Issue 8

Audit Committee Quarterly

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Audit Committee Institute Ireland

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Background

Recognising the importance of audit committees, Audit Committee Institute Ireland (ACI) has been established to serve audit committee members and help them to adapt to their changing role.

Historically, audit committees have largely been left on their own to keep pace with rapidly changing information related to governance, audit issues, accounting and financial reporting. Supported by KPMG, the ACI provides knowledge to audit committee members and a resource to which they can turn at any time for information or to share knowledge.

Our primary objective is to communicate with audit committee members and enhance their awareness and ability to implement effective audit committee processes.

The ACI aims to serve as a useful, informative resource for audit committee members in such key areas as:

- audit committee governance, technical and regulatory issues;
- sounding board for enhancing audit committees' processes and policies;
- surveys of trends and concerns.

The ACI is now in direct contact with over 1,000 ACI members. For more information on the work of the ACI please click on our Web site:
www.auditcommitteeinstitute.ie or **e-mail: info@auditcommitteeinstitute.ie**

Welcome

Kevin O'Donovan
Chairman
Audit Committee Institute
Ireland

Welcome to the latest edition of **Audit Committee Quarterly** Ireland, a publication designed to help keep audit committee members abreast of developments in corporate governance and related matters.

For those of you new to the Audit Committee Institute (ACI) and this publication in particular, a brief outline of the background to ACI is set out opposite.

The content of the eagerly awaited and recently published Company Law Review Group (CLRG) report on the Directors' Compliance Statement is outlined on **page 2**.

As listed companies in Ireland and Europe meet the challenge of IFRS for the first time, we report on the results of a recent KPMG survey that shows that the introduction of IFRS resulted in an average profit swing of 43%. The key survey points are set out on **page 4, IFRSs cause significant swings in companies' reported profitability.**

A review conducted by KPMG UK of **Non-executive director fee levels** highlights some interesting data including fee levels paid by industry sector and company size, together with additional fees paid to board committee members **(page 6).**

We continue our **Audit committee insights** series in which we aim to bring you articles of interest from around the globe. In this edition, we include a piece **These days, is management the biggest risk of all? (page 10)** which focuses on the often neglected area of management risk.

Also included are regular updates on international and financial reporting developments.

Our next general breakfast seminar will take place on 24 January 2006 in the Conrad Hotel. We are delighted to welcome Dr. Tom Courtney, Chairman, CLRG and Mr. Paul Gardiner, SC as speakers.

I hope you will continue to enjoy the ongoing benefits of ACI. Please contact us at info@auditcommitteeinstitute.ie with any comments or suggestions of topics you would like to see covered and do visit our Web site at www.auditcommitteeinstitute.ie for further information on ACI.

Directors' compliance statements and other corporate governance developments

Following concerns expressed about the impact of the requirements for directors' compliance statements introduced by the Companies (Auditing and Accounting) Act 2003 on costs and competitiveness of Irish business, the Company Law Review Group (CLRG) was commissioned during 2005 to review the proposed new reporting requirements. The referral provided a welcome opportunity for re-assessment of the benefits and costs of the new provisions by a group with representation from all parties with an interest in Irish business.

> ...restriction of directors' statements to the two elements of company and tax law, excluding the very wide-ranging category of 'other enactments'

The government has now announced a new model based on the CLRG's report, applying to listed companies and large private companies only. It is substantially less onerous than the original provisions of the 2003 Act.
Under the new model directors must:

- adopt a compliance policy statement;
- acknowledge their responsibilities with regard to these obligations; and
- confirm that arrangements or structures are in place which, in the opinion of the directors, are designed to secure material compliance.

The new model also adopts a 'comply or explain' approach.

The revised approach will allow boards to focus on ensuring compliance with relevant law in a manner that fits with their companies' businesses and processes. It also allows practice in Ireland to develop more in line with other EU-wide developments in governance reporting, under consideration as the 4th and 7th Directives are updated.

Two changes in particular lead to a much more tightly focused and practical reporting regime:

- restriction of directors' statements to the two elements of company and tax law, excluding the very wide-ranging category of 'other enactments' that might have a material effect on a company's financial statements;
- less prescriptive requirements relating to annual review by the directors of arrangements to ensure compliance.

These and the new threshold for private companies – the directors' statements will be required for companies with both turnover and assets of €25 million and €12.5 million – mean that the extent of additional costs to Irish business is greatly lessened.

The principal differences between the original and amended model are set out in the table opposite.

Timing

It is expected that the necessary amendments to section 45 of the 2003 Act (which has not been commenced) will be incorporated in the forthcoming Companies Consolidation Bill, with likely effect in 2007.

Directors' compliance statements – changes following CLRG review	
2003 Act	**Amended compliance statement**
Applied to all listed companies and private companies meeting **either** of two size criteria: - €15.2 million turnover; or - €7.6 million balance sheet total.	Will apply to listed companies and larger private companies meeting **both** of two criteria: - €25 million turnover; and - €12.5 million assets.
Statements to cover three areas of law: - company law; - tax law; - other laws that may have a material effect on the company's financial statements.	Statements to cover two areas of law: - indictable offences under company law; - tax law.
No allowance for materiality or significance of legal obligations.	Focus on material compliance.
Obligation on directors to undertake all reasonable endeavours to ensure compliance, including a detailed review of procedures.	Less prescriptive requirement, allowing directors and boards to focus on the adequacy of overall arrangements rather than detailed procedures.
Auditor to undertake a review and report opinion as to whether the statements are fair and reasonable.	No specific auditor report.

Combined Code

The changes to the directors' compliance statements should allow a much better fit with the existing obligation of directors of listed companies to report on compliance with the Combined Code on Corporate Governance.

Recent reviews of the operation of the Combined Code – and the related Turnbull Guidance on meeting its requirements relating to internal controls – have endorsed the principle-led approach taken to date. However, a number of limited changes have been made to the Turnbull guidance, notably an obligation for boards to confirm that necessary action has been taken, or is being taken, to remedy any significant failing or weakness identified in its review.

New requirements for directors' reports to describe risks and uncertainties

A different reporting challenge faces directors of all Irish companies in the form of a new component in directors' reports, requiring them to include commentary on the "principal risks and uncertainties" affecting the company. This new disclosure – which applies to 2005 year ends – has been rather overshadowed by other changes to company law needed to accommodate the application of IFRS and is required to be a balanced and comprehensive analysis commensurate with the size and complexity of the company. Additionally – to the extent necessary to understand the company's development, performance or financial position – the directors must give an analysis of financial (and, where appropriate, non-financial) key performance indicators relevant to the business, including environmental and employee data.

Financial institutions

Changes to the company law framework for directors' compliance statements do not affect the equivalent provisions under the Central Banks Acts allowing the Irish Financial Supervisory and Regulatory Authority (the Financial Regulator) to require financial institutions to provide compliance statements – though it is likely that the new model will affect the approach taken by the Financial Regulator. Consultation is expected during 2006.

Overall, what is the message for boards and audit committees? Action to make the compliance regime better balanced is a very welcome indication that concerns were heard and understood. Stake holders should be reassured to see that the new model nevertheless remains robust. Ensuring business is done both efficiently and in a manner that meets legal and regulatory obligations – a central element in underpinning Ireland's place in international markets – will remain clearly on boards' agendas.

IFRSs cause significant swings in companies' reported profitability

An analysis by KPMG of the 2004 financial results of 45 European blue chip companies restated under International Financial Reporting Standards (IFRSs) has found that the new standards resulted in an average profit swing of 43%.

For some of the companies – which were based in the UK, France and the Netherlands – the profit swing was upwards, while for others it was down. The largest positive swing was + 407%, while the largest negative change was – 30%. The average effect varied greatly from company to company, and also from country to country: in France the average swing was over 60%, while in the UK it was 36% and in the Netherlands 27%.

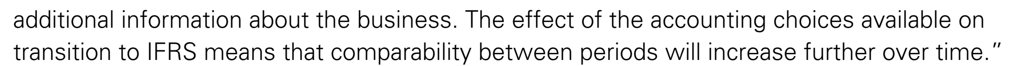
These figures represent the impact on reported profit or loss. One significant impact for many companies is the non-amortisation of goodwill under IFRSs – a change that will increase reported profit or loss if goodwill previously was amortised. Excluding the impact of this change, the average profit swing was 24%.

KPMG's analysis suggests that many companies are taking advantage of the available exemptions by not applying IFRSs to old transactions. For example 58% chose not to expense old share based payments, only 4% chose to restate their previous business combinations (acquisitions) and 58% have chosen not to apply the complex IFRS standards on financial instruments (including IAS 32 and IAS 39) to their restated comparative for 2004. The financial instruments standards also illustrated surprising differences between countries: 86% of the UK companies surveyed chose not to apply the financial instruments standards to their restated comparatives compared with only 29% of French and 40% of Dutch companies.

The analysis also suggests that companies often are applying IFRSs in a way that reflects historical (previous GAAP) accounting, when permitted by IFRSs. For example, in the UK most companies (more than 90%) have chosen to recognise pension obligations in full under IFRSs. By contrast, only 36% of French companies chose to recognise pension obligations in full.

The largest positive swing was + 407%, while the largest negative change was – 30%.

Commenting on the figures, Darina Barrett, KPMG Dublin's Lead International Financial Reporting partner, said: "The widespread application of IFRSs will deliver significant improvements in cross-border comparability and consistency. However, the choices available on transition and in accounting treatments going forward will mean that analysts must look beyond headline figures when making comparisons, particularly cross-border. Understanding the impact of the transition to IFRSs will be key to identifying which impacts are accounting-related and which may provide



additional information about the business. The effect of the accounting choices available on transition to IFRS means that comparability between periods will increase further over time."

KPMG's analysis found that the greatest area of impact of IFRS on income statements was the non-amortisation of goodwill (amongst the three most significant adjustments for 63% of companies). Other significant areas were financial instruments (35%), pensions (33%), share-based payments (28%) and intangible assets (26%) – all of which are treated differently under IFRS than under old national GAAP.

Restatement under IFRS also had an impact on companies' equity levels – at an average of 13% up or down. There was much greater consistency here between countries at the date of transition, with the average effect across all three countries being between 11% and 13%. By the end of the restated comparative period the average impact on equity was still 13% but the range across countries had increased to an average of 7-16%. The main areas impacting on equity were pensions (amongst the three most significant adjustments for 65% of companies), goodwill (43%), tax (43%), dividends (35%) and financial instruments (33%).

Darina Barrett concluded: "Every company's numbers will be affected by IFRS, but differently and to varying degrees. It will get easier as the market's experience and understanding grows, but as we enter the first full reporting season under IFRS, everyone needs to work hard to communicate, analyse and understand the changes that the new standards may cause."

The survey results are available at www.auditcommitteeinstitute.ie/pubs

Non-executive director fee levels

In the latter half of 2005 KPMG UK's Executive Compensation team completed a review of director fee levels in recently published Annual Reports and Accounts of each company listed in the FTSE 100[1] and FTSE 250[2]. The aim of the survey was to identify and analyse remuneration trends seen in UK boardrooms in 2005; the results make interesting reading for directors of Irish companies.

The role of the non-executive director

The findings of the survey have enabled the ACI to examine whether two of Sir Derek Higgs' key recommendations from his review of the role and effectiveness of the non-executive directors[3] have been adopted by the companies surveyed.

Sir Derek stated that:

- the level of remuneration appropriate for any particular non-executive director role should reflect the likely workload, the scale and complexity of the business and the responsibility involved; and
- where a non-executive director had extra responsibilities, for example membership of the audit committee, the total remuneration should reflect this;
- these recommendations were largely incorporated into the revised version of the Combined Code[4].

General fee increases

The following table shows the general fee increases (irrespective of time commitment) for non-executive directors from the latest reported financial year end. The median fee increase for those companies that increased fee levels for all non-executive directors was 12 percent.

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[1]FTSE rankings are as of the FTSE June Review 2005.
[2]All FTSE 250 Investment Trusts are excluded.
[3]Sir Derek Higgs, 'Review of the role and effectiveness of the non-executive director', January 2003.
[4]The UK Combined Code on Corporate Governance, Financial Reporting Council, 2003.

The median pay for non-executive directors...is... £33,000 in the mid 250.

	Fee increases		
	Lower Quartile	Median	Upper Quartile
Non-executive chairman	0%	5%	11%
Senior independent director	5%	13%	29%
All other non-executive directors	4%	13%	23%
All non-executive directors	3%	12%	22%

Source: KPMG LLP (UK)

Those organisations at the higher end of the FTSE 100 have seen a sharp increase in fees. This increase seems to reflect the responsibility and complexity of the role of the non-executive director.

Other non-executive directors

The results of the survey correspond with Sir Derek Higgs' recommendation for fees to reflect the workload, the scale and complexity of the business and the responsibility involved. Non-executive directors in the higher market capitalisation band of the FTSE 100 are being paid at the median £58,000 compared to £40,000 in the bottom band. The median pay for non-executive directors in the FTSE 100 is £48,000 compared to a median of £33,000 in the mid 250.

The following tables show the fees for non-executive directors not classified as chairmen, deputy chairmen and/or senior independent directors broken down by market capitalisation and by industry, inclusive of committee fees and irrespective of time commitment.

Market capitalisation (£m)	Lower Quartile (£000)	Median (£000)	Upper Quartile (£000)
>£10bn	50	58	70
£5bn-£10bn	40	45	55
>£5bn	36	40	48
FTSE 100	40	48	58
>£1000m	32	37	44
£500m-£1000m	30	32	36
>£500m	25	29	34
Mid 250	29	33	39

Source: KPMG LLP (UK)

Industry sector	Median (£000)	
	FTSE 100	Mid 250
Finance and property	55	35
Food, drinks and tobacco	43	33
General industry and manufacturing	40	33
Media and entertainment	48	34
Mining, oil and gas	64	30
Other services	40	33
Pharmaceuticals and biotechnology	46	33
Retailers	43	32
Telecommunications and IT	53	33
Utilities	44	30
All companies	48	33

Source: KPMG LLP (UK)

Among FTSE 100 companies there were some significant differences between sectors with median fees in the mining, oil and gas industry being the highest. Interestingly there is little difference in the median fees in different industry sectors in the mid 250.

Committee fees

Sir Derek Higgs set out a common-sense approach to rewarding non-executive directors with committee commitments: additional fee for extra responsibilities. This would suggest that an organisation should pay a non-executive sitting on several committees more than one sitting on a single committee. In the same vein, one could expect to see higher premiums paid to those chairing committees. However, it is difficult to gauge how many organisations have taken this approach in practice. Unfortunately fees for membership and chairmanship roles are not uniformly disclosed (38 percent of the FTSE 100 and 71 percent of the mid 250 did not disclose anything in terms of if and how committee fees are paid), therefore we cannot state definitively whether Sir Derek's recommendations are being followed.

The table below shows the number of companies that disclose separate membership and chairmanship fees.

Number of companies	Separate fees not provided		Membership fee only		Chairman fee only		Both chairmanship and membership fee		Total number of companies	
	FTSE 100	Mid 250	FTSE 100	Mid 250	FTSE 100	Mid 250	FTSE 100	Mid 250	FTSE 100	Mid 250
Remuneration Committee	7	6	3	2	35	46	17	13	62	67
Audit Committee	0	1	1	1	39	52	22	13	62	67
Nominations Committee	39	51	6	3	9	7	8	6	62	67

Source: KPMG LLP (UK)

Historically, there has been little differential in the fee levels for the audit, nomination and remuneration committees. The increase in scrutiny on the audit committee and the rise in profile of the work of the remuneration committees has, however, led to a rise in fees for both membership and chairmanship of these committees. Anecdotal evidence from a recent ACI straw poll where replies were collected from six companies confirms this practice.

In the upper quartile of the FTSE 100 (see the first table below) non-executive directors who are members of audit or remuneration committees receive almost double the fee of those who are members of the nominations committee. This is to be expected in the current climate. The increased risk associated with being a member of an audit committee and the increased workload of being a remuneration committee member are now dictating higher premiums for directors who take on those roles.

However looking at FTSE mid 250 organisations it can barely be distinguished between those fees paid to a remuneration/audit committee member and those paid to a member of the nominations committee.

The table below details fees paid to directors who are members of, or chair committees.

Committee Membership	Lower Quartile (£000)		Median (£000)		Upper Quartile (£000)	
	FTSE 100	Mid 250	FTSE 100	Mid 250	FTSE 100	Mid 250
Remuneration	5	2	5	5	9	5
Audit	5	2	5	3	10	5
Audit SEC	–	–	5	–	–	–
Nominations	3	2	4	3	5	5

Source: KPMG LLP (UK)
Where there is no information this is due to the small sample size.

The trend seen in the FTSE 100 with regard to membership fees is repeated with Chairman's fees (see the table below) where those chairing the nominations committee are paid significantly less than those chairing the remuneration and audit committees. In fact chairmen of audit committees are the highest paid reflecting the increased workload associated with this role. Not surprisingly those who chair audit committees for companies that are listed in the US (SEC registered) receive larger sums than those listed only in the UK. This can be partly attributed to the introduction of the Sarbanes-Oxley legislation and the US being a more litigious environment.

Those who chair audit committees for companies that are listed in the US (SEC registered) receive larger sums than those listed only in the UK

Committee Membership	Lower Quartile (£000)		Median (£000)		Upper Quartile (£000)	
	FTSE 100	Mid 250	FTSE 100	Mid 250	FTSE 100	Mid 250
Remuneration	5	5	8	5	10	5
Audit	7	5	10	5	15	8
Audit SEC	8	–	12	–	20	–
Nominations	5	3	6	5	5	5

Source: KPMG LLP (UK)
Where there is no information this is due to the small sample size.

When comparing fees paid to members and/or chairmen of committees of the FTSE 100 to those in the mid 250 organisations it was found that fees were almost double.

The survey results are available at www.auditcommitteeinstitute.ie/pubs

Audit committee insights

The second of our recently introduced opinion corner pieces first appeared in the ACI US publication Audit Committee Insights in December 2005 and focuses on the often neglected area of management risk.

These days, is management the biggest risk of all?

By Gary Larkin, Managing Editor, Audit Committee Insights

As the media shines a harsh spotlight on corporate mismanagement, the top risk item for audit committees has become assessing "management risk."

That's because audit committees – and their oversight of the financial reporting process – are under even more scrutiny than ever due to media focus on alleged management failures. These failures have been manifest in the increasing number of financial restatements, as well as financial losses at some companies resulting from poor strategies and poor execution of strategy.

"If management is not competent, a [company's] risk manager worries about the liabilities of the officers and directors," says Steve Scammell, a risk consultant with professional services firm Towers-Perrin. The main issue involves a board's fiduciary duty to oversee management and help ensure that management is competent, he says. "Anytime mismanagement plays out, a company's reputation is [at stake]," Scammell says.

Management risk is often omitted from the usual portfolio of corporate risks, such as strategic, operational, competitive, compliance and financial reporting, that a company manages as part of its risk management processes.

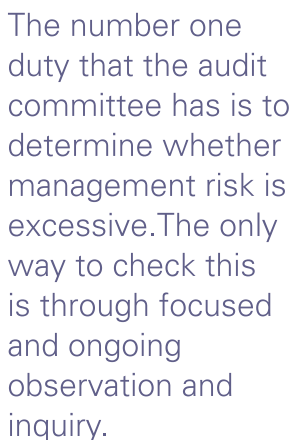
Management risk is often omitted from the usual portfolio of corporate risks, such as strategic, operational, competitive, compliance and financial reporting

But management risk is perhaps the biggest hazard to a company's success, and minimizing such risk requires every corporate board and committee's constant attention.

Kenneth Daly, executive director of KPMG's Audit Committee Institute, sees management risk as twofold – the risk that management does not possess the skills, competence, resources or motivation to successfully manage the business enterprise, and the risk that managers may place their personal interests ahead of the company and its shareholders.

Daly is worried that even with their increased power following governance reform, some independent directors may fail to recognize potential warning signs, or that such directors may not act quickly enough when they see trouble.

Huron Consulting recently reported that the number of financial restatements jumped 28 percent from 2003 to 2004, and that, based on SEC filings for the first three quarters of this year, 2005 may be worse.



The number one duty that the audit committee has is to determine whether management risk is excessive.The only way to check this is through focused and ongoing observation and inquiry.

At the same time, a study by executive recruiter Russell Reynolds Associates showed a 23 percent increase in CFO turnover among Fortune 500 companies in 2004 from 2003, including a 21 percent increase in resignations. For Fortune 500 controllers, the turnover rate was even higher at 25 percent, and there was an astounding 400 percent increase in resignations.

This type of environment hasn't instilled much investor confidence in the financial reporting process.

In response to an ACI Quick Poll question posed in the spring of 2005, more than 26 percent of respondents said they were not confident that their management had the appropriate skills to address financial reporting and accounting issues related to complex business processes and transactions.

Interestingly, only 11 percent of board members, including audit committee members, expressed a similar lack of confidence in management. It is noteworthy that board members who responded to the poll expressed substantially more confidence in management's skills than did management itself.

"The number one duty that the audit committee has is to determine whether management risk is excessive," Daly says. "The only way to check this is through focused and ongoing observation and inquiry."

That calls for the audit committee to understand a company's critical strategies, as well as the corresponding risks and business plans that support these strategies. Such in-depth knowledge allows the audit committee to monitor management performance against business plans, as well as how performance is reflected in the quarterly and annual financial statements.

But in order for the audit committee to understand the business and to monitor management's performance, it must be prepared to ask probing questions.
"The audit committee oversight process has been strengthened over the last few years through the diligence of engaged, insightful and concerned audit committee members," Daly says. "We do, however, still have some audit committees that aren't doing a lot of talking. They don't know what the questions might be. They don't know what to do with the answers."

Daly and other corporate governance observers suggest that an important first step is for audit committees to understand in depth the company as well as its management team's strengths and weaknesses.

Industry observers say that audit committee members can take several steps to improve their corporate knowledge. They suggest site visits, discussions with high- and mid-level employees and using industry benchmarks to compare their company to the competition on performance measurements.

Some audit committees are employing resources such as outside consultants to help assess management risk. That includes an assessment of management's implementation of business strategies and whether financial statements accurately reflect corporate performance.

"When it comes to strategy, it's the full board's responsibility," says Ellen Richstone, audit committee member of electronics manufacturer American Power Conversion and CFO for wireless service provider Sonus Networks. "When it comes to the audit committee, it will show in the numbers if something's not right."

The audit committee helps serve as a check for the full board and management in determining whether a company's strategy is effective, Richstone says.

A recent Booz Allen study highlighted the importance of audit committees to focus on strategy. The study identified 360 companies with market capitalisation of more than $1 billion and whose financial performance trailed the lowest-performing index for 1999 through 2003.

According to the study, 87 percent of shareholder value lost at these companies was attributed to poorly executed strategy

Some audit committees are employing resources such as outside consultants to help assess management risk.

and operational mismanagement – and only 13 percent was attributable to compliance scandals.

Some directors don't seem to have much confidence in their understanding of their company's strategy. According to a recent McKinsey Quarterly survey of 1,000 directors, 51 percent said that they had only a limited understanding of their companies' five to 10 key long-term initiatives.

"When the elements of a company's DNA are aligned, the company can implement strategic and operational decisions quickly," says Gary Neilson, a senior vice president with strategy and technology consulting firm Booz Allen Hamilton. "In fact, whether or not an organization is able to translate important decisions into actions is a sort of 'genetic marker' for the organization's overall functionality or 'health.'"

Another Booz Allen study, called A Global Check-Up: Diagnosing the Health of Today's Organizations, found that healthy organizations are more likely to report clear "decision rights" – knowing who is responsible for what – than are unhealthy organizations. The rank-and-file at healthy companies also have the information they need to understand how their decisions affect the bottom line, and they have the metrics to measure business drivers.

"You have a substantial number of folks who say they don't know what they're accountable for," says Neilson, the author of the study's report. "When it comes to decision rights, it's something that people aren't explicit about. Yet they know about the organizational chart."

"Ensuring the elements of the organization's DNA are aligned with one another and with the company's overall strategic direction is one of the most important jobs of senior management and the board," Neilson says.

Daly emphasizes that in the end, it is essential for audit committees at all companies to take management risk into consideration. "No matter how it's measured, the competency and motivation of senior management has to be one of the most important areas of focus for the audit committee," Daly says.

International update

EU matters

Consultation on the Action Plan "Modernising Company Law and Enhancing Corporate Governance in the EU"

Addressing the conference 'Listed Companies and Legislators in Dialogue' during November, Charlie McCreevy set out the principle 'less is more' in deciding future EU requirements for governance and company law.

Mr. McCreevy, as Commissioner for Internal Markets and Services, was speaking in the context of reviewing progress made against the Action Plan issued by the EU in May 2003. Since then, most measures noted as needing rapid action have been taken, including:

- proposals to amend the Accounting Directives to require listed companies to provide an annual corporate governance statement, following the 'comply or explain' approach and other measures to improve transparency;
- audit quality – the revised 8th Directive sets out key provisions for the audit role and regulation of auditors.

It is therefore important that further action strikes the right balance – both underpinning investor confidence and encouraging competitiveness in European Capital Markets.

The EU has now issued a consultation paper seeking views on the continued relevance of the analysis in the original paper and the overall aim and context for determining future priorities for change in this area – together with the perceived value of steps to modernize and simplify company law in the EU. Replies are sought by 31 March 2006.

The consultation document is available at:
http://europa.eu.int/comm/internal_market/company/consultation/index_en.htm

Proposals for use of shareholders rights within the EU

The European Commission has presented a proposal for a Directive to facilitate the cross-border exercise of shareholders' rights in listed companies, through the introduction of minimum standards. The proposed Directive seeks to ensure that shareholders, no matter where in the EU they reside, have timely access to complete information and simple means to exercise certain rights – notably voting rights – at a distance.

The Commission identifies that, on average, about one third of the share capital of EU listed companies is held by non-residents. Key obstacles to voting faced by non-resident shareholders include share blocking, insufficient or late access to information, and overly burdensome requirements on distance voting. Following two earlier consultations in 2004 and 2005, the Commission now proposes following minimum standards which would eliminate the main obstacles in the cross-border voting process and enhance certain other rights of shareholders:

EU matters
continued

Commission Proposals - Shareholder rights
▪ General Meetings should be convened with at least one month's notice. All relevant information should be available on that date at the latest, and posted on the issuer's website. The meeting notice should contain all necessary information.
▪ Share blocking should be abolished and replaced by a record date which should be set no earlier than 30 days before the meeting.
▪ The right to ask questions should be accessible to non-residents. The maximum shareholding thresholds to benefit from the right to table resolutions should not exceed 5%, in order to open this right to a greater number of shareholders while preserving the good order of general meetings.
▪ Proxy voting should not be subject to excessive administrative requirements, nor should it be unduly restricted. Shareholders should have a choice of methods for distance voting.
▪ Voting results should be available to all shareholders and posted on the issuer's website.

Copies of the proposed Directive can be obtained from http://europa.eu.int/comm/internal_market/company/shareholders/index_en.htm

UK matters

Company Law Reform Bill

On 1 November 2005 the Company Law Reform Bill was introduced into Parliament, following the Company Law Review which began in 1998. The Department of Trade and Industry has expressed the hope that the Bill will receive Royal Assent before July of this year.

Some of the key proposals will impact areas such as accounts and reports, provisions regarding capital maintenance reform and a host of other company law changes.

Further information regarding the Bill can be obtained on our website at: www.auditcommitteeinstitute.ie/pubs.

Operating and Financial Reviews

The Chancellor of the Exchequer, Gordon Brown, has announced the intended removal of the requirement for listed companies to publish an operating and financial review (OFR).

The announcement took many commentators and others by surprise. The Financial Reporting Council commented:
"The FRC has long believed that the publication of a narrative explanation of a company's development, performance, position and prospects should be encouraged as an important element of best practice in corporate reporting. The ASB first produced a statement of best practice in 1993 (updated in 2003). A significant number of FTSE 100 companies already publish an OFR. Regardless of whether or not an OFR is a statutory requirement, the FRC's view of best practice remains unchanged. RS1 is the most up-to-date and authoritative good source of best practice guidance for companies to follow."

Thus Reporting Standard (RS) 1 The Operating and Financial Review, issued by the ASB in May 2005, may continue to provide the benchmark for best practice by the many companies listed in the UK that already prepare OFRs.

The FRC's statement is available at www.frc.org.uk/press/pub0974.

Disclosure to auditors

New provisions contained in the Companies (Audit, Investigations and Community Enterprise) Act 2004 come into effect in April, requiring that directors' reports contain confirmation that:

- so far as the directors are aware, there is no 'relevant audit information' – information needed by the auditors in connection with preparing their report – of which the company's auditors are unaware;
- the directors have taken all appropriate steps to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

US matters

Small Companies May Fall Outside of 404 Provisions

The Securities and Exchange Commission's (SEC) Advisory Committee on Smaller Public Companies has recently recommended to the full SEC that smaller companies no longer be required to comply with the provisions of Section 404 of the Sarbanes-Oxley act.

The committee recently voted overwhelmingly that most companies with a market capitalization below $700 million will no longer have to assess their internal controls over financial reporting and have auditors certify those controls.

Securities Offering Reform (SEC Release No. 33-8591)

The SEC has introduced new rules which will facilitate securities offerings by permitting more communications during the registration process, clarifying liability and further integrating the procedures and disclosures for periodic reporting with those for Securities Act registration statements.

The complex reform package applies to foreign, as well as domestic registrants, and requires large registrants to disclose in annual reports material comments from the SEC staff that are unresolved for more than 180 days. The rules are effective from 1 December 2005.

There are also new SEC rules for shell companies. The new rules address the practice of using Form S-8 to register offerings of securities when a reporting shell company is combined with a formerly private business to make the private operating company into a reporting company. With limited exceptions, a shell company is no longer permitted to use Form S-8 to report events that cause it to cease being a shell company.

Financial reporting update

This year has seen the steepest learning curve in recent accounting history – moving to required formats for company accounts, following implementation of the 4th Directive in 1986, was the last over-arching change in the accounting framework but did not involve the conceptual differences and complexity of this year's introduction of IFRS. As companies and boards grapple with applying the new framework for reports on December 2005 year ends, we give a 'helicopter' view of the options and key challenges they face.

Listed companies with subsidiaries are required by the EU Regulation 2002/1606 ('the IAS Regulation') to apply international financial reporting standards adopted by the EU in their consolidated financial statements, and at this stage have invested considerable effort in preparing initial reports under IFRS and in planning for application of IFRS to their full year consolidated financial statements.

For the parent company's own accounts, and for all other companies, a choice remains – the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005 (SI 116 of 2005) ('the IFRS Regulations') align Irish company law to the IAS Regulation and provide for the use of member state options allowed under the IAS Regulation, with the effect that:

- the effective date for application of IFRS in consolidated financial statements for parent companies with only debt listed on EU regulated markets is deferred to accounting periods beginning on or after 1 January 2007;
- listed parent companies may continue to prepare their individual financial statements in accordance with either IFRS as adopted by the EU (referred to below as IFRS) or Irish/UK accounting standards (Irish/UK GAAP);
- all other companies may choose whether to prepare their group and individual accounts in accordance with IFRS or Irish/UK GAAP – with the constraint that all companies within a group must take the same approach unless there is demonstrably 'good reason' to differ.

The consequential changes are summarised in the tables overleaf. But even for those staying with Irish/UK GAAP, changes this year are significant as the ASB's convergence project continues. Table 1 on page 17 sets out the changes in financial reporting requirements for group companies; table 2 on page 18 sets out those changes which apply to individual companies.

This year has seen the steepest learning curve in recent accounting history

TABLE 1: Application of new financial reporting requirements for December 2005 year ends – group financial statements

	Company law			Irish/UK GAAP					
	Use of IFRS	IFRS Regulation	Fair Value Regulations	FRS 20	FRS 25 (presentation only), FRS 21 and 28, FRS 2 Amendment and FRS 17	FRS 26, 23, 24 and 25 (in full)	FRS 22	UITF 39	UITF 40
Equity securities listed on EU regulated market	**Mandatory**	✓	✓	N/A	N/A	N/A	N/A	N/A	N/A
Only debt securities listed on EU regulated market (IFRS mandatory for 2007)	Optional **Yes**	✓	✓	N/A	N/A	N/A	N/A	N/A	N/A
	Optional **No**	✓ General provisions	✓	✓	✓	✓	✓	✓	✓ from 22/06/05
Debt or equity listed on any other market	Optional **Yes**	✓	✓	N/A	N/A	N/A	N/A	N/A	N/A
	Optional **No**	✓ General provisions	✓	✓ from 1/1/06	✓	Possibly in '06/'07*	✓	✓	✓ from 22/06/05

✓ required for periods beginning on or after 1 January 2005 unless otherwise noted.

* where the company/group opts to fair value financial instruments in its income statement, these standards apply for periods beginning on or after 1 January 2006. Otherwise these standards are expected to apply in 2007.

A key change this year...is that FRS17...now applies in full

Irish/UK GAAP - mandatory for December 2005 year ends

A key change this year – though not a new FRS – is that FRS 17 Retirement Benefits now applies in full for periods beginning on or after 1 January 2005. Companies have had several years in which disclosures relating to pension costs have increased: now, for defined benefit schemes, the difference between the market value of the scheme's assets and the actuarially assessed present value of the scheme's liabilities is presented as an asset or liability on the balance sheet (net of deferred tax, where appropriate). The amount charged to operating profit is the actuarially determined cost of pensions benefits promised to employees that is earned in the year plus any benefit improvements granted to them in that year.

Other FRSs coming into effect for all financial statements prepared in accordance with local GAAP are:

FRS 21 – Events after the balance sheet date
FRS 22 – Earnings per share
FRS 25 – Financial instruments: disclosure and presentation (presentation only)
FRS 28 – Corresponding amounts
FRS 2 – Consolidation (amendment), reflecting changes in the legal definition of a subsidiary and exemptions from group accounts.

TABLE 2: Application of new financial reporting requirements for December 2005 year ends – individual company financial statements									
	Company law			Irish/UK GAAP					
	Use of IFRS	IFRS Regulation	Fair Value Regulations	FRS 20	FRS 25 (presentation only), FRS 21 and 28, FRS 2 Amendment and FRS 17	FRS 26, 23, 24 and 25 (in full)	FRS 22	UITF 39	UITF 40
Parent company with its debt or equity securities listed on an EU regulated market	Optional **Yes**	✓	✓	N/A	N/A	N/A	N/A	N/A	N/A
	Optional **No**	✓ General provisions	✓	✓	✓	Possibly in '06/'07*	✓	✓	✓ from 22/06/05
Other companies (including subsidiaries)	Optional **Yes**	✓	✓	N/A	N/A	N/A	N/A	N/A	N/A
	Optional **No**	✓ General provisions	✓	✓ from 1/1/06	✓	Possibly in '06/'07*	✓	✓	✓ from 22/06/05

✓ required for periods beginning on or after 1 January 2005 unless otherwise noted.
* where the company/group opts to fair value financial instruments in its income statement, these standards apply for periods beginning on or after 1 January 2006. Otherwise these standards are expected to apply in 2007.

...provisions of the EU Modernisation Directive have been implemented by the IRFS Regulations

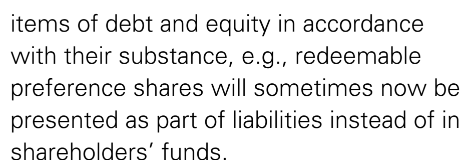
In addition, UITF abstracts 39 Members shares in co-operative entities and similar instruments and 40 Revenue recognition and service contracts apply.

Listed companies (those with securities traded on an EU regulated market) who opt to use Irish/UK GAAP for their individual accounts must also comply with:
FRS 20 – Share based payments
FRS 26 – Financial Instruments: Measurement
and, if applying FRS 26, the following:
- FRS 23 – The effects of changes in foreign exchange rates
- FRS 24 – Financial reporting in hyperinflationary economies
- FRS 25 – Financial instruments: presentation and disclosure in full.

General provisions in the IFRS Regulations

A number of provisions of the EU Modernisation Directive have been implemented by the IFRS Regulations alongside changes needed to accommodate IFRS, and apply to financial statements irrespective of whether IFRS or local GAAP is used:

- Inclusion of 'substance over form' principle
  The accounting principles underlying Irish company law have been changed to include a new principle which requires that the substance of a transaction and not just its legal form should be considered when determining its presentation in the financial statements. This change was brought in to facilitate the presentation of



items of debt and equity in accordance with their substance, e.g., redeemable preference shares will sometimes now be presented as part of liabilities instead of in shareholders' funds.

- Definition of subsidiary
  The definition of a subsidiary in Irish law and in particular in the Group Accounts Regulations, Credit Institution Regulations and Insurance Undertakings Regulations has been changed and now focuses primarily on whether the company has the power to exercise, or actually exercises, dominant influence or control.
- Proposed dividends
  The timing of the recognition of proposed dividends has changed. Under the new law a proposed dividend will not be considered a liability until the approval process is complete. Consequently, dividends proposed to the shareholders for approval at the AGM will not be a liability in the accounts of the entity at the end of the previous financial year. They will merely be separately disclosed in the notes.
- Reconciliation of profit and loss account reserve
  In the past the reconciliation of the profit and loss account reserve has been given on the face of the profit and loss account. This has now been amended and the reconciliation must be given in the notes to the accounts.
- Disclosure of risks and uncertainties in directors' reports.
  A description of the "principal risks and uncertainties" faced by the company is introduced as part of the review of the development and performance of a company already required. In a group, the description given by directors of the holding company must also take account of risks and uncertainties affecting subsidiaries and each subsidiary's directors need to deal with risks and uncertainties affecting that subsidiary.

The WEEE Directive

The WEEE Directive was finalised in 2003 and its objectives are to:

- prevent waste of electrical and electronic equipment (WEEE) and to promote re-use, recycling and recovery so as to reduce the disposal of waste;
- to improve the environmental performance of all operators involved in the life cycle of WEEE including producers, distributors and consumers and in particular those operators directly involved in the treatment of WEEE.

The Irish government implemented this Directive from 13 August 2005, placing the obligation on producers and distributors of WEEE to arrange for its disposal.

The application of the law is complex but its impact may be summarized as follows:

New products put into the market on or after 13 August 2005

- the cost of disposing of these will rest with the producers of these goods.

Old products sold prior to 13 August 2005

- where sold to private households ('historical household equipment'), it will fall to producers of that equipment who are in the market in the period specified in law to pay for its disposal in proportion to their current market share, in the measurement period;
- where sold to business users, it will be the responsibility of those businesses to dispose of their own waste, unless the equipment is replaced, in which case the costs fall to the suppliers.

Implications for the 2005 financial statements

The ASB has issued a draft UITF (based on the equivalent IFRIC 6 Liabilities arising from participating in a specific market - waste electrical and electronic equipment) addressing the timing for recognition of provisions by producers of their liability to pay for the disposal of historical household equipment. It proposes that participation in the market in the measurement period is the obligating event in accordance with FRS 12. Therefore producers would need to make some provision in their December 2005 year end accounts for this obligation.

While not specifically addressed in the draft UITF it is clear that, in accordance with FRS 12, business users will be required to set up a provision in their accounts for equipment that it holds at year end; it is only at some future date when the equipment is actually replaced can the obligation (and the related provision) be considered extinguished.

Notes

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