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**Audit
Committee
Guide**

¹ Case 2017-7987

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1. Introduction

The rules on audit committees were introduced in the Danish Act on Approved Auditors and Audit Firms (the Auditor Act) in 2008, implementing the rules in the Directive on statutory auditing of financial statements and consolidated financial statements (Directive 2006/43/EC).

New EU regulations came into effect in 2014 concerning statutory auditing of financial statements. The new rules concern an amendment to the 8th directive on statutory audit of financial statements and consolidated financial statements (Directive 2014/56/EU of the European Parliament and of the Council) and a regulation on specific requirements regarding statutory audit of public-interest entities (Regulation (EU) No 537/2014 of the European Parliament and of the Council).

These regulations generally come into immediate effect in the member states. However, the Auditor Regulation contains a number of options for the member states, which, if used, must be implemented in national legislation.

According to the preamble of the amendment directive, the audit committee, or those bodies that perform a similar function in the audited public-interest entity, plays a decisive role in performing high quality statutory audits.

The amendments therefore also affect the rules on audit committees. The amendment directive and options in the Auditor Regulation are implemented in Danish law by Act no. 631 of 8 June 2016. The Auditor Regulation also contains a number of rules on the functions of audit committees.

The rules on audit committees apply to public-interest entities. A number of such entities are also covered by the Committee on Corporate Governance Recommendations for corporate governance. The guide therefore includes the committee's recommendations for relevant areas. References to the recommendations indicate that they contribute to compliance with a given statutory requirement. On the other hand, this does not mean that undertakings opting to act differently will not comply with the requirement in another manner. Reference to the recommendations does not thus imply disregard for the “comply or explain principle” or an interpretation of the Committee's recommendations. While the recommendations of the Committee on Corporate Governance are directed at undertakings with shares traded on a regulated market in Denmark, they may also be relevant to other undertakings covered by the statutory requirement for an audit committee.

The guide furthermore uses the term “should”, which indicates examples of how a statutory requirement can be complied with. That does not mean that a statutory requirement cannot be complied with in other ways.

To promote ease of reading, the guide uses the term “board of directors”. In the context of the guide, the board of directors is synonymous with the “senior management”.

Section 2 contains guidance on the rules on setting up an audit committee, on the board of directors taking on the audit committee's functions and on exemption from the rules on audit committees.

Section 3 contains guidance on the composition and qualifications of the audit committee, including the new rules on independence and qualifications.

Section 4 contains guidance on the duties of the audit committee, including the new rules in the Auditor Regulation concerning the function of the audit committee.

Finally, Section 5 covers the new rules on supervision of audit committees and sanctions for violation of the rules.

A separate annex has been compiled, to which the guide refers. The annex contains a brief description of the supervision of audit firms and auditors by the Danish Business Authority along with an example of a set of audit quality indicators and an example of ways of assessing audit quality. The annex also contains an example of the use of the 70% limit for the provision by auditors of non-audit services, whilst Annex 5 includes relevant legal provisions.

The guide is an expression of the Authority's instructive interpretation of the rules and is based on available knowledge of the subject. The Danish Business Authority intends to update the guide as practice and interpretation of the subject are accumulated, including as a result of the supervisory activities of the Danish Business Authority and the Financial Supervisory Authority.

The Danish Business Authority is furthermore responsible for monitoring and appraisal of developments in the market for statutory audit services for public-interest entities. That entails that the Authority compiles a report every three years which must be submitted to a number of European committees and the European Commission. The report shall include an evaluation of the performance of audit committees. The result of such monitoring and exchange of experience and information between the supervisory authorities in each European member state will also lead to the guide being updated.

The Danish Business Authority, May, 2018

2. Setting up an Audit Committee

2.1. Independent Audit Committee

*Scope and definitions
(Section 31 (1) of the Auditor Act)*

The rules on audit committees were implemented in the Auditor Act in 2008, and applied to entities with securities listed for trading on a regulated market in an EU or EEA country. In addition, the Financial Supervisory Authority laid down rules based on the Auditor Act on audit committees in undertakings subject to the supervision of the Financial Supervisory Authority.

The rules on audit committees were revised by the amendment to the Auditor Act in June 2016. The amendment means that the rules on audit committees will apply to undertakings defined as public-interest entities according to Section 1 a (1) no. 3. According to this provision, the following undertakings will be covered by the rules on audit committees:

- 1) Entities with capital shares, debt instruments or other securities listed for trading on a regulated market in a country that is a member of the European Union, or a country with which the Union has entered into an agreement on financial matters,
- 2) Financial undertakings, cf. Section 5 (1) no. 1 a of the Financial Business Act,
- 3) Mortgage credit institutions, cf. Section 5 (1) no. 1 b of the Financial Business Act, and
- 4) Insurance undertakings, cf. Section 5 (1) no. 1 e of the Financial Business Act.

The amendment repealed the grounds that laid down rules on audit committees in undertakings that are subject to the supervision of the Financial Supervisory Authority. Executive Order no. 1393 of 19 December 2011 on audit committees in undertakings and groups subject to the supervision of the Financial Supervisory Authority was thus repealed.

Undertakings that are subject to the supervision of the Financial Supervisory Authority, but which do not fall under the definition of public-interest entities, are therefore no longer covered by the rules on audit committees. However, there is nothing to prevent such undertakings from voluntarily maintaining an already established audit committee, or electing to set up such a committee. Such audit committees will not be subject to the requirements of the Auditor Act for audit committees.

Terms of reference

Neither the Auditor Act nor notes to the Act lay down any details as to how an audit committee is to discharge its duties. However, undertakings should define the framework within which their audit committees discharge their duties based on their size and complexity.

The audit committee's mandate should therefore be defined in terms of reference defined by the board of directors.

The terms of reference should contain a detailed description of the audit

committee's role, its duties and authority. Furthermore, the terms of reference should define the framework for reporting by the audit committee to the board of directors.

Resources

An undertaking shall ensure that its audit committee is given sufficient resources to discharge the duties defined by the terms of reference.

The committee shall therefore be assured access to all necessary data, including from the company's personnel. The committee should also be furnished with the necessary funds to allow it to obtain impartial advice on matters that fall within its area of competence, such as legal, accounting or other advice that it may find necessary. See also Section 3.2 on the requirements for audit committee member qualifications.

Participation in committee meetings

The audit committee plays an important role in matters such as ensuring a true and fair presentation of the undertaking's financial data, including its internal controls and risk management systems and whether any internal audits operate effectively with regard to the undertaking's financial reporting.

Based on the material presented and through discussions at meetings, the audit committee will gain insight into and form a basis on which it can evaluate the company's financial reporting, internal control and risk management systems and, if relevant, internal auditing and the work of an external auditor, etc. The committee can thus perform its own evaluation of whether changes are needed, and whether special measures should be implemented, based on, for example, the presentation and explanations at meetings from the Finance Director or senior account personnel. The audit committee thus arranges participation in its meetings based on a meeting schedule, so that it has the necessary insight into the undertaking's organisation and processes, including the extent to which the Finance Director and senior personnel with responsibility for finance, accounting and economy, internal auditor and the external auditor are to take part in its meetings.

The committee must also be able to invite or summon certain other personnel or experts to attend at the relevant points of its meetings if deemed necessary.

To ensure the audit committee's autonomy and objectivity, the committee should have discussions that are not attended by e.g. members of the executive management or external auditors, to provide the opportunity to conduct discussions and evaluations without the participation of the subjects of such discussions.

Documentation

According to Article 16 (3) f of the Auditor Regulation, the company

shall be able to demonstrate, upon request, that the selection procedure for appointing an auditor was conducted in a fair manner. The Auditor Act does not contain any other actual requirement for proof directed at the audited entities.

Members of the company's board of directors, executive board and audit committee are subject to supervision by the Danish Business Authority or the Financial Supervisory Authority with regard to the duties applied by the Auditor Act, the Auditor Regulation and provisions in the legislation implementing Articles 37 and 38 on choice of and dismissal of auditor. See also Section. 5.1. on supervision.

The audit committee must therefore insure that it can prove compliance with the stipulated requirements, including those stated in the Auditor Regulation as well the above. If the duties of the audit committee are undertaken by the board of directors, the basic considerations shall still be performed and documented.

The Act does not lay down requirements for documentation, but leaves it up to the undertaking. Documentation can, for example, be in the form of minutes of meetings, notes, analyses and reports, etc.

2.2. Audit Committee Functions Undertaken by the Board of Directors

Access for the board of directors to exercise the functions of the audit committee²

(Section 31 (5) and (7) of the Auditor Act)

In principle, public-interest entities have a duty to set up an audit committee. However, the Act does provide access for the board of directors to undertake the functions of the audit committee. If those functions are undertaken by the board of directors, there must be a statement to that effect in the company's financial statement.

Regardless of its size, an undertaking can opt to have its board of directors undertake the functions of the audit committee as long as the following conditions are fulfilled:

1. No board member is concurrently a member of the executive board and
2. At least one board member has qualifications within accounting or auditing.

A former requirement was for the board member with qualifications within accounting or auditing to be independent. This requirement has been repealed. See also Section 3.2 on the requirements for audit committee member qualifications.

Public-interest entities in particular²

(Section 31 (6) and (7) of the Auditor Act)

Small public-interest entities are subject to less stringent criteria for having their board of directors undertake the functions of the audit committee. Listed and unlisted small undertakings are classified differently.

Small listed undertakings can have their board of directors undertake the functions of the audit committee if:

1. The chairman of the board is not a member of the executive board

² The Committee on Corporate Governance recommends (recommendation 3.4.3) that an audit committee be set up

and

2. The company has had an average market value over the last three calendar years of less than EUR 100 million based on share value at the year end.

Note that calculation of share value shall be performed at the end of the calendar year and not at the end of the financial year.

Small unlisted undertakings can have their board of directors undertake the functions of the audit committee if:

1. The chairman of the board is not a member of the executive board and
2. the undertaking did not exceed two of the following size thresholds in two successive financial years on balance sheet date:
 - i) A staff of 250 full-time employees,
 - ii) a balance sheet total of EUR 43 million, and
 - iii) net turnover of EUR 50 million.

Net turnover is not used in the accounts for credit institutions and insurance undertakings. The term “turnover” was introduced in Executive Order no. 281 of 26 March 2014 on financial reports for credit institutions and investment management undertakings, etc. According to Annex 2, no. 7 a of the Executive Order, turnover is defined as the total of the following items:

- a) Interest income
- b) Fees and commission income
- c) Other income.

“Net turnover” for financial and mortgage credit institutions can therefore be recognised in accordance with the aforementioned Executive Order.

Executive Order no. 937 of 27 July 2015 on financial reports for insurance entities and cooperative pension funds does not contain a definition of “turnover”, in contrast to the Executive Order for credit institutions, etc. For insurance entities, “gross premiums”, cf. item 1.1 in Annex 3 of the Executive Order (life insurance entities) and Annex 4 (non-life insurance entities) can be used as the term for “net turnover” when stating value thresholds.

The calculation rules in Section 1 a (2) and (3) of the Auditor Act will also apply with the necessary adjustments to financial and mortgage-credit institutions and insurance companies. This means that the size criteria must be stated at group level.

The less stringent rules for small public-interest entities thus mean that there is no prohibition against board members concurrently being members of the executive board, and there is no requirement for one member to have qualifications within accounting or auditing.

However, credit institutions and insurance companies are always subject to prohibition against board members concurrently being members of the executive board, cf. Section 73 (1) of the Financial Business Act.

Exemption from setting up an audit committee

(Section 31 (8) and (9) of the Auditor Act)

Notwithstanding the above, the following public-interest entities are not obliged to follow the rules on audit committees (setting up an audit committee or having the board of directors undertake the audit committee's functions):

- 1) Subsidiaries, if the parent company is covered by the requirements for setting up an audit committee (Section 31 (8) no. 1 of the Auditor Act).

It is a condition that the parent company is covered by the requirements for setting up an audit committee in pursuance of the rules that implement Article 39 of the Auditor Regulation on audit committees. As such, it is insufficient for a parent company to voluntarily have opted to set up an audit committee.

- 2) Investment associations (Section 31 (8) no. 2 of the Auditor Act).

Exemption extends to investment associations that are covered by the Act on investment associations, etc. (applicable Executive Order no. 1051 of 25 August 2015).

- 3) Alternative investment funds as defined in Article 4 (1) (a) in Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (Section 31 (8) no. 3 of the Auditor Act).

- 4) Companies with the sole objective of issuing securities hedged against assets as defined in Article 2 no. 5 in Commission regulation (EC) No. 809/2004 as regards information contained in prospectuses (Section 31 (8) no. 4 of the Auditor Act).

The company in such an instance shall detail the reasons why it does not find it appropriate to have an audit committee, a board of directors or a supervisory body responsible for exercising the functions of an audit committee in its annual report (Section 31 (9) of the Auditor Act).

- 5) Financial undertakings covered by Section 5 (1) a or b of the Danish Financial Business Act, the shares in which are not listed for trading on a regulated market in an EU or EEA country, and in the event of bond issue regularly or repeatedly have only issued bonds listed for trading on a regulated market, providing that the total nominal value of such bonds is less than EUR 100 million, and that such undertakings have not published any prospectus in accordance with Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (Section 31 (8) no. 5 of the Auditor Act).

Notwithstanding the formulation of the provision, exemption also

applies to financial and mortgage-credit institutions which neither have capital shares listed for trading on a regulated market, nor have issued bonds for trading on a regulated market.

The provision shall be regarded as an exemption from the principle rule of public-interest entities being obliged to set up an audit committee or have the board of directors undertake the audit committee's functions.

A public-interest entity that opts to set up an audit committee has not used the exemption option, and the audit committee shall therefore fulfil the requirements of the Auditor Act for an audit committee.

Undertakings that do not fall under the definition of public-interest entities, but that voluntarily opt to set up an audit committee, are, on the other hand, not covered by the requirements of the Auditor Act for an audit committee.

The Auditor Regulation gives the audit committee a number of duties, e.g. in connection with an auditor's fee (Regulation Article 4 (3)), provision of non-audit services (Regulation Article 5 (4)) and recommendation and election of auditor (Regulation Article 16). Notwithstanding that the undertaking has opted to use the exemption provision and is therefore exempt from the duties stated in Section 31 (3) of the Auditor Act, the requirements of the Auditor Regulation for the undertakings apply.

Neither the Auditor Regulation nor the Auditor Act stipulate which body within the undertaking is to discharge the relevant duties if the undertaking is exempt from the rules on audit committees.

It will therefore be up to the undertaking itself to determine any arrangements or guidelines that will apply concerning the requirements applied by the Regulation for setting up an audit committee.

In an undertaking consisting, for example, of a board of directors and executive board, it would be logical for the board of directors to discharge the duties of the audit committee according to the Regulation.

3. Composition and Qualifications

3.1. Composition

*Members
(Section 31 (1), second
sentence of the
Auditor Act)*

The audit committee shall consist of members of the company's board of directors, supervisory board or persons elected by the general meeting or equivalent body as a member of the committee. At least one member shall have qualifications within accounting or auditing (see Section 3.2 on qualifications).

The Act does not lay down any more detailed requirements on the number of members of the audit committee, but a committee shall consist of more than one person.

According to the EU Commission's recommendation (2005/162/EC) on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (EUT L 52 of 25 February 2005, page 51 and the following), the audit committee should normally be composed of at least three members. In undertakings with small (supervisory) boards, they could exceptionally be composed of two members only.

When considering the number of members, the company's size and complexity should be taken into account, including ensuring that the audit committee's members overall have competences that are relevant to the sector in which the company operates, cf. Section 3.2 below.

External members

(Section 31 (1), second sentence of the Auditor Act)

The fact that the general meeting, etc. can elect members of the audit committee who are not concurrently members of the board of directors (external members) is new.

The provision does not contain any restrictions regarding the number of external members of an audit committee. As such, it is left up to the company to consider whether the option should be exercised and, if so, the number of external members of the audit committee. There is nothing to prevent all members of the committee from being external members.

The Committee on Corporate Governance recommends that the audit committee's members are selected from board members (recommendation 3.4.3) and that a chairman is appointed for the committee who is not the chairman of the board.

The responsibilities of external members

(Section 31 (2) of the Auditor Act)

When discharging their office in the audit committee, external members are subject to the same regulations as those that apply to members of the audit committee who are also members of the company's board of directors, and are generally subject to the same duties and responsibilities that apply to board members.

Independence

(Section 31 (1), third sentence of the Auditor Act)

There is no requirement for independence if all members of the committee are concurrently members of the board of directors or supervisory board.

The requirement for independence therefore only applies if an external member of the committee is elected.

The Committee on Corporate Governance recommends that the majority of the audit committee's members be independent (recommendation 3.4.2).

It was formerly a requirement for the committee member with qualifications within accounting or auditing to also be independent. This requirement has been repealed. If the requirement for independence applies, it is thus not a requirement in itself that a qualified member is subject to the requirement for independence, when only the requirement concerning the independence of the majority of members (including the chairman) is fulfilled.

The Act does not lay down any detailed requirements for when a member is deemed to be independent. According to the notes on the provision, the board of directors is responsible for ensuring that the requirement on independence is met.

The definition of the term “independence” has not changed. According to the notes in the Act, the European Commission's recommendation (2005/162/EC)³ can be used, Annex II of which lays down a series of criteria which the board of directors or executive board can use when evaluating independence. According to the recommendation, the criteria should be adapted to national requirements. The Committee on Corporate Governance has adapted the criteria according to the recommendation to Danish requirements. The criteria of the Committee on Corporate Governance for independence are stated in Annex 2.

The Committee on Corporate Governance thus recommends (recommendation 3.2.1) that at least half of the members of the board of directors elected by the general meeting be independent persons, in order for the board of directors to be able to act independently of special interests.

If the recommendations of the Committee on Corporate Governance for independence are to be followed, its requirement for documentation will apply instead of the general requirement for documentation, and the board of directors must therefore ensure that the requirement for independence is fulfilled.

3.2. Qualifications

The rules apply the requirement that at least one member of the audit committee must have qualifications within accounting or auditing.

There is also a new requirement for the committee members collectively to have competences relevant to the sector in which the company operates.

The Act does not lay down any detailed requirements for a qualified member's qualifications or the overall competences of the committee, but they must be sufficient to ensure that the audit committee can fulfil its duties in relation to presentation of the company's accounts, internal control, risk management and statutory audit, including the quality and independence of the audit. The composition must therefore ensure that the relationship between special qualifications within accounting or auditing and competences within the sector in which the company operates contribute to high quality when discharging the committee's duties.

The board of directors of the company shall ensure that the composition of committee members fulfils the requirements.

³ The European Commission's recommendation on the role played by private board members and members of the supervisory bodies of listed companies, and on committees set up by the board of directors/management body

Qualifications within accounting or auditing (Section 31 (1), fourth sentence of the Auditor Act)

In accordance with the Act's notes on introduction of the rules in 2008, it will normally suffice if qualifications within accounting or auditing are obtained through one or more of the following educations or positions within a listed undertaking, in other public-interest entities or in entities that follow corresponding rules for presenting their accounts:

- management responsibility for presenting financial statements obtained as Finance Director,
- responsibility delegated by the management of an internal audit function,
- experience of membership of an audit committee,
- other experience from monitoring the presentation and auditing of accounts,
- authorisation to perform an audit of accounts (state-authorized or registered public account), or other corresponding qualifications, or
- other relevant experience.

The above qualifications may be obtained through working in Denmark or abroad, and should include a full financial year at a minimum.

A key factor in evaluating competence is whether the person concerned has sufficient awareness of the requirements for presenting accounts and/or conducting audits in undertakings corresponding to the undertaking in question.

4. Duties of the audit committee.

The Act lays down minimum requirements for the duties of the audit committee. There is nothing to prevent a decision that the audit committee shall also take on other duties.

The duties of the audit committee do not affect the responsibilities of members of the board of directors, executive board or other members appointed by the company's general meeting.

As such, the board of directors retains full responsibility for the decisions prepared in a management committee, such as the audit committee. The audit committee shall prepare (in line with other management committees) for discharging its duties prior to consideration by the board of directors. However, the audit committee is subject to a special duty to act in connection with monitoring the presentation of the accounts in relation to the day-to-day management of the undertaking, and according to Article 5 (4) of the new regulation on specific requirements for auditing public-interest entities, shall approve provision of non-audit services from an auditor, etc.

The audit committee's duties according to the Act, are in principle “to monitor” or “to check and monitor” a given aspect. As such, the Act does not lay down any requirement on the audit committee performing any duties that legally belong under other bodies, e.g. the executive board, internal audit or external audit, which would undermine the responsibility they have.

The audit committee thus does not form part of the company's internal control function, but shall perform a supervisory function as part of the company's overall governance. The monitoring and checking performed by the audit committee will therefore primarily be based on the information, reports, etc., provided by others, such as the executive board or the internal or external audit.

4.1. Reporting to the board of directors

(Section 31 (3), no. 1 of the Auditor Act)

The audit committee shall inform the board of directors of the result of the statutory audit, including the financial reporting process.

It is now stipulated that the audit committee has a duty to inform the board of directors of the result of the statutory audit, including the financial reporting process. Notwithstanding the fact that this was not stated previously and directly by the Act, it must solely be presumed to be a codification of applicable practice.

According to Section 8 of the Financial Statements Act and Section 184 of the Financial Business Act, each individual member of the responsible management bodies is responsible for preparing the financial statements in accordance with the law and any other requirements. Informing the board of directors is therefore important, as the duties of the audit committee, cf. the above, do not affect the responsibilities of members of the board of directors, executive board or other members appointed by the company's general meeting.

The company shall therefore ensure that its board of directors receives sufficient and necessary information to enable it to perform its function and discharge its responsibility on a reasonable and well-informed basis.

At the very least before approving the financial statements and other financial reporting, the audit committee should monitor and report to the board of directors on:

- Accounting policies for significant areas,
- significant accounting estimates,
- related party transactions, and
- uncertainty and risks, including in relation to the outlook for the current year.

Reporting shall also include the result of the statutory audit. The auditor shall report on the audit performed in an additional report to be sent to the audit committee and board of directors. If the audit committee has discussed the additional report with the auditor, including and in particular reporting by the auditor on major omissions in the company's internal control system or accounting system, the committee shall report it to the board of directors, including on any measures it has or will implement.

The audit committee's report should not, however, be given in connection with closing of the accounts, but should be done in the course of the financial year if any events have occurred of significance to the board of directors.

The Committee for Corporate Governance, in its guide for appointing management⁴, states that

“Minutes of committee meetings should be taken, and after approval by the relevant committee, should be provided to all members of the board of directors. A report from each committee on its work during the preceding period should also be a fixed item on the agenda of board meetings.”

4.2. Monitoring the financial reporting process

(Section 31 (3) no. 2 of the Auditor Act) The audit committee shall monitor the financial reporting process and present recommendations or proposals to ensure integrity.

The requirement for monitoring financial reporting is a continuation of the applicable rules, whereas the requirement for the audit committee to make recommendations or proposals to ensure the integrity of the process is new.

The audit committee must therefore be aware of the organisational structure and delegation of responsibility within the undertaking to be able to determine whether the organisation and delegation of responsibility in the accounting functions are appropriate and effective, including whether there is sufficient control to ensure that internal guidelines and policies are implemented within the company.

The Committee for Corporate Governance also recommends (recommendation 3.4.4) that the audit committee, prior to the approval of the annual report and other financial reports, monitors and reports about:

- Accounting policies for significant areas,
- Significant accounting estimates,
- Related party transactions, and
- Uncertainty and risks, including in relation to the outlook for the current year.

With particular regard to the new legislation, the audit committee should ensure that the company's description is adjusted and updated.

⁴ Guidance on management committees, version 1, May 2013, the Committee for Corporate Governance

If the audit committee finds that there are omissions or possible improvements in the company's organisation and delegation of responsibility in its accounting functions, it shall compile recommendations or proposals for rectification.

Omissions and possible improvements will often be identified through the ongoing dialogue with the auditor.

4.3. Monitoring the internal control system, internal audit and risk management systems

(Section 31 (3) no. 3 of the Auditor Act)

The audit committee shall monitor whether the undertaking's internal control systems, any internal audits and risk management systems function efficiently with regard to the financial reporting process in the undertaking, without compromising its independence.

This is a continuation of the applicable rules, although with a stipulation that it is the effectiveness of the undertaking's internal control systems, etc. in relation to the financial reporting process that should be monitored.

The wording does not make it absolutely clear what is meant by “without compromising its independence”, but the probable intention is that the audit committee cannot become part of the undertaking's internal control system, but must maintain its role of being able to perform impartial monitoring of the undertaking's internal control systems, etc.

The provision must be viewed in the context of corporate and financial legislation (Companies Act Sections 115-116 and Financial Institutions Act Section 71), according to which the board of directors must ensure that bookkeeping and presentation of financial reporting are performed in a satisfactory manner, and that the necessary procedures for risk management and internal controls are in place.

The provision should also be viewed in the context of the accounting requirements for undertakings with securities listed for trading on a regulated market in a country that is a member of the European Union or a country with which the Union has entered into an agreement on financial matters that is to receive a report from the company's management, including a description of the main elements of the company's internal control and risk management systems in connection with the financial reporting process (Financial Statements Act Section 107 b, Section 134 of the Executive Order on financial reports for credit institutions and investment firms, etc., and Section 131 of the Executive Order on insurance companies and cooperative pension funds). According to the notes on the provision in the Financial Statements Act, the description must reflect the actual situation and be adjusted to the characteristics of the individual undertaking (e.g. its size, complexity and structure) and should include:

- Procedures or systems that the undertaking has introduced for risk

management, including whether the management regularly identifies and manages risks of significant errors in financial report presentation, and

- Internal control systems introduced in the undertaking to ensure that significant errors in financial report presentation are countered, discovered and corrected.

The job of the audit committee is to support the responsibility of the board of directors, and the committee should, as part of its monitoring of the undertaking's internal control and risk management systems, obtain information from the management and/or internal auditor on whether such systems function effectively and appropriately.

The Committee on Corporate Governance recommends (recommendation 3.4.5) that the audit committee

- assesses the need for an internal audit function annually and, in such a case, presents terms of reference and recommendations on selecting, appointing and removing the head of any internal audit function and on the budget for the internal audit,
- ensures that if an internal audit has been established, a description of its functions is available and approved by the board of directors,
- ensures that, if an internal audit has been established, adequate resources and competences are allocated to carry out the work, and
- monitors the executive board's follow-up on the conclusions and recommendations of the internal audit function.

*Notes in the audit record
(Auditor Regulation Art.
11 (2) j and (2),
final section)*

The auditor shall report on any significant deficiencies in the undertaking's internal control system and/or in the accounting system in his records, including whether the management has rectified said deficiencies.

The audit committee should discuss the situation with the auditor, particularly if the deficiencies have not been rectified.

4.4. Monitoring the statutory audit

*(Section 31 (3) no. 4 of the
Auditor Act)*

The audit committee shall monitor the statutory audit of financial statements, etc., taking into account the result of the latest quality assurance review by the audit firm.

*Monitoring the statutory
audit*

What monitoring of the statutory audit involves has not been stipulated.

However, it is important that the audit committee helps to ensure that the audit is performed by independent, objective and competent auditors. The audit committee must also help to ensure that the audit is performed with a level of quality that provides a high degree of assurance that the financial statement is presented without significant errors or omissions.

The Committee on Corporate Governance recommends (recommendation 5.3.2) that the audit agreement and the auditor's fee be agreed by the board of directors and the general meeting based on a recommendation from the audit committee.

Certain areas in the audit process are deemed to be key to being able to perform the above monitoring. Consequently, the audit committee should ask the auditor as early as possible in the audit process to provide the intended audit strategy and plan, and discuss with the auditor the envisaged materiality level and identification of significant risks.

The auditor's materiality level is determined based on evaluating the possible effects on the decisions of primary users of the accounts in the event of errors and/or omissions found in the financial statements⁵.

Discussion of the materiality level should furthermore include the “benchmark” (i.e. financial and operating data/KPIs) that the auditor has used to determine the materiality level.

When a group is involved, the audit committee should furthermore discuss the auditor's consideration of scoping the consolidated audit, i.e. from which subsidiaries auditors' statements on consolidated financial data are obtained, and from which subsidiaries only reviewer statements, etc. are obtained.

In the course of an audit, the auditor must identify and evaluate significant risks related to the audit. The audit committee should discuss the risks identified and the auditor's reaction to them, including involving the committee's own evaluation of the undertaking's financial reporting process and internal control/risk management systems.

Consideration of the auditor's staffing and schedule should be included in an agreement and planning context. The audit committee shall help to ensure that the audit can be performed effectively and within an appropriate timeframe. The audit committee may consider discussing staffing with the auditor responsible, including staffing for more complex and risky areas.

During and at the end of the audit, significant aspects and issues that have arisen during the audit must be discussed between the auditor and audit committee. This should also include the result of the audit of areas subject to significant accounting estimates. There should generally be a regular dialogue between the auditor and committee during the audit.

Monitoring by the audit committee of the statutory audit should include continual discussion with (and feedback from) key personnel in undertakings linked to performing the audit, including the undertaking's CEO, CFO, internal audit manager, etc.

Discuss significant

The auditor shall submit the audit records to the audit committee no later

⁵ If false information or omissions (individually or collectively) are expected to influence financial decision-making users make on the basis of the financial statements, such false information or omissions are significant.

factors with the auditor than the date of presentation of the auditor's report. The content of the audit report shall fulfil the requirements in Article 11 of the Auditor Regulation, including reporting on significant difficulties and issues that arose during the audit, and on issues that occurred during the statutory audit and that in the professional opinion of the auditor are significant to the overview of financial reporting. As stated above, such difficulties and issues should be regularly discussed during the audit process as part of the audit committee's monitoring of the statutory audit.

Consideration of the latest quality assurance review

As part of its monitoring of the statutory audit, the audit committee shall take into account the result of the latest quality assurance review of the audit firm.

All audit firms and auditors are subject to a statutory quality assurance review performed by the Danish Business Authority. PIE audit firms⁶, which perform audits on small and medium-sized public-interest entities⁷, must be reviewed every six years, while other PIE audit firms must be reviewed every three years.

However, audit firms auditing OMXC25 Cap, OMXC Large Cap or OMXC Mid Cap customers are subject to annual quality assurance review based on risk assessment.

The Danish Business Authority publishes an annual individual report on the results of quality assurance reviews of PIE audit firms that are subject to the annual quality assurance review. The report includes a summary of the main conclusions of the Authority's review and any points recommended by the Authority for improvement. The report states the name of the audit firm, but is otherwise in anonymised format.

Annex B.1. contains a general description of the Danish Business Authority's public supervision of auditors and audit firms, including stating the measures that the Authority can put in place following a quality assurance review, and details of which the audit committee can ask the audit firm to provide.

All PIE audit firms must also publish an annual transparency report, including details of when the latest quality assurance review took place. However, there is no requirement to publish the results of a quality assurance review.

⁶ Audit firms that audit public-interest entities

⁷ Undertakings that do not exceed two of the following size thresholds in two successive years: balance sheet total of DKK 156 million, net turnover of DKK 313 million and an average of 250 full-time employees during the financial year.

When the Danish Business Authority does not publish a report on the result of the quality assurance review of an audit firm, the audit committee can ask the audit firm for details of the result of the most recently completed quality assurance, along with any follow-up measures from the Authority, cf. a more detailed description in Annex B.1.

The audit committee shall decide whether the result of the latest quality assurance review of the audit firm gives cause for special consideration in relation to performing the statutory audit of the entity.

Such considerations can include any remarks linked to the audit firm's independence, including the provision of non-audit services and evaluation of the same.

Furthermore, remarks on the result of the quality assurance review of audit engagements may be of interest to the audit committee. Such details are not publicly available and cannot be released, but the audit committee can ask the auditor to state whether audit of the undertaking's accounts was covered by the review and discuss the results of the review with the audit committee.

4.5. Checking and monitoring the auditor's independence

(Section 31 (3) no. 5 of the Auditor Act)

The audit committee shall check and monitor the auditor's independence in accordance with Sections 24-24 c of the Auditor Act and Article 6 of the Auditor Regulation, and approve the auditor's provision of non-audit services, cf. Article 5 of the Auditor Regulation.

The provision continues the requirement for the audit committee to check and monitor the independence of an auditor. The requirements for auditor independence have been amended, however, and the rules in the Auditor Act on auditor independence are now supplemented by additional requirements in the Auditor Regulation.

The audit committee shall be particularly aware of the new rules in Article 4 of the Auditor Regulation on audit fees, including restrictions on the provision by auditors of non-audit services and the proportion represented by the fee of the auditor's total fees, and Article 5 on provision of non-audit services by auditors.

(Article 6 of the Auditor Regulation)

Before undertaking or continuing an audit engagement, an auditor shall assess and demonstrate that the requirements for independence are fulfilled, including the requirements in the Auditor Regulation's rules on fees (Article 4), on performance of non-audit services (Article 5) and the rules on the duration of an audit engagement and partner rotation (Article 17).

The audit committee shall receive annual confirmation from the auditor that the auditor, the audit firm and the audit partners, senior managers and managers conducting the statutory audit are independent from the audited entity. The declaration on independence shall be stated in the audit record.

Similarly, the auditor shall discuss with the audit committee any threats to their independence and the safeguards applied to mitigate those threats, as documented by the auditor or audit firm.

Restriction of provision of non-audit services by an auditor

(Article 4 (2) of the Auditor Regulation)

The Auditor Regulation has introduced a restriction on how large a proportion an audit firm's fees from an audit customer can stem from other non-audit services. The provision only applies to the audit firm selected. Fees for network entities related to the selected audit firm are therefore not covered by the provision.

The restriction comes into effect if the audit firm has performed non-audit services for the audit customer itself, its parent undertakings or its subsidiaries for three or more consecutive years.

The restriction comprises 70% of the past three years' average fees for the statutory audit of the audit customer, its parent undertakings and its subsidiaries. The estimated restriction comes into effect in the year after the three-year period used for the estimate.

The restriction does not concern services required in accordance with EU or Danish law. This means, for example, that fees paid to an auditor for checking an outstanding balance according to the rules of the Companies Act in connection with payment of extraordinary dividends will not be affected by the restriction.

The audit committee must be aware of whether the undertaking is covered by the restriction on provision of non-audit services by the selected auditor. If this is the case, it must be taken into account when the committee approves provision of non-audit services, cf. below.

See Annex B.3. for an example of the provision's application for an undertaking with a calendar financial year.

Auditor fees from the undertaking in relation to the auditor's overall fee

(Article 4 (3) of the Auditor Regulation)

According to the Auditor Regulation, the auditor shall inform the audit committee if the proportion of the auditor's fees from the undertaking comprises more than 15% of the auditor's overall fee in each of the past three consecutive financial years. The auditor shall discuss with the audit committee any threats to the auditor's independence and the safeguards the auditor has applied to mitigate those threats.

The audit committee shall consider on that basis whether the audit engagement should be subject to a quality control review by another statutory auditor or audit firm prior to the issuance of the audit report.

According to the Auditor Regulation, the audit committee shall furthermore decide, based on objective information, whether the auditor can continue the audit engagement for a new period if the proportion of the fee from the undertaking continues to exceed 15% of the auditor's total turnover. However, the period cannot exceed two years.

The provision probably has limited significance, but may be relevant in situations when the undertaking has chosen a small audit firm, perhaps as joint auditor.

*Provision of non-audit services by an auditor
(Article 5 (4) of the Auditor Regulation)*

The audit committee shall approve the provision of permitted non-audit services by auditors, including those belonging to the same networks, after performing a suitable evaluation of threats to independence and the safeguards the auditor has applied to mitigate those threats. The approval requirement does not apply to those tax and valuation services permitted according to Section 24 a of the Auditor Act, cf. the following.

The audit committee shall take extra care in this context to ensure that none of the prohibited services listed in the Auditor Regulation are involved.

*Guidelines for the provision of permitted tax and valuation services by auditors
(Section 24 a and Article 5 (4) of the Auditor Act)*

The audit committee shall draw up guidelines for the provision of the tax and valuation services permitted according to the Auditor Act. On the other hand, there is no requirement for the audit committee to pre-approve each provision of the permitted tax and valuation services.

While there is no requirement for pre-approval of such services, the audit committee will remain responsible for monitoring and assessing whether the guidelines for provision of such services are followed.

The permit to provide tax and valuation services is an exception to Article 5 (1) of the Regulation, which solely concerns prohibited services within the EU/EEA zone. The permit to provide tax and valuation services according to the Auditor Act only applies in relation to Danish undertakings and cannot be extended to parent undertakings or subsidiaries located in other EU/EEA countries or parent undertakings or subsidiaries located in third countries. In principle, the guidelines will only apply to Danish companies.

The scope of Article 5 (4) of the Auditor Regulation

According to the wording of the Regulation, the audit committee shall also approve the provision of permitted non-audit services to the undertaking's parent companies and subsidiaries.

However, it will be very far-reaching and in violation of general corporate governance principles if the audit committee of the audited undertaking is required to approve provision of non-audit services to a parent company. It will also be far-reaching if the audit committee also has to approve the provision of permitted non-audit services to subsidiaries.

Understanding of the requirement has been discussed at EU level, but the European Commission has not yet issued a Q&A regarding the issue. Based on the discussions so far, and until an authoritative decision on interpretation of the requirement is available, it will be deemed to have been fulfilled if the audit committee approves provision of non-audit services to the undertaking itself, i.e. the audited undertaking.

Provision of non-audit services to the audited undertaking's parent companies and subsidiaries must, however, be included in the audit committee's monitoring of auditor independence, cf. Section 31 (3) no. 5 of the Auditor Act, and must thus be included in any evaluation of whether the auditor can continue to audit the undertakings, notwithstanding provision of permitted services to the Danish parent undertaking and to Danish subsidiaries.

The same applies to the requirement on drawing up guidelines for an auditor's provision of permitted tax and valuation services. Until clarification is available, the requirement is deemed to be fulfilled by the audit committee drawing up guidelines for the provision of permitted tax and valuation services to the audited undertaking.

Provision of permitted tax and valuation services to Danish parent undertakings and Danish subsidiaries must also be included in the audit committee's monitoring of auditor independence, however, and thus in any evaluation of whether the auditor can continue the audit, notwithstanding provision of permitted services to Danish parent undertakings and subsidiaries.

The requirements also apply to undertakings who have opted to not set up an audit committee in accordance with Section 31 (8) of the Auditor Act.

Undertakings that have not opted to set up an audit committee or to have the board of directors undertake the audit committee's functions are referred to the description in Section 2.2 on exemption from setting up an audit committee.

*Partner rotation
(Article 17 of the
Auditor Regulation)*

The requirements on partner rotation – the replacement of the signing auditor(s) – are repealed in the Auditor Act and are now part of the Auditor Regulation.

A requirement still applies for the signing auditor(s) to be replaced within seven years of appointment. On the other hand, the period within which auditors must be replaced – the cool-off period – has been extended from two to three years.

Employment by the undertaking of former employees of the external auditor

(Section 24 c of the Auditor Act)

In its monitoring of auditor independence, furthermore, the audit committee shall observe Section 24 c of the Auditor Act, according to which the auditor(s) signing the auditor's report for the undertaking cannot accept a senior position or become a member of the board or supervisory body or an audit committee at the undertaking within two years of leaving their post as an auditor. Other auditors who have been members of the audit team are subject to a prohibition of one year.

The audit committee should therefore discuss guidelines with the board of directors for appointment of former employees of an external auditor.

4.6. Selection and recommendation of auditors

(Section 31 (3) no. 6 of the Auditor Act)

The audit committee is responsible for the procedure of selecting and recommending auditors for election in accordance with Article 16 of the Auditor Regulation.

(Article 16 of the Auditor Regulation)

The audit committee is still responsible for recommending choice of auditor to the board of directors. Formerly, it was up to the audit committee to determine the process of auditor recommendation.

This has been revised by the new Auditor Regulation, which lays down the requirements for the audit committee's selection procedure. The Regulation regulates both the situation in which continuing with an existing auditor can be recommended and that in which either a new auditor is selected or the existing auditor's engagement is extended for a period of over 10 years.

The audit committee is responsible for recommending an extension for the existing auditor, but no other requirements are laid down in the Regulation. However, the audit committee should consider the results of its monitoring of the statutory audit and of quality assurance reviews and monitoring of auditor independence before recommending continuation.

If continuation with the existing auditor or possible extension with the existing auditor for a period of over 10 years is not under consideration, the recommendation should be made after putting the audit engagement out to tender. The Regulation lays down the requirements for procurement by tender in Article 16 (3).

The audit committee shall then draw up a recommendation for choice of auditor supported by explanation, which shall contain at least two choices, and the audit committee shall express a duly justified preference for one of them.

The Auditor Regulation stipulates that extension with the same auditor for a period of over 10 years may only be done after inviting tenders. An undertaking can opt to conduct procurement by tender within the 10 year period, e.g. after seven years, and extend with the existing auditor. However, it will still be necessary to conduct procurement by tender at the end of the 10-year period if the undertaking wishes to continue with the same auditor for more than 10 years.

The Auditor Regulation does not contain detailed rules on selection of auditor and audit firms for groups. The Regulation does not, however, prevent undertakings belonging to the same group from coordinating procurement by tender with regard to selecting the same auditor or audit firm as far as possible in the group undertakings. However, when facilitating such coordination it is important that the individual group undertakings covered by the definition of public-interest entities, and thus subject to the requirements of the Auditor Regulation, each fulfil the requirements in Article 16.

*Nomination
committee*

*(Section 31 (4) of the
Auditor Act)*

A new initiative is that the job of selecting and recommending choice of auditor can be undertaken by a nomination committee. A condition of doing so is that the shareowners or owners have significant influence on the nomination committee and that the nomination committee is empowered to make recommendations for choice of auditor.

The undertaking must be able to demonstrate that the shareowners or owners have significant influence on the committee. According to the Act's notes, the requirement can, for example, be met by the general meeting appointing members of the committee or stating how members can be appointed. This means that existing nomination committees will not necessarily meet the conditions laid down by the Act.

If the task is left to the nomination committee, steps should be taken to ensure that the knowledge acquired by the audit committee, through monitoring statutory audits and quality assurance reviews and monitoring of auditor independence, is provided in good time to the nomination committee before the final decision on recommendation of auditor is made.

Contrary to what happens when the audit committee handles the task, there is no requirement for the nomination committee's recommendation to be submitted to the general meeting. It is up to the undertaking to decide whether the recommendation should be submitted.

5. Supervision and sanctions

5.1. Supervision

*(Sections 37-42 of
the Auditor Act)*

The Danish Business Authority has now been given responsibility for supervising compliance by members of the board of directors, executive board or audit committee in a public-interest entity with the duties implied by the Auditor Act, the Auditor Regulation and rules on choice and dismissal of auditors in other legislation, where the relevant rules of the Audit Directive are implemented.

The Danish Financial Supervisory Authority will act in place of the

Danish Business Authority to perform supervision concerning public-interest entities subject to supervision by the Financial Supervisory Authority. The Financial Supervisory Authority has supervised audit committees for several years as part of the general supervision of credit institutions and insurance companies.

The supervisory authority can obtain the information necessary in the course of supervision to be able to determine whether any violation of the rules has occurred.

If it is found that the rules have been violated, the supervisory authority will consider whether the violation gives grounds for:

- 1) Issuing a reprimand,
- 2) ordering that any violations be brought to an end, or
- 3) bringing a member of the board of directors or audit committee in a public-interest entity, a public-interest entity or both before the Disciplinary Board on Auditors.

A summons to appear before the Disciplinary Board on Auditors will be based on a specific consideration of the nature, scope and degree of the violation. The undertaking may be summoned along with one, several or all members of the relevant management body.

The Danish Business Authority is furthermore responsible for monitoring and appraisal of developments in the market for statutory audit services for public-interest entities. According to the Auditor Regulation, the Danish Business Authority shall evaluate the performance of the audit committee in connection with this, which shall form part of a report to the following supervisory authorities: CEAOB (auditors), ESMA (stock market), EBA (banks), EIOPA (insurance) and the European Commission. The report must be produced at least once every three years, and the Danish Business Authority can obtain details from public-interest entities for use in compiling the report.

5.2. Sanctions available to the Danish Disciplinary Board on Auditors

Sanctionable offences

(Section 44 a, (1) of the Auditor Act)

Composition of the Danish Disciplinary Board on Auditors

(Section 44 a (2) of the Auditor Act)

Sanctions

It is now possible to sanction public-interest entities or members of their board of directors, executive board or audit committee for failure to fulfil their duties according to the Auditor Act, the Auditor Regulation or rules in corporate law, which implement the Audit Directive's rules on dismissal or resignation of auditors.

Such cases are heard by the Danish Disciplinary Board on Auditors. When hearing cases, a representative of the users of financial statements with management experience from public-interest entities shall take part. This is to ensure that someone with knowledge and experience of the matters to be considered by the Board is present when a case is heard.

The Danish Disciplinary Board on Auditors can apply the following sanctions:

*(Section 44 b of
the Auditor Act)*

- 1) Warning
- 2) Fines up to a maximum of DKK 300,000.
- 3) In the event of gross or persistent negligence of duties, a person can be prohibited from being a member of one or more of the following company bodies in public-interest entities for up to three years:
 - a) The board of directors,
 - b) the executive board, and
 - c) the audit committee.