

European
Communities
(Statutory Audits)
(Directive
2006/43/EC)
Regulations 2010

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European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010

The Minister for Enterprise, Trade and Innovation has published the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 (the “Regulations”) to give effect to Directive 2006/43/EC on statutory audits.

The Regulations provide for an approval process for statutory auditors. They also provide for the establishment of a public register of auditors, contain detailed provisions with regard to public oversight of statutory auditors and set out provisions regarding the independence of auditors.

Of particular interest are the provisions requiring public-interest entities to establish audit committees. The Regulations also contain provisions in respect of the removal of auditors, the independence of auditors and the disclosure of auditor’s remuneration in company accounts. For the purposes of the Regulations “public-interest entities” are defined as:

- (a) companies whose transferable securities are admitted to trading on a regulated market of any Member State (in Ireland this means the Main Securities Market of the Irish Stock Exchange);
- (b) credit institutions; and
- (c) insurance undertakings.

Audit Committees

The Regulations include for the first time a statutory requirement for public-interest entities to establish an audit committee. The committee must be established within six months of the date of the Regulations and must include no less than two non-executive directors who possess the requisite degree of independence so as to enable them to contribute effectively to the committees functions.

The Regulations specify that in order to have the requisite degree of independence, a non-executive director at no time during the three years preceding his/her appointment to the committee, should have had a material business relationship with the public-interest entity either directly, or as a partner, shareholder, director or senior employee of a body that has

such a relationship with the company or held a position of employment in the public-interest entity. One of the independent non-executive directors must have a competence in accounting or auditing. The responsibilities of the audit committee include the monitoring of the financial reporting process, the effectiveness of the entities systems of internal control, internal audit and risk management, the statutory audit, and the independence of the statutory auditor or audit firm.

The Regulations provide that the statutory auditor or audit firm shall report to the audit committee of the public-interest entity on key matters arising from the statutory audit of the entity, and, in particular, on material weaknesses in internal controls in relation to the financial reporting process.

Subsidiaries of undertakings which comply with the Regulations, UCITS funds and most EU non-UCITS funds are exempt from the requirement to have an audit committee.

Removal of Auditors

Where an auditor ceases to hold office either by virtue of Section 160 of the Companies Act 1963 or Section 185 of the Companies Act 1990, the auditor is obliged under the Regulations to notify the Irish Auditing and Accounting Supervisory Authority ("IAASA") within one month of the date of cessation.

Where the auditor resigns the notification must be accompanied by the notice served under Section 185(1) of the Companies Act 1990. For the purposes of the Regulations, resignation includes an indication of unwillingness to be re-appointed at an annual general meeting. Where that notification specifies that there are no circumstances connected with the resignation which the auditor concerned consider should be brought to the notice of the members or creditors of the company, it must be accompanied by a statement of the reasons for the auditors resignation.

In the case of the removal of an auditor at a general meeting pursuant to Section 160(5) of the Companies Act 1963, a copy of any representations made in writing to the company must accompany the notification to IAASA.

In addition to the requirements for the company to notify the Registrar of Companies under both Section 160 of the Companies Act 1963 and Section 185 of the Companies Act 1990, it must under the Regulations also notify IAASA within one month of the date of the auditor ceasing to hold office. In the case of a resignation of the auditor the notice served by the company on IAASA must be accompanied by the notice served by the auditor under Section

185(1) of the Companies Act 1990. In the case of the removal of the auditor at an annual general meeting the notice sent to IAASA by the company must be accompanied by a copy of the resolution removing the auditor and a copy of any representations made to the company by the auditor.

The Regulations impose a new restriction on the ability of a company to remove an auditor by virtue of passing an ordinary resolution at the companies annual general meeting which applies to a resolution seeking to remove an auditor from office, a resolution appointing somebody other than the retiring auditor as auditor, and a resolution providing expressly that the retiring auditor shall not be reappointed.

The Regulations provide that the passing of a resolution which relates to the removal of the auditor from office shall not be effective unless there are good and substantial grounds for the removal related to the conduct of the auditor in the performance of his duties as auditor of the company or otherwise. Diverging opinions on accounting treatment or audit procedures cannot under the Regulations constitute the basis for the passing of a resolution to remove the auditors of a company.

Independence

Regulation 70 provides that when carrying out a statutory audit the statutory auditor or audit firm shall be independent of, and not involved in, the decision taking of the audited entity. A statutory auditor or audit firm may not carry out a statutory audit if there is a relationship between the statutory auditor or audit firm and the audited entity. The statutory auditor or audit firm will be considered to have a relationship with an audited entity where there is any direct or indirect financial, business, employment or other relationship from which an objective, reasonable and informed third party will conclude that the statutory auditors or audit firms independence is compromised.

Regulation 71(3) provides that if the statutory auditors or audit firms independence is effected by threats, such as self review, self interest, advocacy, familiarity or trust or intimidation, the statutory auditor or audit firm shall apply safeguards in order to mitigate those threats. If the significance of the threats compared to the safeguards applied is such that his independence is compromised, the statutory auditor or audit firm shall not carry out the statutory audit.

There are additional requirements in the case of public-interest entities. A statutory auditor or audit firm shall not carry out a statutory audit of a public-interest entity in circumstances which involve a case of self review or self interest and from the circumstances of which case

an objective, reasonable and informed third-party will conclude that (so as to safeguard the statutory auditors or audit firms independence) the auditor's or firm's not carrying out that audit would be appropriate.

Statutory auditors and audit firms are required to document in audit working papers all significant threats to their independence as well as the safeguards applied by them to mitigate those threats.

Statutory auditors or audit firms carrying out a statutory audit of a public-interest entity are required to (a) confirm annually, in writing to the audit committee of the entity his, her or its independence from the public-interest entity, and (b) disclose annually to the audit committee any additional services provided to the public-interest entity and discuss with the audit committee the threats to the independence of the auditor or firm and the safeguards applied to mitigate those threats.

Disclosure of Auditors Remuneration in Accounts

The Regulations require the disclosure in notes to annual accounts of the remuneration for all work in respect of audit services, other assurance services, tax advisory services and other non-audit services.

There is an exemption for small and medium sized companies and companies which are subsidiary of a companies which prepares group accounts in accordance with the Group Accounts Regulations, the European Communities (Credit Institutions: Accounts) Regulation 2002 or the European Communities (Insurance Undertakings: Accounts) Regulations 1996.

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