To the managing and supervisory directors

The Hague, 6 October 2014

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Subject: **Eumedion Focus Letter 2015**

Dear managing and supervisory directors,

This letter is the 10th annual 'Focus Letter' that Eumedion, the corporate governance platform for institutional investors, sends to the Dutch listed companies.

The priorities highlighted below are subjects we believe deserve your attention. Not only because we regard them as important for the company you are managing or supervising, but also because they are of particular importance for the Eumedion participants – engaged institutional investors. The topics raised in this letter tend to be discussed in the dialogues that Eumedion facilitates between listed companies and participating investors in the run-up to the 2015 general meetings, and possibly also at the meeting itself.

Based on Eumedion's evaluation of the 2014 annual report and AGM season, our two priorities for 2015 are *integrated reporting* and the *effectiveness of the in control statement*. Below, these two priorities will be explained in more detail.

Priority 1: Integrated reporting

Corporate reporting is of the utmost importance for investors. Long-term investors are already well known to look beyond the financial facts and figures only. The increased relevance of all material information for institutional investors required a reporting framework that results in a concise communication about how a business' governance, performance, strategy and prospects lead to value creation over the short, medium and long term. In December 2013, the International Integrated Reporting Council (IIRC) presented a reporting framework that enables companies to combine all information that is relevant for analysing the long term development of the company in a single, integrated report.

Eumedion believes that integrated reporting is a logical and necessary next step in corporate reporting, as environmental, social and governance information already is critical for assessing the performance and prospects of companies, and for the important stewardship role that investors both want and need to exercise. Currently, finding all the relevant information is very time consuming and makes good research very expensive for each investor. The IIRC's integrated reporting framework draws an accurate picture of what long-term investors need for their investment analysis and their engagement activities.
We expect integrated reporting to be very helpful for both investors and preparers. We experience preparers are often eager to learn the information needs of stakeholders with a long term horizon. We also understand that it may prove to be a challenge to implement integrated thinking throughout the organisation, and produce a report in accordance with the IIRC integrated reporting framework, but we are convinced that this is a challenge worth taking up.

Priority 2: A more informative, effective 'in control statement' and internal audit function
The accounting irregularities experienced by a number of companies in 2013 underline the importance of maintaining sound risk management and internal control systems. The Dutch corporate governance code contains the provision *"as regards financial reporting risks, the Management Board states in the annual report that the internal risk management and control systems provide a reasonable assurance that the financial reporting does not contain any errors of material importance and that the risk management and internal control systems worked properly in the year under review. The Management Board shall provide clear substantiation of this".*

A number of recent incidents at Dutch listed companies showed that such an in control statement has a too narrow scope: e.g. operational, governance and compliance risks fall outside the scope. Moreover, the code does not contain an obligation for the Management Board to review the effectiveness of the risk management and the internal control system, as is currently the case in the United Kingdom.
Such a review is necessary as establishing an effective system of internal control is not a one-off design and implementation exercise, but should include adequate monitoring and reporting on effectiveness. No such system remains effective unless it develops to take account of new and emerging risks (e.g. cyber security), control failures or changes in the company's circumstances or business objectives. As a result, the current in control statement of Dutch listed companies is not very informative nor effective.

To increase the meaningfulness and effectiveness of the 'in control statement' and to reduce the risk of new accounting irregularities, we would like to recommend that:

1. the Management Board has an ongoing responsibility for monitoring the company's governance, risk management and internal control systems and, at least annually, for carrying out a review of their design and effectiveness and reports on that review in the annual report. The monitoring and review

cover the control environment, all material controls, such as financial, operational, IT and compliance controls, as well as internal control awareness (‘soft controls’).

2. the Management Board summarises the process it has applied in monitoring and reviewing the design and effectiveness of the system of governance, risk management and internal control in the annual report. The board describes any significant failings or weaknesses identified during the monitoring or the annual review and explains what actions have been or are being taken to remedy these.

3. all listed companies establish an internal audit function or extend the scope of the external audit to the quality and effectiveness of the company’s internal control and risk management systems. Companies that do not have an internal audit function consider annually whether there is a need for an internal audit function and make a recommendation to the Supervisory Board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.

4. the internal audit function executes a risk-based audit plan to assess governance, risk management and control, including the strategic risks of the company, and reports to the Management and Supervisory Board. The internal audit function reviews the quality and effectiveness of the company’s governance, risk management and internal control systems at least annually. The internal audit function reports a summary of the findings to the Management and Supervisory Board.

5. the internal audit function assesses the impact of significant changes in the risk profile of the company, in particular if these are caused by major acquisitions, mergers and joint ventures. The internal audit function reports the main findings to the Supervisory Board before the Supervisory Board decides on such significant changes in the risk profile.

Responses to this letter are much appreciated. We are available should you require further clarification.

Yours faithfully,

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