Chapter 9
The Audit Committee as Component of Corporate Governance:
The Case of the Netherlands

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ABSTRACT

Recently, numerous financial scandals (WorldCom, Enron, Parmalat, eToys) have shown that plentiful companies produce manipulated financial information. Consequently, regulators have prescribed corporate governance structures to protect investors and to avoid fraudulent financial reporting which are likely to control managers and limit their opportunistic behavior. Thus, there has been much debate over the extent to which corporate governance is playing a crucial role in increasing financial reporting quality from the theoretical perspective of agency theory, signaling theory, and stakeholder theory. This chapter aims at scrutinizing the internal and external mechanisms of corporate governance mainly the audit committee in the Dutch context. Firstly, the authors expose the numerous corporate governance mechanisms. Secondly, they focus on the audit committee as the main component of corporate governance, and they present the theoretical background, the role, and the characteristics of audit committee. Eventually, they exhibit the regulatory background of the Dutch context of the audit committee.

INTRODUCTION

The recent invigorated debate over financial reporting quality has often made reference to corporate governance structure. To address the regulators' concerns and rebuild investors' confidence, corporate governance reformers have considered the audit committee as having a central role in ensuring improved

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financial reporting quality as it is charged to oversee the financial reporting process. However, financial statements have raised the question on the effectiveness of Good Corporate Governance implementation in a company for minimizing earnings management. The conflict of interest between the management and the company owners can be minimized by a monitoring mechanism capable of balancing the interests between the management and shareholders. The level Good Corporate Governance users can be measured and it can be compared with each other. Nevertheless, the indicator of Good Corporate Governance mechanism used the mechanism of composition of Commissioners and Audit Committee. Overall, the composition of Commissioners is given the responsibilities to monitor the information quality contained in the financial statements. Regarding the Audit Committee, it consists to monitor and evaluate the planning and execution of the audit, as well as to monitor the follow-up of audit outcome for assessing the adequacy of the financial statement process (Muda et al.2018).

The present chapter is primarily motivated by the fact that, to the best of our knowledge, there has been no prior academic study dealing with the committee characteristics in the Netherlands. Given the uniqueness of the Dutch market, this chapter examines some audit committee characteristics in this context characterized by a small economic market that is quite different from that of the larger ones.

The remainder of this chapter is organized as follows. The next section presents the corporate governance definition and some governance mechanisms. In the second section, we accord more attention to the audit committee as the main component of corporate governance. Afterwards, we exhibit the regulatory background of the Dutch context in the third section. Eventually, we provide the conclusion.

1. CORPORATE GOVERNANCE: MAIN DEFINITIONS AND MECHANISMS

Corporate Governance is a concept which improve management performance in monitoring or supervising the management performance while guaranteeing the management accountability for the shareholders based on regulatory framework (Dalimunthe et al., 2016; Lubis et al., 2016). The concept of Corporate Governance is projected for achieving more transparent company management for all financial statements' users. If the concept is used properly, then the economic growth is expected to move forward in line with better transparent company management, which ultimately gives benefits to many parties.

In this section, we are going to define the main notions of corporate governance and mechanisms.

1.1. Corporate Governance: Main Definitions

Corporate governance has received increased attention and scrutiny over the last decades. In fact, corporate governance issues have became the most problematic one worldwide not only in the academic literature, but also in public policy debates.

The definition of this term is excessively "puzzling" (Aguilera et al., 2015)[1]. Actually, a great effort was made to give a universally accepted clarification. For instance, Corporate Governance was initially defined as "the total of operations and controls of an organization" (Fama and Jensen, 1983) or as "an overall structured system of principles according to which an enterprise operates and is organized, managed and controlled" (Dey, 1994).

The Cadbury Report (1992) also defined it[2] as "the systems and methods by which companies are controlled and managed". Another definition is granted by Parkinson (1994) which defines that Corporate

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