



## EVALUATION OF THE 2017 AGM SEASON

### Introduction

Every year Eumedion<sup>1</sup> prepares an evaluation of the season of annual reports and shareholders meetings, the AGM season. The main substantive findings concerning the annual reports for the year 2016 and the regular shareholders' meetings held in 2017<sup>2</sup> are considered below.

### Summary

- The average number of votes cast at the AGMs remained at a relatively high level: 71% at the AGMs of AEX companies and 68% at the AGMs of AMX companies. This year, shareholders of KPN and PostNL had the possibility to vote with their own smartphone or tablet at the respective AGMs. It was the first small step by Dutch listed companies to bring voting at AGMs to the 21<sup>st</sup> century. Eumedion encourages listed companies to take the next step next year by running a pilot to apply blockchain technology in supporting AGM voting.
- Three voting items were rejected by the AGM (2016: 3) and seven voting items were withdrawn prior to the AGM (2016: 4). Shareholders submitted two resolutions: one at the Shell AGM and one at the ASM International AGM (2016: 1).
- The AGM season took place in the midst of various unsolicited takeover proposals, amongst them potential offers for the shares of AkzoNobel, Unilever, Refresco, Accell Group and Telegraaf Media Groep (TMG). Especially the first two unsolicited bids sparked a broad discussion in Dutch society on the Dutch bidding rules and the level of protection at Dutch listed companies. The Government considers the introduction of a legal one-year cooling off period for hostile takeovers and undesired shareholder activism, during which the target shareholders cannot request an extraordinary general meeting of shareholders and cannot submit shareholder proposals for removing members of the management and/or supervisory board. During a Parliamentary Hearing, Eumedion has spoken out against this proposal. Eumedion believes that such a legislative proposal will undermine the quality of the Dutch corporate governance system and shareholders' confidence in the Dutch stock market. As a consequence the long-term value creation capacity of Dutch listed companies will be endangered. Eumedion has suggested to explore a substantial increase of the minimum legal acceptance level for a declaring a bid unconditional as an alternative to the legal cooling off period. If the target company and the bidder reach agreement on the bid, the bidder is allowed to lower the acceptance condition threshold.

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<sup>1</sup> Together, the Eumedion participants represent approximately 25% of the shares of the Dutch listed companies.

<sup>2</sup> This evaluation report covers the AGMs of companies that have its registered office or headquarters in The Netherlands and are listed on Euronext Amsterdam.

- Various companies proposed amendments to their executive remuneration policy. Just a few companies considered internal pay ratios – such as the ratio between the pay of the CEO and the median employee – in drafting the amendments. In many instances the amendments were purely driven by external benchmarking exercises. The amendments only led to thorough discussions at the AGM when the amended policy would result in large increases in total income – at target and/or at maximum – or when the amended policy was presented after a period of very moderate business performance.
- Just like in previous years, a large number of companies submitted a proposal to amend the Supervisory Board remuneration package. This only led to discussion at the AGM when such a proposal was presented shortly after the previous amendment and in the situation when a strong increase was proposed. For this reason, Royal Philips decided to withdraw its proposal.
- In their annual report, the largest companies paid attention to the possible impact of climate change on their policies and strategies, their own efforts to help deliver the goals of the Paris Climate Agreement, accompanied by relevant data on greenhouse gas emissions and targets to lower these emissions. However, especially the oil and gas industry and companies related to this industry have not set clear emission reduction targets yet.
- Just a few companies have incorporated a competence matrix in their Supervisory Board report yet. The reports on board evaluations generally contain boilerplate language. Many companies do not report on the results and follow-up actions of the self-evaluation.
- The number of listed companies that published an ‘integrated annual report’ increased with more than 55%: from 18 in 2016 to 28 this year. An integrated report provides investors better insight into the long-term value creation model of the company and the accompanying risks. In practice, the quality of the integrated reports varies. Many companies describe their long-term value creation process, but are not very clear on describing their strategy for realising long-term value creation and which contributions were made to the long-term value creation in the past financial year.
- The long-format audit report has contributed to better communication between the external auditor and investors. However, further enhancements could still be made, e.g. a more dynamic assessment of changes in the audit approach over time, including a year-on-year comparison of changes in the identified key audit matters, providing more information on the testing results of the effective operation of the company’s internal control framework and the incorporation of the external auditor’s observations with respect to the key audit matters. Besides this, we still see a downward pressure on audit fees during tender procedures, but this is followed by a rise in the audit fee in the second audit year.

## **1. Shareholder participation rate stabilises at a relatively high level**

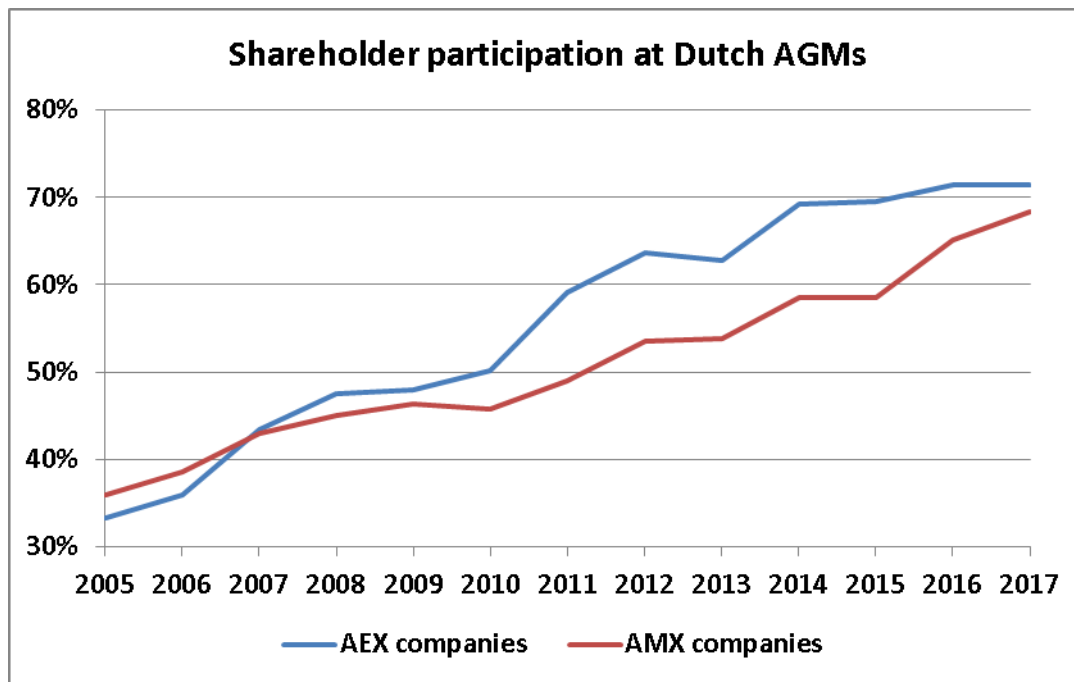
Shareholders were able to vote on 945 proposals, one of which was a shareholder’s proposal. Follow This, a collective of Shell shareholders that wants to make the world sustainable quicker by making Shell a renewable energy company, submitted a resolution calling on Shell to set concrete, company-wide, quantitative and annually disclosed reduction targets for its greenhouse gas emissions. These

targets should be aligned with the objective of the Paris Climate Agreement to limit global warming to well below 2°C. Follow This requested Shell not only to set reduction targets for its own operational activities, but also for activities outside of its own organisation, such as Shell's clients. Especially because of the request to establish targets for activities outside the managerial sphere of Shell, the resolution was rejected by almost 94% of the votes cast; with approximately 5% abstentions.

Eminence Capital also submitted a shareholder proposal upon which could not be voted. This 9.6% shareholder of ASM International (ASMI) requested to discuss the company's policy with respect to its 39% shareholding in ASM Pacific Technology (ASM PT) and the risks and benefits of a full divesture of it. Two weeks after having tabled this resolution for discussion at the AGM, ASMI decided to reduce its stake in ASM PT by 5% to 34%. ASMI intends to use the proceeds for a new share buyback program. ASMI has no intention to further reduce its stake in ASM PT, as it believes that, at this moment, a significant stake remains of strategic value for the company and an important factor towards long-term value creation. As the shareholder proposal was only a discussion item, an AGM vote did not take place.

In the end – besides the shareholders' resolution for Shell – only two proposals were rejected by the AGM, namely the authorisation of the board of Tie Kinetix to issue up to 20% new shares in the forthcoming 18 months and the disapplication of shareholders' pre-emption rights in the situation that the board of BAM Group decides to issue up to 20% new shares in the forthcoming 18 months; see also the appendix to this report. Six proposals were withdrawn: the proposed increase in remuneration of the Philips Supervisory Board members, the proposed amendments to the Pharming Group articles of association, the proposed reappointment of Esperite's external auditor and four voting items related to the delayed publication of the 2016 annual accounts of Value8: the adoption of the 2016 annual accounts, the adoption of the dividend and the discharge of the members of the Management and Supervisory Board.

The number of votes cast at the AGMs of the AEX and AMX companies stabilised at a relatively high level: 71% at the AEX companies and 68% at the AMX companies (graph below). This year, shareholders of KPN and PostNL had the possibility to vote with their own smartphone or tablet at the respective AGMs. It was the first small step by Dutch listed companies to bring voting at AGMs to the 21st century. Eumedion encourages listed companies to take the next step next year by running a pilot to apply blockchain technology in supporting AGM voting.



## 2. Society-wide discussion on hostile takeovers and protection of Dutch companies

The 2017 AGM season took place in the middle of increased takeover activities in the Netherlands. What is different from earlier ‘takeover waves’ is the number of unsolicited approaches: Unilever by Kraft Heinz, AkzoNobel by PPG Industries, Refresco by PAI Partners, Accell Group by Pon Holdings and Telegraaf Media Groep by Talpa. The increased takeover activities seem to be driven by the expansionary monetary policy of the European Central Bank, the increasing profitability of companies and the relatively low euro/US dollar exchange rate. The potential takeovers led to widespread uncertainty about the future of job security and personal income in the Netherlands. Will the most important Dutch companies be sold to large foreign companies who intend to move production facilities to their own country and who intend to quickly benefit from the knowledge developed and – indirectly – financed by Dutch citizens? As a result, widespread commentary and public discussion arose on various aspects of the regulation of takeover bids for Dutch companies and their possibilities to protect themselves. During the discussion, the Rhineland corporate governance tradition in the Netherlands was underlined, i.e. focusing on long-term value creation, taking into account the interests of all stakeholders instead of only those of shareholders.

Although there are already safeguards in Dutch legislation that support long-term value creation and to weigh the interests of all stakeholders, the Dutch Government believed that some shift in the balance of responsibilities between the different stakeholders seemed desirable. The Government intends to give the Management and Supervisory Board of Dutch listed companies an opportunity to provide more space and time to review an acquisition or substantial adjustment of strategy proposed by shareholders to assess the effects for all stakeholders. The Government favours to create a legal ‘time-out’ period of up to one year. This would give the board of a company time and room for manoeuvring in case of a hostile takeover bid and/or undesired shareholder activism. The proposal

would imply that decision-making at the general meeting of shareholders on appointment and dismissal of directors and company strategy can be suspended by the board.

In its reaction on this proposal, Eumedion underlined the aim of ensuring that the interests of those seeking short-term returns from a merger or acquisition do not override the long-term interests of the company involved. Eumedion also recognised that it is the target company’s board fiduciary duty to weigh all the options – including a stand-alone scenario – especially in a hostile takeover bid situation. At the same time Eumedion considered the possibility for the general meeting of shareholders to hold the management board and supervisory board to account for fulfilling their fiduciary duties to be a fundamental aspect of a well-balanced governance system, especially in a takeover bid situation where personal interests of board members are not always aligned with the long-term interests of the company and its stakeholders. The Government’s proposal to disenfranchise shareholders – not only short-term oriented shareholders, but also long-term, engaged and responsible shareholders – during a hostile takeover bid is incompatible with this fundamental principle. An institutional investor’s ability to exercise stewardship is dependent on sufficient shareholder rights. The legislative proposal would undermine the quality of the Dutch corporate governance system and shareholders’ confidence in the Dutch stock market. As a consequence the long-term value creation capacity of Dutch listed companies will be endangered.

*Table 1: statutory and economic anti-takeover measures of the 50 largest Dutch listed companies*

Anti-takeover device	%, July 2017
Anti-takeover preference shares	57%
Priority shares	12%
Depositary receipts	12%
Binding nomination rights for appointing new board members	60%
Economic protection via affiliated controlling shareholder	14%
No anti-takeover devices	2%

Eumedion believes that Dutch listed companies are generally well-protected (see table 1 above). Therefore there is no urgent need for additional, legal protection. However, if the legislator believes that some additional, legal protection would be helpful, Eumedion has suggested to explore increasing the minimum legal acceptance level for declaring a bid unconditional as an alternative to the legal time-out period of up to one year. Raising the acceptance condition threshold requirement would ensure that the outcome of a takeover bid is determined primarily by the long-term shareholders of the target company, who will have a greater commitment to, and a better understanding of, the company, its management and its employees than those shareholders who are driven by short-term trading strategies. On the basis that the latter group of shareholders is more likely to want the bid to succeed,

in order that they can then reap a short-term profit, it can be argued that one way of achieving the above-mentioned outcome would be to raise the acceptance condition threshold in order to maximise the chances that a bid will only in fact succeed if a majority of the long-term shareholders are in favour of it.

Despite the society-wide discussion on more protection of listed companies, the small cap companies Heijmans and Brill decided to limit their number of anti-takeover devices. Heijmans decided to cancel its put-option to issue anti-takeover preference shares to its anti-takeover foundation. This foundation still has its call-option to take anti-takeover preference shares in hostile situations. Brill decided to limit the influence of its Trust Office in non-hostile situations. Under normal circumstances the Trust Office will abstain from voting on those shares for which the holders of depositary receipts have not requested a proxy to vote by themselves. At the same time, the scope for Brill's anti-takeover foundation to exercise its call-option on anti-takeover preference shares was broadened from hostile take-over situations to also situations in which there is a concentration of the voting rights in the general meeting of shareholders.

### **3. New remuneration policies still originate from an external benchmarking exercise**

Ten out of the 50 largest Dutch listed companies had placed a change in the remuneration policy on the agenda of the AGM. Just a few remuneration committees considered internal pay ratios – such as the ratio between the pay of the CEO and the median employee – in drafting the new executive remuneration policy. This is in contrast with the fact that remuneration guidelines of an increasing number of shareholder organisations and individual institutional investors recommend to also consider internal relativities in determining the size of total pay. The Dutch Corporate Governance Code Monitoring Committee has also incorporated such a best practice provision in the 2016 version of the Dutch corporate governance code. This year, however, in many instances the amendments were still purely driven by external benchmarking exercises.

The amended executive remuneration policies only led to thorough discussions at the AGM when the amended policy would result in large increases in total income – at target and/or at maximum – or when the amended policy was presented after a period of very moderate performance. The Philips Supervisory Board proposed to increase target total income for the CEO by 33% and maximum total income by 40%, while the size and complexity of Philips have recently decreased as a result of the divestment of the Lighting division. The proposed increase in target total income was only justified by external benchmarking. As a result a relatively high number of votes were cast against the new long-term incentive plan (27.5%) and against the new remuneration policy (24.8%).

One of the reasons why the proposal was not voted down was the fact that more robust shareholding guidelines for the Philips Management Board were introduced: the minimum shareholding requirements were increased from three times base salary to four times base salary for the CEO, and from two times base salary to three times base salary for the other members of the Management

Board. This will further strengthen the alignment of interest between the Philips Management Board and the Philips shareholders and the long-term focus of the executives. But not only at Philips, also the shareholding requirements for the executives of ASML Holding, Unilever and RELX were increased. Currently, approximately 50% of the AEX companies have introduced shareholding guidelines for their executives (table 2 below).

*Table 2: shareholding guidelines for executives of AEX companies*

<b>Company</b>	<b>CEO guideline (x base salary)</b>	<b>Other executives' guideline (x base salary)</b>
Ahold Delhaize	1.5	1.5
AkzoNobel	3	1
ASML Holding	3	2
DSM	3	1
KPN	2	1
Philips	4	3
RELX	4	3
SBM Offshore	3	2
Shell	7	4
Unilever	5	4
Vopak	2	1

Unilever further underlined the long-term focus of its executives by extending the performance period for share matching arrangement from three to four years. Another positive note was that some companies simplified their remuneration structures, e.g. RELX. This company decreased the number of remuneration schemes from four to two, abandoned the share matching plan and decided to no longer grant performance stock options, but only performance shares. This company also strengthened the performance criteria.

#### **4. Strong increases in remuneration of supervisory directors**

Just like in previous years, a large number of companies submitted a proposal to amend the Supervisory Board remuneration package (table 3).

*Table 3: proposed increases in remuneration of the Chairmen of the Supervisory Board*

<b>Company</b>	<b>Increase of Chairman's remuneration</b>
BAM Groep	40%
Vopak	25.8%
Philips	22.2% (withdrawn before AGM)

Aalberts Industries	20%
Vastned Retail	14.3% (ordinary member: 20%)
NN Group	13.3%
ASML Holding	5.3%
Refresco	0% (however: deputy chairman: 33.3%; ordinary member: 11.1%)

The increases were mainly motivated by the increased activities and responsibilities of the Supervisory Board in the last number of years and the fact that in some instances the last increase took place in 2007 (Aalberts Industries) and in 2008 (BAM Groep). In a particular case – Philips – the proposed increase was only motivated by remuneration developments and changes in its own peer group, in which not only companies with a two-tier board structure are incorporated, but also with a one-tier board structure. The remuneration levels of – especially – a Chairman of a company with a one-tier board structure are much higher than those of a Chairman of a company with a two-tier structure as a result of different time-commitments and different legal responsibilities and liabilities. Moreover, Philips increased the Supervisory Board fees by 28% only two years ago due the increased activities and responsibilities. Three days before the 2017 Philips AGM, the Philips Supervisory Board decided to withdraw the proposal “based on consultations with shareholders that made it clear that further discussions are needed to get to a broader consensus”.

Eumedion recommends companies to review the Supervisory Board remuneration once every four years in order to prevent strong increases at a time. If benchmark exercises are conducted, Eumedion recommends companies with a two-tier board structure to only incorporate companies with such a board structure in the peer group.

## 5. Impact climate change and Paris Climate Agreement

In its 2017 Focus Letter, Eumedion asked all listed companies to analyse the potential risks and opportunities – both physical and transitional – related to climate change for their business model and strategy, and to disclose what concrete efforts will be made to contribute to a carbon-neutral economy in the second half of this century as agreed in the 2015 Paris Climate Agreement.

An overwhelming majority of companies provided explicit information regarding any material exposure to climate risks and regarding potential business opportunities in their annual reports and/or in their sustainability reports. These companies also provided an overview of the company’s efforts to help deliver the goals of the Paris Agreement, accompanied by relevant greenhouse gas emissions and energy consumption data and specific reduction targets. Companies such as Philips, Philips Lighting, ASML Holding and ING Group have set the target to be 100% carbon-neutral in their operations by 2020 and sourcing all of their electricity usage from 100% renewable sources. AkzoNobel and BAM Groep have set such target for 2050. Unilever has committed to being *carbon positive* in its operations by 2030, with all electricity purchased from the grid coming from renewable sources and coal



eliminated from its energy mix by 2020. Most important outliers, by setting no specific emission reduction targets, are the oil and gas industry and companies related to this industry. Companies such as Royal Dutch Shell (see also section 1 of this report), SBM Offshore and Fugro are wrestling with setting such targets, but SBM Offshore has promised to set new objectives in 2017 and Fugro aims to externally report on carbon emissions from next year onwards.

Companies rarely provide information on the governance process that explains how the board considers and approaches climate-related risks and opportunities in their business management, such as investment planning, risk management, and reporting. Companies are also rather reluctant to identify material climate change-related risks and opportunities in the supply chain and to disclose the relevant findings and conclusions of this analysis in the annual report and/or sustainability report.

Besides information on the impact of climate change and the Paris Agreement, many of the largest Dutch listed companies refer to the Sustainable Development Goals (SDGs) in their annual report or sustainability report. Although the quality of the SDG reporting differs, 17 AEX companies already indicate on which of the SDGs they generated the largest impact. While companies such as Ahold Delhaize, ASML and DSM already aligned their corporate strategy with the SDGs, others like ABN Amro and Heineken announced to do so in 2017. Currently, it is relatively easy for companies to report on the SDGs. The future challenge is to disclose their material and measurable contribution to solve the urgent global issues by 2030.

Reporting on greenhouse gas emissions and energy consumption by listed companies is gaining more and more importance for institutional investors as some of them have publicly announced that they will drastically cut the carbon footprint of their investment portfolios with the aim of reducing the climate risks. In that context it is also important that some form of external assurance is provided to the reported data. More and more companies have requested their external auditor or another independent assurance services provider to provide 'limited assurance' on the sustainability data, including the carbon footprint. Only the external auditor of Philips has provided 'reasonable assurance' to the sustainability data reported by Philips. Eumedion believes that more companies should request their external auditor or another independent assurance services provider to provide 'reasonable assurance'. This will lead to increased trust by investors that the reported figures are also reliable.

## **6. Board effectiveness**

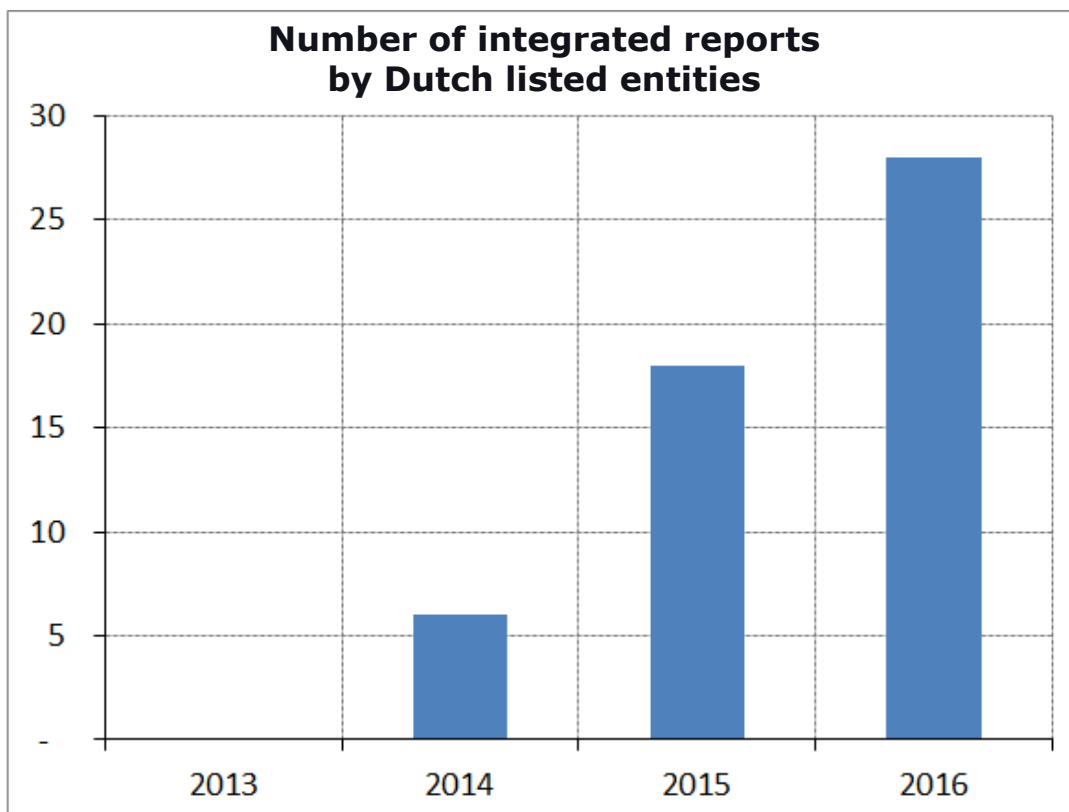
Eumedion also requested Dutch listed companies to provide information on the board recruitment process, including information on the search and selection criteria and diversity (a.o. age, gender, nationality), competences, skills and experiences, preferably in the format of a board diversity and competence matrix. Eumedion also requested information on the main content and objectives of the company's diversity policy, a report on the progress in reaching the objectives of this policy and a report on the most significant findings and conclusions of the evaluation of the effectiveness of the (management and supervisory) boards and what follow-up action has been agreed.

With respect to this focus point not much progress was realised. There is a tendency for Supervisory Board reports to become more 'boilerplate' with a list of who sat in the Board, a standard set of responsibilities and a broad review of the activities in the reporting year. Good Supervisory Board reporting provides details of the Board's focus in the previous year and what the next year holds. It should also highlight the link to the company's strategy and include director biographies that focus on the skills they add to the Board, not simply list their work history. Just a few companies have incorporated a competence matrix in their Supervisory Board report.

It is apparent from the Supervisory Board reports that the majority of companies are recognising the importance of succession planning and its relevance in achieving long-term success. It is an area for continued focus in a number of board evaluation disclosures. However, the information value of board evaluation reports is general rather low. While full disclosure may be difficult given this can be a sensitive issue, it is possible to provide information on actions taken following an evaluation, the processes the company has in place for succession planning and how it fills board and senior executive positions. It is particularly important that investors gain clarity on a company's approach to board evaluation, succession planning and refreshment. Indeed, an important component of stewardship of institutional investors is to monitor the Board's overall composition, including its diversity of skill sets, and its approach to corporate governance and sustainability.

#### **7. Increasing number of listed companies that publish an integrated report**

The number of companies that published a so-called integrated report maintained its increasing trend and amounted to 28 in 2017 (see graph below).



In an integrated annual report investors and other stakeholders are provided concise information on how a business' governance, strategy, business model and prospects lead to value creation over the short, medium and long term. It enables companies to combine all information that is relevant for analysing the long term development of the company in a single, integrated report. 28 listed companies published an integrated annual report for the 2016 financial year, in comparison with 18 for the 2015 financial year and 6 for the 2014 financial year. The dialogues that Eumedion has held with listed companies reveal that this number will continue to increase in the forthcoming years. A number of listed companies are still busy with the process of 'integrated thinking' and with the incorporation of sustainability risks and opportunities into the strategy and the business model of the company. Integrated reporting by Dutch listed companies is expected to be further incentivised by the new edition of the Dutch corporate governance code. A new best practice provision is incorporated which reads that "in the management report, the management board should give a more detailed explanation of its view on long-term value creation and the strategy for its realisation, as well as describing which contributions were made to long-term value creation in the past financial year. The management board should report on both the short-term and long-term developments" (best practice 1.1.4). This best practice provision is aligned with the objective of integrated reporting.

The quality of the integrated reports that are yet published, varies. Best practices are the integrated reports of Randstad Holding and KPN. However, many companies describe their long-term value creation process in general terms, but are not very clear in communicating their strategy for realising

long-term value creation and how the long-term value creation process also delivers value at the short-term. Many companies fail to explain how much value was created in the last number of years and how much value will be created in the near future.

## **8. Divergence in the authorisations to issue new shares**

To date, it has been *market practice* for Dutch listed companies that the AGM provides a 'standard' authorisation to issue new shares up to 10% of the issued capital, increased by 10% in the case of mergers or takeovers. The management board is also authorised to limit or exclude the statutory pre-emption rights for existing shareholders to these percentages. An increasing number of primarily non-Dutch institutional investors enforce more stringent guidelines for the exclusion or limitation of the pre-emption rights – sometimes to a maximum of 5%. In contrast, after the financial crisis the guidelines were loosened with regard to authorisations to issue new shares with the retention of the pre-emption rights. Some investors use the guideline to permit authorisation of up to 100% of the issued or authorised capital when the pre-emption rights are retained.

This AGM-season saw more divergence with respect to the authorisations to issue new shares. As a consequence we can hardly speak of 'a market practice' in the Netherlands anymore. At the 2017 AGM twelve AEX companies asked for an authorisation to issue – in total – up to 10%, varying from 0%, 3%, '5% + 5%' and 10% for general purposes, with an accompanying proposal to limit or exclude the statutory pre-emption rights for existing shareholders. Nine AEX companies asked for an authorisation of higher than 10%, varying from the former market practice of '10% + 10%', '10% + 10% + an additional percentage for settlement of share and/or stock option plans' (Aegon and RELX) to 30% (Gemalto) and 50% (ING Group). Gemalto limited the authorisation to exclude pre-emption rights to 5% when shares are issued for general purposes or for the purpose of M&A or (strategic) alliances and 10% when shares are issued for the purpose of a non-dilutive tradable rights offering. Just as in last year, ING Group limited the authorisation to exclude pre-emption rights to 10%. Proposals to authorise the board to limit pre-emption rights of existing shareholders for share issuances of up to 20% met a relatively high resistance: in some instances more than 20% of the votes cast was against.

## **9. Added value of external auditor should become more visible**

External auditors play a key role in contributing to the credibility of the annual accounts on which they are reporting. All company's stakeholders rely on the quality of an external auditor's or an audit firm's work. There is, however, still a mixed picture whether the audit quality improved in recent years. Mandatory audit firm rotation, the separation of audit services and other services, the long-format audit report, the recast of the auditor's relationship with the listed company through promotion of the role of the audit committee and the introduction of Supervisory Boards to the audit firms have bolstered confidence. At the same time, AFM reviews of the audits conducted in 2014 and 2015 cannot lead to the conclusion that the overall quality of audits has improved.

Although audit quality itself, let alone improvements in audit quality, is not directly visible to investors, communication between external auditors and investors has improved in the last number of years thanks to the requirement to publish a long-form audit report. The long-form audit report provides shareholders and other stakeholders with a window into the audit – an understanding of how the auditor’s opinion was formed and hence more confidence in the audit. It sets out the materiality threshold used, the degree to which parts of the group were scoped-in to the audit and, most importantly, specifically what key audit matters the external auditor faced, their underlying causes and how they were addressed. It tells the stakeholders what the external auditor did, explained in terms highly specific to the audit in question. The key audit matters sections of the long-form audit report generally contain a description of the matter followed by a description of how the audit addressed the matter. As also remarked in the 2016 AGM evaluation report, the added value of the long-form audit report could be further enhanced if the key audit matters section is supplemented by the external auditor’s ‘results, observations or conclusions’ with regard to the matter specified. The audit reports of a number of listed companies, including DSM, Gemalto, ING Groep, NN Group, OCI, Accell Group and Core Laboratories, already contain this three-way split. As a result of the entering into force of the European Audit Regulation, as from financial year 2017 onwards the audit report should also contain “where relevant, key observations arising with respect to those risks [i.e. key audit matters]”. We believe that when an audit matter is designated as “key”, the external auditor’s observations with respect to that matter are always relevant. Therefore, we expect that from next year onwards *all* key audit matters should be concluded with ‘observations or conclusions’ by the external auditor. Besides this, we encourage all external auditors to start the key audit matters section with a reflection on the follow-up of the company with respect to the key audit matters identified in the previous audit report, e.g. by describing why some audit matters are no longer ‘key’ in the relevant financial year and/or by making a reference to the relevant disclosures in the management report. In that way, stakeholders can assess whether the key audit matters are sufficiently addressed by the company’s management and supervisory board. The external auditor of Ordina has already set the tone with respect to this recommendation. We also encourage external auditors to give greater insight in their assessment of the quality and effectiveness of the listed company’s internal control framework. We recommend starting the key audit matters section of the auditor’s opinion with the external auditor’s general observations with respect to the company’s internal control framework, as the external auditor of KPN did in his opinion on KPN’s 2016 annual accounts.

We see also some signs of increased professional scepticism. At one listed company – Esperite – the external auditor decided to express no opinion on the annual accounts. EY was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. The external auditor was unable to determine whether any adjustments were necessary in respect to the going concern assumption of management, a number of balance sheet accounts and the related statement of profit or loss accounts. At another company – Oranjewoud – the external auditor issued a qualified opinion on the 2016 annual accounts, which were published with a delay of two months. PwC was not able to obtain sufficient appropriate audit evidence with respect to the underlying documents of the agreement

with and the activities of an agent used for Oranjewoud's subway project in Riyad. Two other companies – Value8 and FNG – had to delay the publication of their management report and annual accounts as their external auditor needed more time to provide assurance over the annual accounts of these companies.

23 Dutch listed companies rotated from external auditor in financial year 2016. For 17 companies this was accompanied by a drop in the audit fee (varying from 1.7% at RELX to 36% at Batenburg Techniek), while the audit fee rose for 6 companies (varying from 6% at Wereldhave and Nedap to 32% at ASR Nederland). It is striking that the auditor rotation led to a reduction in audit fees for all 7 AEX companies that rotated their auditors in 2016 (on average 6.8%). The same picture arose from the rotations that took place in 2015 (14 of the 26 auditor rotations led to a drop in the audit fee, including 5 out of 6 AEX companies and in 2014 (9 of the 16 auditor rotations led to a drop in the audit fee, including for all 4 AEX companies). This may indicate that these companies are the most desirable for audit firms ('trophy clients'), which is why they submit very 'competitive' tenders. However, this seems a one year effect only; as we see an increase in the audit fee for AEX companies in the second audit year: on average 11.6%. This rise in audit fees in the second year seems counterintuitive. We would generally expect that in the first year the audit requires more activities and resources than in the subsequent year(s). Audit costs recorded in a year should reflect the efforts of the external auditor. Currently, this seems not to be the case.

2017 was the first year that listed companies had to comply with the new, Europe-wide harmonised rules if they decided to rotate their statutory auditors. Since this year, the audit committee of a listed company is required to submit a recommendation to the supervisory board for the appointment of new audit firm. The recommendation must be justified and must contain the names of at least two audit firms for the audit engagement and the audit committee must express a duly justified preference for one of them. The audit committee has to take into account specific criteria for the selection procedure. The proposal to the AGM for the formal appointment of the new audit firm must include the recommendation and preference made by the audit committee. If the proposal departs from the preference of the audit committee, the proposal must justify the reasons for not following the recommendation of the audit committee. In 2017 two Dutch listed companies decided to appoint a new audit firm: ICT Group and AND International Publishers and, as a consequence, had to comply with the new appointment rules. Both companies failed. ICT Group provided a very brief explanation why PwC was nominated as the new statutory auditor. The AGM of AND International Publishers was requested to ex-ante approve the nomination of the Supervisory Board without knowing the name of the audit firm that will be selected. At the request of a number of shareholders, ICT Group decided to publish a more extensive explanation before the AGM date why PwC was nominated as the new statutory auditor. ICT Group disclosed the selection criteria, their weights and the individual performance score of the invited audit firms on an anonymous basis. The company decided not to disclose the name of the audit firm that ranked number two. Apparently, the shareholders of AND International Publishers did not have problems with the proposed ex-ante approval of the Supervisory

Board's choice of a new statutory auditor based on only very general information on the selection criteria that will be used: the AGM unanimously voted in favour of the proposed procedure. Eumedion recommends companies that decide to appoint a new statutory auditor in 2018 to precisely follow the new appointment rules stemming from the European Audit Regulation.

**Appendix 1: AGM proposals with strongest shareholder resistance (excluding votes cast by Trust Offices)**

<b>AGM</b>	<b>Subject</b>	<b>Result</b>
Royal Dutch Shell	Establishing greenhouse gas reduction targets (shareholder resolution)	93.7% against ( <b>resolution voted down</b> )
Tie Kinetix	Authority to issue new shares	72.3% against ( <b>resolution voted down</b> )
Fugro	Authority to issue new shares	44.5% against
Fugro	Disapplication of pre-emption rights	43.9% against
AMG	Disapplication of pre-emption rights (second 10% tranche)	41.0% against
BAM Group	Disapplication of pre-emption rights	36.8% against ( <b>resolution voted down</b> ) <sup>3</sup>
Heijmans	Disapplication of pre-emption rights	35.8% against
Telegraaf Media Groep	Disapplication of pre-emption rights	34.3% against
Heijmans	Authority to issue new shares	34.2% against
BAM Group	Authority to issue new shares	34.1% against
AkzoNobel	Authority to issue new shares	33.6% against
KPN	Disapplication of pre-emption rights	32.0% against
Telegraaf Media Groep	Discharge of two supervisory directors for execution supervision in 2017	31.1% against
Telegraaf Media Groep	Authority to issue new shares	31.1% against
Telegraaf Media Groep	Addition remuneration for certain supervisory directors	30.9% against
Telegraaf Media Groep	Discharge of the Supervisory Board	30.9% against
Telegraaf Media Groep	Reappointment Supervisory Board member Nooitgedagt	30.9% against
Wereldhave	Appointment Supervisory Board member Nühn	30.2% against
AkzoNobel	Disapplication of pre-emption rights	29.6% against
Pharming	Granting of performance shares to Supervisory Board	28.3% against
AkzoNobel	Discharge of the Supervisory Board	28.3% against
AkzoNobel	Discharge of the Management Board	27.5% against
Philips	Amendment Long-Term Incentive Plan	27.5% against
Core Laboratories	Amendment of Articles of Association	26.3% against
AMG	Disapplication of pre-emption rights (first 10% tranche)	26.2% against
Wereldhave	Disapplication of pre-emption rights	25.7% against
IMCD	Disapplication of pre-emption rights (first 10% tranche)	25.7% against
IMCD	Authority to issue new shares (second 10% tranche)	25.7% against
Philips	Amendment of remuneration policy	24.8% against
DSM	Disapplication of pre-emption rights	22.5% against
IMCD	Disapplication of pre-emption rights (second 10% tranche)	22.4% against
Philips	Disapplication of pre-emption rights	22.2% against
AMG	Appointment Supervisory Board member Van Hassel	21.3% against
AMG	Re-appointment Supervisory Board member Messman	21.3% against
AMG	Re-appointment Supervisory Board member Depp	21.3% against
Philips	Re-appointment Supervisory Board member Van der Veer	20.3% against

<sup>3</sup> Approval of this proposal required a legal 2/3 vote majority since less than 50% of the issued capital was present or represented at the BAM Group general meeting.