

Audit Committees

Introducing new regulations

*Audit committees:
A summary of new
regulations effective
20 November 2010*

Audit Committees - New Regulations

Introduction

The European Communities (Statutory Audits)(Directive 2006/43/EC) Regulations 2010 (the Regulations) were signed into Irish law on 20 May 2010 as Statutory Instrument 220 of 2010. The Regulations require that public interest entities (with some exceptions) establish an Audit Committee by 20 November 2010. In addition the Regulations set out in law:

- certain responsibilities of the Audit Committee, and
- the qualification criteria to be met by those who serve as independent members of the Audit Committee

These responsibilities and qualification criteria will apply to existing public interest entity Audit Committees as well as those newly established in accordance with the Regulations.

Public Interest Entities

Public Interest Entities are defined in the Regulations as follows:

- EEA* companies, or other corporate bodies, with transferable securities admitted to trading on a regulated market within the EEA.
- Credit Institutions
- Insurance undertakings

Each Public Interest Entity, with certain exceptions, is required to establish an Audit Committee by 20 November 2010.

Are you exempt?

The categories of entity exempted by the Regulations from the requirement to establish an Audit Committee are:

- A subsidiary company where its EU parent has an Audit Committee that has responsibilities and membership that

comply with the requirements of the Regulations in such a manner as to ensure that it has purview of the subsidiary's audit.

- UCITs
- Regulated non- UCITs that have depository exercising functions
- Credit Institutions which do not have securities listed on a regulated market, have not issued a prospectus and have issued debt securities with a total nominal amount of less than €100,000,000.
- Securitisation entities with the sole business of issuing asset-backed securities (SPVs)

If an SPV avails of the exemption, it is required to make a statement of the reason it has not established an Audit Committee in any annual report it issues and in all periodic statements it makes to the Companies Registration Office or to the Central Bank of Ireland.

Membership of the Audit Committee

At least two independent directors of the Public Interest Entity must be members of the Audit Committee. The Regulations set out that independence is to be demonstrated by:

- A statement in the terms of the director's appointment to the Public Interest Entity that he/she is appointed in a non-executive capacity and
- At no time in the three years prior to the appointment to the Audit Committee was the director
 - an employee of the Public Interest Entity or
 - in a material business relationship with the Public Interest Entity.

*All EU incorporated companies and companies incorporated in Iceland, Lichenstein and Norway



Public Interest Entities must comply with all the requirements of the Regulations in relation to Audit Committees

Additionally, the Regulations require that at least one of the independent director members of the Audit Committee be competent in Accounting or Auditing.

Responsibilities of the Audit Committee

The responsibilities which the Regulations require an Audit Committee to fulfil are:

- Monitoring of the financial reporting process
- Monitoring of the effectiveness of the Public Interest Entity's systems of
 - Internal control,
 - Internal audit, and
 - Risk management
- Recommending the statutory auditor or audit firm to the Board of Directors for appointment
- Review and monitoring of the:
 - independence of the statutory auditor or audit firm; and
 - the provision by the statutory auditor or audit firm of additional services to the Public Interest Entity.
- Monitoring of the statutory audit of the annual and consolidated financial statements.
- Receiving reports of the statutory auditor or audit firm relating to
 - Key matters arising from the statutory audit
 - Material weaknesses in internal control relating to the financial reporting process.

Audit Committees may also adopt responsibilities additional to those required by law.

The new requirements apply to existing audit committees of public interest entities as well as those newly-established under the regulations

Do you already have an Audit Committee?

A Public Interest Entity with an Audit Committee already established may need to consider whether that Committee satisfies all the requirements of the Regulations.

Listed Companies

Until now, under the listing rules of the Irish Stock Exchange ("ISE"), a listed company could either set up an Audit Committee or explain why it had not done so. This option will no longer exist for Public Interest Entities which are required to have an Audit Committee under the Regulations.

The ISE announced on 29 September 2010 that its listing rules will require companies with equity shares listed on that exchange for financial periods commencing on or after 30 September 2010 to comply with:

- the UK Corporate Governance Code (previously the Combined Code on Corporate Governance), and
- a separate Irish corporate governance annex that will be set out in the ISE Listing Rules for financial periods commencing on or after 1 January 2011.

The proposed annex's requirements will address the recommendations made in the ISE/IAIM Report on Compliance with the Combined Code on Corporate Governance, published in March 2010. The responsibilities of the Audit Committee prescribed by the Regulations are similar to those required by the UK Corporate Governance Code but the Irish corporate governance annex is expected to introduce further requirements for Audit Committees in relation to the information they provide in the Annual Reports.

Audit Committees should review the independence criteria of the Regulations as they are different from those of the UK Governance Code. Additionally under the Regulations any failure to satisfy the Independence criteria will prevent a non-executive director becoming a member of the Audit Committee.

Credit Institutions and Insurance Undertakings

The Financial Regulator (now the Central Bank of Ireland) issued a consultation paper on Corporate Governance Requirements for Credit Institutions and Insurance Undertakings in April 2010. This paper envisages a regulatory framework for the proposed new corporate governance requirements. The new requirements have not yet been published following the consultation process but are imminent.

Among the proposed new requirements is a stipulation that all members of an Audit Committee should be non-executive directors, the majority of them independent. The Independence criteria are different again to those set out in the Regulations and in the UK Corporate Governance code. The proposals also recommend responsibilities for the Audit Committee which are similar to those in the Regulations.

The expected requirements of the Central Bank of Ireland will be in addition to the requirements of the Regulations as described in this publication.

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