

CORPORATE GOVERNANCE FOR LISTED COMPANIES
Implementation of the 8th Company Law Directive and Statutory Audit Directive

The United Kingdom financial regulator the Financial Services Authority (FSA) has recently published a Policy Statement (PS) and instruments making rules to implement the European Union's (EU) Statutory Audit Directive and the Company Reporting Directive in the UK. Other jurisdictions have also updated or are consulting on updating their corporate governance requirements.

1. WHO DOES THIS AFFECT?

In the UK, the changes affect UK companies with transferable securities admitted to trading on a regulated market in any EU Member State. The changes also affect companies incorporated outside the European Economic Area (EEA) whose transferable securities are admitted to trading on a regulated market within the EEA. Accountants and statutory auditors, including auditors from non-EEA countries of issuers admitted to trading on a regulated market should be aware of the changes and how they affect clients. In addition, fund management groups (as investors and shareholders in affected listed securities) should be aware of the changes.

2. KEY POINTS

2.1 Statutory Audit Directive

The Statutory Audit Directive introduces a requirement for affected firms to have an audit committee that meets certain requirements set out in the directive, or have a body performing equivalent functions. The changes also mean that this body must have at least one independent member and a member who has competence in accounting and/or auditing. The independence requirement and the financial expertise requirement may, but need not, be fulfilled by the same person. Firms will also have to issue a statement which identifies the body which carries out the audit functions and describes how that body is composed.

In its policy statement, the FSA has declined to prescribe what would constitute independence or expertise in performing audit functions in the Disclosure Rules and Transparency Rules Sourcebook (DTR). This does give firms flexibility over their arrangements and allows shareholders to play an important role in the corporate governance of a company, and thus establish specific arrangements which are appropriate to their own circumstances.

The FSA will also not prescribe what would constitute independence and expertise of members of a body.

2.1.1 Third Country Auditors

The Statutory Audit Directive requires that every third-country auditor and audit entity providing an audit report on the annual or consolidated accounts of a company incorporated outside the EEA whose transferable securities are admitted to trading on a regulated market within the EEA, must be registered.

The FSA has ruled that the Disclosure Rules and Transparency Rules Sourcebook (DTR) in the UK will require that a company incorporated outside the EEA whose transferable securities are admitted to trading must use:

- an auditor on the register of third-country auditors kept for the purposes of Regulation 34 of the Statutory Auditors and Third Country Audit Regulations 2007 (i.e. the register of third-country auditors maintained by the UK's Professional Oversight Board);
- an auditor eligible for appointment as a statutory auditor under section 1212 of the Companies Act 2006; or
- an EEA Auditor (as that term is defined in s. 1261 of the Companies Act 2006) from another EU Member State.

The position is complicated because the EU Commission has not yet finalised its position on the equivalence of third country auditors. It has carried out a preliminary assessment, with the assistance of the European Group of Auditors' Oversight Bodies, but this has not allowed final equivalence decisions to be taken. On the basis of the initial review of audit standards, transitional measures have been agreed. There are 36 affected countries (or jurisdictions) – to be known as transitional countries. The EU Commission has decided that such transitional country auditors will be able to continue to audit annual or consolidated accounts for financial years starting from 29th June 2008 to 1st July 2010, if they provide information about themselves to Member State authorities. Member States are allowed to register transitional country auditors as long as the public is informed that transitional countries are not yet recognised as equivalent.

Auditors from non-transitional countries wishing to act as a third-country auditor for UK purposes will still have to comply with all elements of Article 45 of the Directive and will have to undergo the complete registration process as proposed by the Professional Oversight Board (POB) in the UK.

The EU Commission's Decision noted that the following countries and jurisdictions are considered to be transitional:

Argentina	Hong Kong	Russia
Australia	India	Singapore
Bahamas	Indonesia	South Africa
Bermudas	Israel	South Korea
Brazil	Japan	Switzerland
Canada	Kazakhstan	Taiwan
[Cayman Islands]	Mauritius	Thailand
Chile	Mexico	Turkey
China	Morocco	Ukraine
Croatia	New Zealand	United Arab Emirates
Guernsey, Jersey, Isle of Man	Pakistan	United States of America

Malaysia has subsequently been added to this list.

The Decision requires the position of each jurisdiction/country to be reviewed in two years.

2.2 Company Reporting Directive

The Company Reporting Directive requires companies whose securities are admitted to trading on a regulated market to produce a corporate governance statement in their annual reports. This must refer to the corporate governance code applied by the company and explain whether, and to what extent, the company complies with that code. It will also have to include a description of the main features of the company's internal control and risk-management systems in relation to the financial reporting process. The statement must also refer to certain matters related to the company's share and control structures and the composition and operation of the board and its committees.

These provisions are to be copied out in the UK Disclosure Rules and Transparency Rules Sourcebook (DTR).

There has been one change to the proposals in that the FSA has decided, following responses to the consultation, to keep (as far as is possible) the provisions of LR 9.8.6R(5), which requires a company to set out how it has applied the principles of the Combined Code. The FSA will now modify the rule so that a company to whom the rule applies will need to include in its annual report a statement of how it has applied the Main Principles in Section 1 of the Combined Code, so that shareholders will be able to evaluate how the principles have been applied. Where a company has applied the Code's Main Principles by complying with the associated provisions it should be sufficient for the company simply to report that it has done so. However, where a company has taken additional actions to apply the principles or otherwise improve its governance, it would be helpful to shareholders to describe these in the annual report.

2.3 Combined Code

The Financial Reporting Council (FRC) has also updated the Combined Code to reflect the changes in FSA rules.

The changes remove the restriction on an individual chairing more than one FTSE 100 company and allow the chairman of a listed company below the FTSE 350 to be a member of, but not chair, the audit committee provided he or she was considered independent on appointment.

The FSA has decided to retain the guidance that compliance with the Combined Code will result in compliance with the new rules. However, it will also amend the guidance so that it is clear that compliance with Combined Code provisions A.1.2, C.3.1, C.3.2 and C.3.3 will result in compliance with the new rules in DTR.

3. IMPLEMENTATION DATE

Although the new Rules and revised Code will apply to accounting periods beginning on or after 29th June 2008, in practice, this means most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

Auditors from the designated transitional countries will be able to continue to audit annual or consolidated accounts for financial years starting from 29th June 2008 to 1st July 2010, if they provide information about themselves to Member State authorities.

4. FURTHER INFORMATION

FSA policy statement PS 08/6, entitled "Implementation of the 8th Company Law Directive Feedback on CP07/24 and final rules" published in June 2008, can be found at the following link:

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2008/08_06.shtml

A copy of the Statutory Audit Directive can be found at the following link:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:01:EN:HTML>

The Company Reporting Directive can be found at the following link:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:224:0001:01:EN:HTML>

Combined Code is published by the Financial Reporting Council and a copy of it can be found at the following link:

www.frc.org.uk/corporate/combinedcode.cfm

The EU Decision on Third Country Auditors can be found at the following link:

http://ec.europa.eu/internal_market/auditing/docs/revisions/draft-decision-4th_en.pdf

Reference: RCUK/PTG/SAC/KG

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