-externe factoren bestaat uit de ‘disciplinary culture’ ofwel de normen en conventies die bepalen hoe een zakelijke brief eruit moet zien. Deze regels bepalen de inhoud en de structuur van een zakelijke brief, bijvoorbeeld dat het brievenhoofd bestaat uit het adres van de afzender en de geadresseerde en ook bestaat uit de plaats en datum en verder bestaat het uit het onderwerp van de brief. De laatste groep factoren zijn de ‘discursive practices’ die bestaan uit (1) de keuze van het genre en (2) de gebruikte communicatie methode. Dat betekent dat bijvoorbeeld het genre zakelijke brief gekozen wordt en dat de communicatie vorm formeel-zakelijk is.

De tekst-interne factoren bestaan uit de directe en bredere context waarin een tekstsoort gecreëerd wordt. De directe context van een zakelijke brief bestaat bijvoorbeeld uit de formele opbouw en de inhoud zoals de schrijver van een bepaald bedrijf gewend is die toe te passen met gebruikmaking van bijvoorbeeld standaardzinnen. De bredere context van een zakelijke brief bestaat bijvoorbeeld uit bepaalde externe richtlijnen ten aanzien van bepaalde regelgeving of vanuit een bepaalde branche. Verder bestaan de tekst-interne factoren uit het communicatie doel van het genre. Voor een zakelijke brief geldt bijvoorbeeld dat het communicatie doel is dat er bepaalde goederen besteld worden. Andere tekst-interne factoren zijn de ‘move structures’. Deze structuren bestaan uit vaststaande tekstdelen – vaak in een bepaalde vaststaande volgorde – die allemaal bijdragen aan de realisatie van het algemene doel van de tekst. De ‘move structures’ van een zakelijke brief bestaan bijvoorbeeld uit brievenhoofd, aanhef, inleiding, bestelling, afsluiting. Een ander belangrijke factor bestaat uit het thema of de thema’s. Een zakelijke brief kan bijvoorbeeld als thema een bestelling van producten of juist de levering van goederen of een klacht hebben. De laatste tekst-interne factor bestaat uit intertekstuele elementen, waarbij de interrelatie tussen genres met andere genres centraal staat. Het kan dan bijvoorbeeld gaan om een zakelijke brief die als antwoord op een andere (zakelijke) brief geschreven wordt of het gaat om een brief die een onderdeel is van een langere briefwisseling tussen het bedrijf en een ander bedrijf. Verder kan ook een verwijzing in een zakelijke brief naar een wetsartikel een intertekstueel element zijn.

Bhatia onderscheidt verschillende genre ‘hiërarchieën’, namelijk de ‘genre ketting’, die gekenmerkt wordt door een chronologische volgorde van de genres. Verder is de ‘genre set’ een vorm van genre hiërarchie die bestaat uit een specifiek deel van het totale genre netwerk waar één persoon vanuit zijn beroep bij betrokken is. Het ‘genre systeem’ is een andere hiërarchie dat door Orlikowski en Yates (2004) beschreven wordt als een complex web van onderling gerelateerde genres, waarin iedere participant een herkenbare handeling verricht in een herkenbaar genre dat tot gevolg heeft dat anderen hierop adequaat zullen reageren. De laatste hiërarchische vorm is het ‘genre netwerk’, dat volgens Swales (2004) bestaat uit alle beschikbare genres voor een specifieke sector gezien vanuit elk gekozen synchronisch moment. Het jaarverslag genre is een dergelijk genre netwerk, omdat het bestaat uit meerdere teksten en tekstsoorten die allemaal deel uit maken van en nodig zijn voor het jaarverslag genre, maar ook omdat er in een jaarverslag bijvoorbeeld verwezen wordt naar wet- en regelgeving en dus naar andere genres. Een genre netwerk is daardoor een complex genre.

Genre analyse wordt eerst voor deze dissertatie gebruikt om te onderzoeken welke factoren van de genre integriteit ofwel van de integriteit van het Nederlandse jaarverslag worden bepaald door de Code Tabaksblat en welke factoren van de integriteit van het Amerikaanse

jaarverslag (Form 20-F) worden bepaald door de Sarbanes-Oxley Act. Op die manier wordt een beeld gemaakt van hoe de integriteit van beide jaarverslag genres eruit zou moeten zien. Vervolgens wordt genre analyse gebruikt om te bepalen of de beide ‘echte’ jaarverslag genres van een Nederlandse onderneming (case studie) de aanpassingen in de organisatie laten zien die de onderneming gedaan zou moeten hebben als gevolg van naleving van beide codes voor goed bestuur. Het communicatiedoel van beide codes is transparantie en naleving van alle constitutieve communicatieregels van beide codes zou dan betekenen dat de betreffende onderneming transparant is. Op die manier is er een vergelijking mogelijk tussen de ‘zou’ en de ‘is’ situatie. Indien de ‘is’ situatie van ieder jaarverslag volledig overeenkomt met de betreffende ‘zou’ situatie zou er dus van transparantie sprake kunnen zijn en dan zou er dus sprake zijn van acceptatie van de institutie ‘goed bestuur’ binnen de ‘case studie onderneming’. Als alle jaarverslagen en Forms 20-F van de betreffende beursgenoteerde ondernemingen de gevraagde integriteit demonstreren is ‘goed bestuur’ binnen de Nederlandse en Amerikaanse context geaccepteerd en dan zouden beide vormen van ‘goed bestuur’ geïnstitutionaliseerd zijn.

Hierboven is uitgelegd dat de tekst-externe factoren de grootste groep elementen vormen die bepalen hoe de integriteit van een genre eruit ziet. Dat betekent dat de context waarin een tekstsoort ontstaat van enorm belang is. Verder is duidelijke gemaakt dat het jaarverslag genre een genre netwerk is dat een erg complex genre is. Dit zijn belangrijke redenen waarom de case studie een grote rol speelt in dit onderzoek. Verder wordt de geschiktheid van de institutie theorie van Searle door middel van het instrument genre theorie in een case getoetst.

Case studie

De institutie theorie van Searle en de prescriptieve communicatie regels bepaald door de Code Tabaksblad en de Sarbanes-Oxley Act ten aanzien van het jaarverslag genre worden getoetst in één case. Dat betekent concreet dat het Nederlandse en Amerikaanse jaarverslag van één case, dus van één onderneming onderzocht wordt, omdat er op die manier inzicht gekregen wordt in hoe de jaarverslag genres volgens de codes er in het algemeen uit behoren te zien (de ‘zou’ situatie) en hoe een specifiek geval er uiteindelijk uitziet (de ‘is’ situatie).

Yin (2003) heeft case studies gedefinieerd als een empirisch onderzoek, dat een hedendaags fenomeen binnen de werkelijke context onderzoekt, specifiek wanneer de grenzen tussen het fenomeen en de context niet heel duidelijk zijn. Case studies worden met name gebruikt om het totale beeld van een fenomeen in zijn geheel te onderzoeken. Dat betekent dat de context van een specifiek geval erg belangrijk is en in het onderzoek meegenomen wordt. Hiervoor werd al aangegeven dat de context ook voor een genre, zoals het jaarverslag genre, erg belangrijk is en daarom is er een onderzoeksvorm zoals een case studie nodig om de complexiteit van het fenomeen jaarverslag genre te omvatten.

Er kunnen twee soorten case studies onderscheiden worden, namelijk single-case studies en multiple-case studies. Single-case studies worden met name gebruikt indien de case (1) een kritische test van een bestaande theorie representeert; (2) een zeldzame of unieke omstandigheid is; of als de case (3) een representatieve of typische case is; of wanneer de case dient om (4) een fenomeen te onthullen of omdat het een case (5) betreft die over een lange periode plaats vindt.

Voor deze dissertatie is de single-case studie het meest geschikt, omdat de complexiteit van de context van de case alleen maar omvat kan worden door een diepgaand onderzoek van het Nederlandse jaarverslag genre en van het Amerikaanse jaarverslag van één onderneming. Het jaarverslag genre als genre netwerk op zichzelf immers is al erg complex, omdat het uit meerdere teksten bestaat en omdat meerdere personen of groepen personen hun bijdrage

voorbereid en uitgevoerd hebben. Verder betreft het in dit onderzoek twee verschillende jaarverslag genres met ieder zijn eigen integriteit gevormd door zijn eigen complexe context. Niet alleen wordt de institutie theorie van Searle in één case getoetst, maar ook de voorgeschreven communicatie regels ten aanzien van het jaarverslag genre in beide codes worden getoetst door de vergelijking van de ‘zou’ met de ‘is’ situatie.

Behalve de tweedeling van multiple- en single-case studies kan er ook een verdeling gemaakt worden in ‘uitleggende’ case studies, waarin de oorzaak-gevolg relatie centraal staat, ‘beschrijvende’ case studies, waarin een fenomeen in zijn context beschreven wordt, namelijk het gehele gebied rondom en de diepgang van de case, en de ‘ontdekkende’ case studies, die gebruikt worden om een studiekader te maken of om vragen en hypotheses voor een volgende studie te definiëren.

In deze dissertatie gaat het om een case studie, die niet binnen de categorieën van Yin valt, omdat het om een ‘illuminative’ case (Parlett and Hamilton 1972). De case studie, namelijk ‘illlumineert’ ofwel belicht hoe een bedrijf het spel ‘goed bestuur’ speelt. De case studie belicht ook hoe de ‘case studie onderneming’ zich aan de constitutieve regels van ‘goed bestuur’ in de codes houdt en in welke mate het dus gelukt is om ‘goed bestuur’ te institutionaliseren. Dit onderzoek laat aan de hand van één case zien hoe het ‘spel’ ‘goed bestuur’ gespeeld wordt.

In deze dissertatie wordt gebruik gemaakt van een aantal bronnen. Ten eerste vormen de interviews met een vertegenwoordiger²¹⁹ van de ‘case studie onderneming’, die met name bijzonder goed op de hoogte is van de aanpassingen in de organisatie ten behoeve van de Nederlandse Code, een bron. Ook de e-mails van deze interview partner naar de onderzoeker van deze dissertatie bevatten belangrijke informatie. Ten tweede zijn er ook interviews gevoerd met een vertegenwoordiger van een groot Nederlands accountantskantoor. Deze interview partner²²⁰ is gespecialiseerd in de gevolgen van de Sarbanes-Oxley Act voor de (externe) accountants en de financiële audits in het algemeen en dus ook voor de accountants en de audit van de ‘case studie onderneming’. De derde bron bestaat uit het Nederlandse jaarverslag (Engelstalige versie) en de vierde bron bestaat uit het Amerikaanse jaarverslag (Annual Report on Form 20-F), beide van de ‘case studie onderneming’. De interview partner van het accountantskantoor heeft ook bronnen aangeleverd, die bestaan uit een aantal documenten en een CD-rom met formats, die gebruikt kunnen worden door audit commissies. Andere bronnen zijn de websites van beide ondernemingen en overige websites zoals bijvoorbeeld van de SEC²²¹, de PCAOB²²², en van de Monitoring Committee Corporate Governance Code.

Wat is nu ‘good corporate governance’ of goed bestuur?

Om deze vraag te kunnen beantwoorden is het eerst nodig om te weten wat nu eigenlijk ‘bestuur’ ofwel corporate governance is. Groenewegen (2004) definieert corporate governance kortweg als het beheersen van de activa in ondernemingen (de “control of the resources in firms”) of zoals de OECD goed bestuur beschrijft als het systeem waardoor ondernemingen worden bestuurd en beheerst (“[...] the system by which business

²¹⁹ De vertegenwoordiger van de ‘case studie onderneming’ blijft anoniem.

²²⁰ De vertegenwoordiger van het accountantskantoor blijft anoniem.

²²¹ SEC: Securities and Exchange Committee

²²² PCAOB: Public Company Accounting Oversight Board

corporations are directed and controlled.” (1999²²³). Het besturen en beheersen is echter niet eenvoudig, omdat allerlei tegengestelde belangen gelden. Agency Theory gaat ervan uit dat een ‘agency relationship’ bestaat uit een contract waarin (meestal) één persoon – de principaal – een andere persoon – de agent – verplichten om een dienst ten behoeve van de principalen uit te voeren, waarbij zij de agent beslissingsbevoegdheid geven. Het management van een onderneming (agent) kan ondernemen in brede zin, omdat het beschikt over het kapitaal dat door aandeelhouders (de principalen) – investeerders in het algemeen – in die onderneming geïnvesteerd is. De aandeelhouders willen graag dat de onderneming zo bestuurd wordt dat de opbrengst maximaal is, maar het management zal niet altijd in het belang van de aandeelhouders handelen als dat niet in het eigen voordeel is, omdat opportunisme hun handelen bepaalt. De aandeelhouders zullen daarom bijvoorbeeld willen dat het management goed beloond wordt, zodat de bestuurders eerder geneigd zijn hun werk goed te blijven doen, maar de aandeelhouders zullen ook controle uit willen oefenen op het handelen van het bestuur.

In Nederland controleert de raad van commissarissen het management, terwijl in de Verenigde Staten het management bestaat uit uitvoerende (executives) en niet-uitvoerende managers (non-executives), waarbij de niet-uitvoerende een controlerende functie hebben. De machtsverdeling tussen de aandeelhouders, het management en het controlerende orgaan vormt één van de kernen van corporate governance. De macht van de aandeelhouders betreft het uitoefenen van hun stemrecht. Verder zullen de aandeelhouders over voldoende informatie willen beschikken om te kunnen beoordelen welke beslissing ze moeten nemen: kapitaal blijven verschaffen of zich terug trekken, en het management belonen of (laten) ontslaan. Het management daarentegen zal alleen die informatie verstrekken, die bewijst hoe goed zij presteren en dat zij handelen overeenkomstig de wensen van de kapitaal verstrekkers, namelijk een zo hoog mogelijke winst.

Ondernemen betekent risico’s nemen en management neigt ernaar om (te) grote risico’s te nemen, omdat er zij er vooral zelf voordeel van zouden kunnen hebben – afhankelijk van de beloningsstructuur - want hoe meer de onderneming waard is hoe meer hun opties en aandelen waard zijn. De beloningsstructuur van de leden van het management zou verder zodanig moeten zijn, dat er niet te veel opties en/of aandelen in hun pakket zitten. Maar het is vooral ook in het belang van het bedrijf op de lange termijn om de risico’s die de onderneming loopt te erkennen en deze zorgvuldig in kaart te brengen, en vervolgens om maatregelen te treffen om de waarschijnlijkheid dat de onderneming aan een risico bloot gesteld wordt zo klein mogelijk te houden. Alhoewel het niet mogelijk is om alle risico’s te ondervangen, is het beheersen van de risico’s (‘risk management’) van groot belang. Het voorgaande betekent, dat de grote thema’s van corporate governance de volgende zijn: (1) informatie verstrekking, waarbij (2) financiële verslaglegging als apart issue aangemerkt kan worden; (3) onafhankelijke supervisie en daarmee samenhangend (4) een juiste balans in de governance governance structuur van een onderneming; (5) risico management; en (6) een goede beloningsstructuur.

Ieder land heeft zijn eigen problemen op corporate governance gebied en ieder land vindt zijn eigen oplossingen. Dit kan verklaard worden door het feit dat corporate governance een institutie is. Searle (2005) definieert een institutie als een systeem van constitutieve regels van de soort ‘*X geldt als Y (‘goed bestuur’) in C*’.

223 OECD April 1999. OECD's definition is consistent with the one presented by Cadbury [1992, page 15]: Report of the Committee on The Financial Aspects of Corporate Governance, 1 December, 1992. Or can be found on the following web site: <http://stats.oecd.org/glossary/detail.asp?ID=6778>

De invloed van (nationale) instituties bepaalt welke weg een land op economisch gebied gaat ('path dependency'). Het systeem van 'goed bestuur' waaruit het instituut 'goed bestuur' bestaat verschilt daarom per land. Dat betekent dat ieder land zijn eigen corporate governance systeem of business system heeft met zijn eigen kenmerken.

De corporate governance codes

De inhoud van de Code Tabaksblat bevat de kernpunten die overeenkomen met de kernpunten van het Nederlandse corporate governance systeem, omdat de code explicet maakt wat impliciet opgesloten ligt in de Nederlandse institutie corporate governance. Dat betekent dat de Code Tabaksblat de verhoudingen ('balances') tussen de raad van bestuur, de raad van commissarissen als onafhankelijke monitor ('checks') van de raad van bestuur ten behoeve van de aandeelhouders – en de aandeelhouders aan de andere kant, die samen het juiste systeem van 'checks' and 'balances' moeten vormen, hoog in het vaandel heeft. Een ander kernpunt betreft de rechten van de aandeelhouders. De commissie die de Code heeft opgesteld vond dat de aandeelhouders een belangrijkere positie moeten innemen en dat de raad van bestuur minder macht zou moeten toekomen. Het feit dat de aandeelhouders minder macht hebben dan het management is een historisch ontwikkeld kenmerk van het Nederlandse corporate governance systeem, dat door de invoering van de Code voor het eerst meer ten gunste van de aandeelhouders zou moeten gaan uitvallen. Weer een ander kernpunt is de beloning van de leden van de raad van bestuur en dus de daaraan gerelateerde en inmiddels beruchte regel dat een ontslagpremie niet meer dan een jaarsalaris mag zijn, maar de meeste ondernemingen houden zich daar niet aan. Dat is mogelijk omdat de Nederlandse code geen wet is, maar een code waarbij het 'pas toe of leg uit' principe wel wettelijk verankerd is.

Het principe behelst dat ondernemingen zich ofwel gewoon aan de regels van de code houden, ofwel ze mogen afwijken, maar dan moeten ze uitleggen waarom ze zich er niet aan houden. Overigens bestaat de Code uit principes en best 'practice provisions' en mag er uitsluitend van de 'provisions' afgeweken worden. Het 'pas toe of leg uit' principe is verplicht gesteld omdat de codes geen keurslijf moesten worden, maar meer flexibel moesten zijn, maar dit principe heeft consequenties voor de constitutieve regels van de Code Tabaksblat. Doordat een onderneming mag afwijken van de regels, indien het uitlegt waarom het afwijkt, ondermijnt het 'pas toe of leg uit' principe de constitutieve communicatie regels en is het de vraag of aan het Nederlandse jaarverslag genre überhaupt de integriteit volgens de Code toegekend kan worden.

De kernpunten van de Sarbanes-Oxley Act betreffen de onafhankelijkheid van de externe accountant, de rol en taken van de audit commissie vooral met betrekking tot the externe accountant, en de verklaringen van de Chief Executive Officer (CEO) en de Chief Financial Officer (CFO) dat de jaarcijfers correct zijn en dat de interne controle over de financiële verslaglegging effectief is en daaruit voortkomend zijn er geen 'material weaknesses' of 'significant deficiencies' geconstateerd. Dat zijn allemaal punten die in dienst staan van de betrouwbaarheid van de financiële verslaglegging. De Act heet officieel ook de 'Accounting Industry Reform Act 2002', omdat de financiële schandalen veroorzaakt werden doordat accountants gefaald hadden. De accountants verleenden hun cliënten namelijk ook niet audit (gerelateerde) diensten waardoor ze niet meer onafhankelijk waren. Aangezien de Sarbanes-Oxley Act met name gericht is op betrouwbare en correcte financiële verslaglegging om het vertrouwen van de investeerders weer terug te winnen, zijn de rol, de taken en de onafhankelijkheid van de accountants scherp vastgelegd. Bovendien zijn de CEO en CFO hoofdelijk aansprakelijk voor eventuele 'material weaknesses' of 'significant deficiencies' die tevoorschijn komen en die bewijzen dat de financiële situatie niet in orde is.

De Sarbanes-Oxley Act is in tegenstelling tot de Code Tabaksblat een wet, waaraan iedere onderneming met een beursnotering in de VS en ieder accountantskantoor dat geregistreerd staat bij de PCAOB, die in het leven is geroepen om supervisie uit te oefenen ten behoeve van de naleving van de Act, zich aan moet houden. De constitutieve regels van de Act zijn daarom in vergelijking met de regels van de Code veel duidelijker en ze worden niet ondermijnd door een ‘pas toe of leg uit’ principe.

Conclusies

De case studie had twee doelen, namelijk belichten hoe de prescriptieve regels van ‘goed bestuur’ nageleefd worden door de ‘case studie onderneming’ en dus in welke mate ‘goed bestuur’ door de ‘case studie onderneming’ geaccepteerd wordt. Daarbij wordt de ‘zou’ situatie ten aanzien van het jaarverslag genre en het Form 20-F genre volgens de codes vergeleken met de ‘is’ situatie.

De conclusie die getrokken kan worden uit de resultaten van de vergelijking tussen de ‘zou’ en de ‘is’ situatie van het Nederlandse jaarverslag genre volgens de Code Tabaksblat en het jaarverslag van de ‘case studie onderneming’ uit 2006 is dat doordat het niet duidelijk is of de uitleg voor niet-naleving geaccepteerd wordt, het jaarverslag van de ‘case studie onderneming’ niet overeenkomt met het Nederlandse jaarverslag genre. Daardoor is het onduidelijk of er (formele) transparantie bereikt is. De ‘pas toe of leg uit’ regel leidt tot onzekerheid ten aanzien van naleving. Aangezien constitutieve regels als een ‘systeem’ voorkomen, volgens Searle 1969 (1978), zou aan alle regels voldaan moeten worden. Dat is moeilijk vast te stellen en dat is een niet-wenselijke situatie.

Uit de resultaten kan verder de conclusie getrokken worden, dat het Form 20-F van 2006 van de ‘case studie onderneming’ wel de integriteit toekomt van het Form 20-F genre volgens de Sarbanes-Oxley Act, omdat de betreffende constitutieve regels volledig nageleefd zijn. Dat betekent, dat er wel (formele) transparantie bereikt is en er dus collectieve acceptatie van de US institutie ‘goed bestuur’ is en er ook een nieuwe machtsrelatie ontstaan is in de vorm ‘*We accept (S has power (S does A))*’. Dat betekent, dat de ‘case studie onderneming’ de US ‘goed bestuur’ geaccepteerd heeft. Toch is naleving van de meeste constitutieve regels door de auditor vooral indirekte naleving. Als de auditor’s namelijk zijn statements vastgelegd heeft betekent dat ook dat hij alle regels naleeft. Dat heeft als consequentie dat naleving van één regel impliceert dat alle regels nageleefd worden, waarbij de ‘outsiders’, die niet over de audit documenten beschikken, en de client op de auditor’s statements moeten vertrouwen.

Er kan verder geconcludeerd worden dat het Nederlandse spel van ‘goed bestuur’ een open spel is. Het is duidelijk geworden, dat de ‘case studie onderneming’ haar eigen spel ‘goed bestuur’ speelt. Aangezien het bedrijf zich niet aan het hele systeem van constitutieve regels heeft gehouden, is ‘goed bestuur’ niet geïnstitutionaliseerd. Het Amerikaanse spel van ‘goed bestuur’ werd echter volgens de regels gespeeld.

Verder kan de conclusie getrokken worden, dat Searle’s institutie theorie een bruikbare methode was om te beschrijven hoe het ‘spel’ ‘goed bestuur’ in de praktijk door de ‘case studie onderneming’ gespeeld werd.

De ‘case studie onderneming’ zelf, overigens, vindt dat het veel transparanter geworden is, met name door de eisen van de Sarbanes-Oxley Act, die ervoor gezorgd heeft dat (financiële) informatie vanuit de laagste tot de hoogste niveaus boven water is gekomen, meer dan vóór de Act. De conclusie zou getrokken kunnen worden dat de ‘case studie onderneming’ door haar open en eigen spel van ‘goed bestuur’ een eigen transparantie bereikt heeft, die mede door de naleving van beide codes tot stand gekomen is. Echter, Searle beschouwt ‘goed bestuur’ als

naleving van de constitutieve regels die communicatie acties bevatten. Misbruik kan niet door naleving ontdekt worden en dus blijft dat een zaak van juridisch oordeel, zeker wat SOX betreft.

Curriculum Vitae

Saskia Laval was born on July 13, 1963 in Heerlen, the Netherlands. After receiving her *Gymnasium* (pre-university secondary education) diploma from the Paulus Lyceum in Tilburg in 1981, she initially studied German language and literature at the Katholieke Leergangen in Tilburg. After graduating with a Bachelor of Education in 1984, she started lecturing at a middle school of economic studies in Tilburg.

Alongside her work, she completed a second Bachelor in Business German (1986), followed by a Master of Education (German language and literature) in 1989. She subsequently took up a position at the University of Agricultural Sciences in Den Bosch, while studying for a second Master in German Language and Linguistics at the Catholic University of Nijmegen. She then lectured from 1992 to 1999 at different universities in Breda, namely the University of Applied Science, the University of Economics, and the International University for Tourism and Traffic Studies.

Since 1999, she has worked within the International Business and Management Studies team at the Fontys International School of Economics in Venlo. She lectures in German, Dutch as a second language, communication skills, and research and methodology. She is also the tutor for work placements and graduating students.