

21 November 2006

Mr Michael Ahern, T.D.,
Minister for Trade and Commerce
Kildare Street
Dublin 2

Dear Minister

I am writing to you today to set out my views and recommendations with respect to the commencement of Section 42 of the Companies (Auditing and Accounting) Act 2003 which inserts a new Section 205B into the Companies Act 1990 ("Section 205B") and makes provision for audit committees in public limited companies and certain large private companies.

In advance of the commencement of this provision, the ODCE has, as you know, been engaged this year in a public consultation exercise with respect to draft guidance on this new audit committee provision. Some 18 submissions were received, and my Office has now finalised its guidance in this area having taken account of the useful comments and observations contained in these submissions. I intend to publish this guidance in the next few days, subject to finalisation of a number of technical matters. The guidance is focused predominantly on the provisions of Section 205B, and it avoids repeating the contents of various codes of best practice with respect to audit committees which are readily available from other sources. A copy of this guidance is also enclosed with this letter.

You may recall that in publishing our draft guidance earlier this year, we specifically invited comment both on the draft ODCE guidance on audit committees and on a number of issues with respect to Section 205B which fall for decision by you. Our Consultation Paper suggested that correspondents could relay their views on these issues direct to you as well as responding to the ODCE. At our meeting on 16 June last, I said that I would give you our perspective on these matters prior to your addressing the commencement of Section 205B. The issues in question are:

- the date and form of commencement of Section 205B;
- the companies affected by the provision;
- the qualifying turnover and balance sheet thresholds and
- the composition and operation of audit committees and the qualification of their members.

I append herewith a summary of the comments which were made to us by various parties on these issues and related matters (see **Appendix 1**). I am also attaching an ODCE commentary on the relevant matters which explains the approach of the ODCE to the substantive comments which have been made (see **Appendix 2**). I can make available to your Department on request a full set of the submissions received by us.

On the basis of the ODCE conclusions contained in Appendix 2, I propose that you consider the following ODCE recommendations with respect to these issues:

- the date and form of commencement of Section 205B: The Section be commenced for all financial reporting periods commencing on or after 1 April 2007;
- the companies affected by the provision: The Section be commenced with an immediate exemption for:
 - every Irish-registered public limited company which is a wholly owned subsidiary undertaking of a public limited company registered outside the State and which has a duly constituted audit committee and
 - every unlisted public limited company that does not meet the specified balance sheet total and turnover thresholds contained in Section 205B(1).

The Minister may also wish to discuss with the Financial Regulator and the Revenue Commissioners (where appropriate) the extent to which immediate exemption should also be given to other classes of company or undertaking within the meaning of Article 41(6) of the 8th Directive, including:

- every company or undertaking the sole business of which is to act as an issuer of asset-backed securities as defined in Article 2(5) of Commission Regulation (EC) No. 809/2004, subject however to the obligation of disclosure contained in Section 205B(4);
- every investment company or undertaking which is a collective investment undertaking as defined in Article 1(2) of Directive 85/611/EC, and
- every credit institution within the meaning of Article 1(1) of Directive 2000/12/EC subject to the conditions in Article 41(6);
- the qualifying turnover and balance sheet thresholds: The Section be commenced without altering the existing thresholds;
- the composition and operation of audit committees and the qualification of their members: The Section be commenced having transposed the following requirements from Article 41 of the 8th Directive:
 - the requirement that at least one member of the audit committee shall have competence in accounting and/or auditing, and

- the requirement that the audit committee shall monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems.

Although it would be preferable, in the view of the ODCE, to commence Section 205B having transposed all of the new elements required by Article 41, these stricter requirements could be postponed and introduced nearer the deadline of 29 June 2008 for transposition of the 8th Directive if the Minister so wished.

Pending your decisions on the above matters, I have decided to publish the ODCE Guidance on Audit Committees now in order to help companies and audit committee members prepare in good time for compliance with the provisions of both Section 205B as it stands and the associated Article 41 of the EU's 8th Directive. The ODCE Guidance discusses both provisions and suggests in respect of the Directive that boards of directors and audit committee members in particular may wish to take the new EU law into account in defining the role of their audit committees. It would obviously be my intention to make any required adjustments to this Guidance after you make the relevant statutory instruments giving effect to your decisions on the above issues.

I am of course available for consultations with your Department on these issues in the coming weeks.

Yours sincerely

Paul Appleby
Director of Corporate Enforcement

cc Ms Breda Power, A/Secretary, D/Enterprise Trade and Employment

**Summary of Responses Received to Consultation Paper C/2006/1: ODCE
Guidance on Audit Committees**

Comments on Questions of Relevance to the Minister

a) Date of Commencement

Interpolis Reinsurance Services Limited: Believe two months is too short a period for implementation.

John Moore: Commencement date proposed (originally 1 July 2006) is acceptable.

Institute of Chartered Secretaries and Administrators (ICSA): Commencement should follow end of consultation process. Should apply to companies for periods commencing on or after commencement date. Should apply to subsidiaries' accounting periods commencing on or after date of commencement for parent company, to avoid situations where a subsidiary may qualify prior to its parent company.

KPMG: Legislation should be commenced but in a limited fashion. Amend remainder of section to bring it into line with EU 8th Directive before bringing the complete section into effect. In effect commence requirements (a) to (d) and then require the committee to consult with the board and prepare for approval by the board and for inclusion in the directors' report a statement describing the extent to which the committee's remit incorporates all other matters set out in the section, together with explanations for any omitted.

UCD Diploma in Corporate Governance Class ("UCD Dip"): Agree with the proposal.

Irish Bankers' Federation (IBF): Believe there should be a full consultation process followed by a proper implementation period to allow any necessary changes by companies. Perhaps a "wait and see" approach is appropriate to consider EU 8th Directive and Financial Regulator's Guidance Note on Corporate Governance.

Institute of Chartered Accountants in Ireland (ICAI): A number of elements are out of date, e.g., Directors' Compliance Statements. Other elements await commencement of the 2003 Act, e.g., provisions relating to recognition of accounting standards. S.I. 116 of 2005 and the Investment Funds, Companies and Miscellaneous Provisions Act 2005 introduced highly technical changes. Any implementation of this legislation should be on the basis of careful consultation, including IAASA. In addition, the EU 8th Directive is not fully reflected in the legislation, specifically the monitoring of the effectiveness of internal control. In summary, commencement should be deferred pending a review and refinement of its provisions.

William Fry: Commencement should be deferred to allow companies time to ensure compliance. They agree that it should apply to all periods commencing on or after commencement.

Ernst & Young: Certain elements of the legislation are obsolete or uncommenced. In addition the EU 8th Directive will require further change. In summary they see no pressure for its commencement. Listed companies already report under a sound framework.

Robert J Kidney, Chartered Accountants: 1 July 2006 too soon. Suggests 1 December 2006.

Association of Chartered Certified Accountants (ACCA): Difficulties in commencing legislation where elements are obsolete or uncommenced. Also the legislation does not take into account the EU 8th Directive. It should not be commenced until these are resolved. After revised guidance issues, there should be a clear six month gap before commencement.

Ulster Bank: Commencement should be from 1 January 2007.

b) Scope of companies to be affected by the provision

John Moore: All companies over the exemption limit should be required to have audit committees.

ICSA: Large private companies that are subsidiaries of plcs should be exempted.

IBF: Securitisation vehicles should be exempted. So should “funds entities”.

ICAI: Consideration and consultation on the scope of application is necessary.

William Fry: Financial thresholds should also apply to unlisted plcs. Members of Stock Exchanges which already require Audit Committees as part of their listing rules should be exempted. Consideration should be given to exempting entities in the fund management industry.

Ernst & Young: All subsidiaries should be exempt. Securitisation vehicles should be exempt. Also, plcs that are subsidiaries of plcs incorporated outside the State that have a duly constituted Audit Committee. Also, plcs that do not trade, as well as holding companies whose subsidiaries do not trade. Investment funds should also be exempt, as well as any other entity exempt under the EU 8th Directive. Section 42 should not be implemented for private companies at this juncture.

Robert J Kidney: Thresholds should apply to plcs also.

Ulster Bank: All subsidiaries, whether private or plc, should be exempted.

c) Qualifying balance sheet and turnover thresholds

John Moore: Thresholds should be retained pending experience but this period should not exceed three years.

IBF: If turnover thresholds are to be changed, this should happen before commencement rather than forcing companies to incur compliance costs when they may subsequently fall outside the requirements. Understand that thresholds under EU 8th Directive depend on definition of “Public Interest Company”. Should both definitions be conformed?

d) Composition of audit committees, qualifications of members and operation of audit committees

John Moore: One member should have financial experience, and appointments should be for three year periods. Remainder should not be amended pending experience but this period should not exceed three years.

UCD Dip: Legislation is deficient in respect of the independence of the members. Members should not have any material relationship with the company or be in a position to benefit financially from decisions made by the company. More guidance on necessary skills for members should be included.

IBF: EU 8th Directive will introduce certain measures to enhance auditor independence and objectivity and clarify their duties. May be more appropriate to introduce measures through transposition of this Directive.

ICAI: The Institute is strongly against the prescriptive nature of obligations of audit committees. This removes flexibility and in certain aspects the law is already out of date.

William Fry: Audit Committee should allow non-executive Chairman of Board to be on Audit Committee. In complying with NASDAQ rules, companies have an audit committee member with a high level of financial expertise. Frequently the person who meets these criteria is also the person best suited to be chairperson of the Board.

Ernst & Young: Strongly disagree with the need to enshrine in legislation emerging “best practice.”

Office of the Director of Corporate Enforcement
21 November 2006

ODCE Commentary on the Submissions received on the scope of Section 205B

Commencement Date

1. The ODCE's Consultation Paper proposed that Section 205B be commenced with effect from company financial years starting on or after 1 July 2006.
2. The comments received on this proposal included:
 - acceptance of this proposal;
 - commencement some time after the end of the consultation period (i.e., 26 May 2006);
 - suggestions of later dates (e.g., 1 January 2007);
 - commencement some six months after issue of the revised guidance and
 - postponement pending transposition of the audit committee elements included in the EU's 8th Directive.
3. The ODCE believes that as indicated below, only minor adjustments to Section 205B are required to give effect to the relevant provisions of the EU's 8th Directive and that these elements can be readily accommodated on commencement or where the Directive's provisions entail higher standards than those contained in Section 205B, before the transposition deadline of 29 June 2008.
4. Accordingly, the ODCE proposes that the Minister commence Section 205B for company financial years commencing on or after 1 April 2007. Companies will accordingly not be obliged to comply with Section 205B until the start of their following financial year which in many cases will be the financial year starting 1 January 2008. Having regard to the fact that many qualifying companies will already have audit committees, little or no additional regulatory burden will be involved for them in complying with Section 205B. To the extent that some work is involved, the ODCE submits that its proposal provides sufficient lead-in time for them to make the required preparations.

Affected Companies

5. Various proposals were made with respect to reducing the scope of companies which would be subject to Section 205B. Suggestions included:
 - securitisation vehicles;
 - investment funds entities;
 - all subsidiaries, whether private or public companies,
 - large private companies that are subsidiaries of public limited companies;
 - public limited companies that are subsidiaries of public limited companies incorporated outside the State that have a duly constituted audit committee;
 - public limited companies that do not trade;
 - holding companies whose subsidiaries do not trade;
 - unlisted public limited companies that do not meet the specified balance sheet total and turnover thresholds.

6. In reviewing these exemption suggestions, it is useful to recall that under Section 205B, audit committees are only mandatory for Irish-registered public limited companies (other than public limited companies which are wholly owned subsidiary undertakings of Irish-registered public limited companies). For the qualifying large private companies and relevant undertakings, a 'comply or explain' regime only operates. In other words, these entities are only required to disclose the nature of the decision they have made with respect to an audit committee, and where they have decided not to establish one, to give the reasons for that decision. In the circumstances, the ODCE sees little merit in exempting entities that are only subject to a 'comply or explain' regime from this limited disclosure obligation.

7. On the other hand, it is appropriate to examine if there are Irish-registered public limited companies which are subject to a mandatory requirement to have an audit committee when such an obligation is unnecessary or excessively onerous. In the ODCE's view, two of the suggestions made are worthy of consideration.

8. Section 205B(16)(a) already exempts Irish-registered public limited companies which are wholly owned subsidiary undertakings of Irish-registered public limited companies. There would seem to be little reason why this should not be extended to Irish-registered public limited companies which are wholly owned subsidiary undertakings of public limited companies which are registered in other jurisdictions in the EU, US or elsewhere and which have a duly constituted audit committee. It would seem unnecessary to require that an audit committee should be established for an Irish subsidiary when that subsidiary is already within the remit of the parent's audit committee.

9. The ODCE is also disposed to the suggestion that unlisted public limited companies that do not meet the specified balance sheet total and turnover thresholds should also be exempted. It would seem unduly onerous and inappropriate to require that small unlisted public limited companies which have been incorporated in anticipation of a planned listing at some time in the future or because the planned corporate activity cannot be undertaken through the vehicle of a private company (due, for instance, to the prohibition on inviting public subscriptions for shares and the limit of 50 members contained in section 33(1) of the Companies Act 1963) should be subject to a requirement to have an audit committee pursuant to Section 205B.

10. In the circumstances, the ODCE believes that it would be appropriate to exempt:

- every Irish-registered public limited company which is a wholly owned subsidiary undertaking of a public limited company registered outside the State and which has a duly constituted audit committee and
- every unlisted public limited company that does not meet the specified balance sheet total and turnover thresholds contained in Section 205B(1),

on the basis that it would be unnecessary or excessively onerous for these companies to be required to comply with the mandatory requirements of Section 205B.

11. The ODCE is not disposed to recommend that the Minister exempt the following classes of company and undertaking from the scope of Section 205B for the reasons indicated:

- public limited companies that do not themselves trade: These companies may nevertheless have substantial subsidiaries which would warrant review by an audit committee;
- holding companies whose subsidiaries do not trade: These companies may themselves have a large trading business which would warrant compliance with Section 205B;
- all subsidiaries, whether public or private companies: These subsidiaries are either already exempted under Section 205B(16)(a) or are only subject to the light ‘comply or explain’ approach provided for in Section 205B where they meet the qualifying balance sheet total and turnover thresholds.

12. The ODCE notes that with respect to securitisation vehicles and investment fund entities, Article 41 of the 8th Directive permits the exemption of certain securitisation vehicles, collective investment undertakings and certain credit institutions from the requirements of Article 41. While the general ODCE approach to exemption requests is in agreement with that outlined in paragraph 6 above, the ODCE is conscious that it has had no submission in these areas from either the Financial Regulator or the Revenue Commissioners. Accordingly, the ODCE will leave it to the Department of Enterprise Trade and Employment to invite both organisations to comment on these particular matters to the extent that these organisations’ views are not already known to the Department.

13. As to the timing of any exemptions, the ODCE considers that any Ministerial regulations under Section 48(1)(j) of the 2003 Act exempting additional entities from the scope of Section 205B should apply with effect from the date of commencement of Section 205B. Any such regulation is subject to Section 49 of the Act which requires that a resolution be passed by each House of the Oireachtas before the regulation can be effective.

Qualifying Balance Sheet and Turnover Thresholds

14. No strong view was expressed in favour of altering the current thresholds contained in Section 205B, and accordingly, the ODCE proposes that these thresholds should be commenced unchanged.

Composition and Operation of Audit Committees and Qualification of Members

15. There was some criticism of the scope of the current requirements in Section 205B as enacted on the grounds that they are too prescriptive. On the other hand, comments were made in favour of more explicit requirements with respect to the qualification of audit committee members.

16. The ODCE takes the view that it would be inappropriate to reopen the content of Section 205B as enacted, save that account should be taken of the relevant provisions of the EU’s 8th Directive which must in any event be transposed into Irish

law by mid-2008. Two provisions from Article 41 of the Directive are relevant in this context, neither of which is contained in Section 205B as enacted. These relate to:

- the requirement that at least one member of the audit committee shall have competence in accounting and/or auditing, and
- the requirement that the audit committee shall monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems.

17. The ODCE is of the view that both of these requirements will be in place in practice in many existing audit committees and that the amendment of Section 205B to accommodate them would not be an onerous imposition on qualifying companies. Accordingly, the ODCE recommends to the Minister that regulations under Section 48(1)(m) of the Companies (Auditing and Accounting) Act 2003 Act should be made to give effect to the above new requirements with effect from the proposed commencement date of Section 205B. However, these stricter requirements could be postponed and introduced nearer the deadline of 29 June 2008 for transposition of the 8th Directive if the Minister so wished.

Other Issues

18. Reference was made in a number of submissions to the fact that Section 205B(2)(f), (g) and (h) deals with the question of directors' compliance statements which will be the subject of amending legislation in due course. The ODCE does not see this as a barrier to the commencement of the rest of Section 205B, although for the avoidance of doubt, the commencement order may require to omit the relevant paragraphs.

Office of the Director of Corporate Enforcement
21 November 2006