



## **Audit Reform In Ireland** How does it affect your Funds?

July 2016

In 2014 the European Parliament and Council introduced new rules in relation to audits carried out in Europe. These changes are contained in a Directive and related provisions of an EU Regulation (the 'Directive and Regulation').

On the 15 June 2016 a Statutory Instrument ('SI 312') was signed in Ireland that gives effect to the EU Directive and Regulation.

SI 312 provides clarity on how the rules will be implemented in Ireland and what options allowed within the EU Directive and Regulation (so called 'member state options') will be taken.



### What Funds are affected?

Audit reform introduces some rules that affect all audits undertaken in Ireland, in particular in the way that audit firms are regulated, and other rules that relate to individual audit relationships that apply only to the audit of Public Interest Entities ('PIE').

The definition of a PIE has not been modified for Ireland and remains as defined in the EU Directive. PIE's include, as well as credit institutions and insurance companies, entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State.

For example Irish Funds that are listed on the Irish Stock Exchange main market (which is an "EU Regulated Market"<sup>1</sup>) would be defined as a PIE; also, ETFs that are listed on other European Regulated Market would meet the definition. It is important to note the definition is related to listing of the transferable securities and not the regulatory structure of the fund such as UCITs or AIF.

### Key impacts on PIE Funds



**Length of Audit Firm Tenure**



**Prohibited Non-Audit Services**



**The Effect on Audit Committees**



**Audit Reporting**



#### 1. Length of Audit Firm Tenure

SI 312 introduces mandatory rotation of audit firms after 10 years for each PIE. The transition arrangements depend on the length of the existing relationship, specifically relationships that have been established for longer than 11 and 20 years as of June 2014 have longer to transition. The table below sets out the transitional arrangements.

The commencement of the audit relationship is the first day of the period that the audit firm first audited. There is also a requirement that the audit partner on a PIE serves a maximum of five years.

The rules also set out the requirements for the running of an audit tender process including a prohibition on contractual clauses that would restrict choice of auditors to certain categories of statutory auditors (Big 4 clauses).

There are specific rules around how a tender process must be run. PIEs will be obliged to have a tender process with the close involvement of the audit committee when considering the selection of a new auditor.

### Length of Audit Firm Tenure

	Years of audit appointment	Audit Relationship Commenced After	Audit Relationship Commenced Before	New Auditor to be appointed for Year Commencing On or After
1	>=20	N/A	16/06/1994	17/06/2020
2	<20 but >=11	17/06/1994	16/06/2003	17/06/2023
3	<11 Years	17/06/2003	16/06/2006	17/06/2016
4	<11 Years	17/06/2006	16/06/2014	Initial Date + 10 Years

## 2. Prohibited Non-Audit Services

For a PIE the statutory auditor and its network is prohibited, save for the exemptions set out in the SI 312 for certain tax and valuation services, to provide either directly or indirectly to the audited entity, to its parent undertaking or to its controlled undertakings within the Union a range of non-audit services.

The prohibited services that are most likely to affect funds include:

- a) Tax services relating to:
  - i. preparation of tax forms;
  - ii. payroll tax;
  - iii. customs duties;
  - iv. identification of public subsidies and tax incentives unless support from the statutory auditor or the audit firm in respect of such services is required by law;
  - v. support regarding tax inspections by tax authorities unless support from the statutory auditor or the audit firm in respect of such inspections is required by law;
  - vi. calculation of direct and indirect tax and deferred tax;
  - vii. provision of tax advice;
- b) Services that involve playing any part in the management or decision-making of the audited entity;
- c) Bookkeeping and preparing accounting records and financial statements;
- d) Payroll services;
- e) Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems;<sup>2</sup>

- f) Valuation services, including valuations performed in connection with actuarial services or litigation support services;
- g) Various legal services
- h) Services related to the audited entity's internal audit function;
- i) Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity;
- j) Promoting, dealing in, or underwriting shares in the audited entity;
- k) Various human resources services

SI 312 does provide for certain 'member state options' that have the effect of allowing for certain tax and valuations services which are not permitted under the Directive and Regulation may be provided where:

- they have no direct or have immaterial effect on the audited financial statements, and
- the estimation of the effect on the audited financial statements is comprehensively documented and explained in a report to the audit committee, and
- the principles of independence are complied with, and
- In compliance with guidelines that may be issued by the Audit Committee with regard to the non-audit services permitted.

The other relevant restriction on non-audit services is in relation to the overall fees paid to the audit firm. The total fees for non-audit services shall be limited to no more than 70 % of the average of the fees paid in the last three consecutive financial years for the statutory audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings.





### 3. The Effect on Audit Committees

All PIE's will be required to have an audit committee except where exempted under S.I. 312 article 115 (10),<sup>3</sup> the PIE is an UCITS or its sole business is to act as an issuer of asset backed securities. Moreover the impact of the Irish Companies Act 2014 should also be considered. Where audit committees are required the following changes are relevant:

- a) The majority of members of the audit committee need to be independent of the audited entity;
- b) The members of the audit committee as a whole are required to have competence relevant to the sector in which the audited entity is operating;
- c) The chairman of the audit committee is to be appointed by its members and be independent of the audited entity;
- d) The list of functions assigned to the audit committee has been extended to:
  - i. informing the directors of the entity of the outcome of the statutory audit and explaining how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process,
  - ii. submitting recommendations or proposals to the directors of the entity to ensure the integrity of the financial reporting process,
  - iii. Audit committee is now required to monitor the effectiveness of the entity's internal quality control and risk management systems and, where applicable, its internal audit, regarding the financial reporting of the entity without breaching its independence,
  - iv. monitoring the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any findings and conclusions by IAASA audit inspection,
  - v. reviewing and monitoring the independence of the statutory auditors and, in particular, the appropriateness of the provision of non-audit services to the audited entity,

- vi. approving any non-audit services that are not prohibited by law following an assessment of the threats to independence and the safeguards that can be applied to mitigate or eliminate those threats;
- vii. and, to be responsible for the procedure for the selection of a statutory auditor or audit firm and recommend the statutory auditor or audit firm to be appointed.



### 4. Audit Reporting

There are a number of detailed requirements on what should be incorporated into the audit report for a PIE. The audit report will now include:

- a) Who appointed the statutory auditor (e.g. the members of the company or the Board of directors);
- b) The date of the statutory auditors appointment and the period of time since the statutory auditor was first appointed.;
- c) A description of the most significant assessed risks of material misstatement, a summary of the auditor's response to those risks; and where relevant, key observations arising with respect to those risks.
- d) An explanation to what extent the statutory audit was considered capable of detecting irregularities, including fraud;
- d) A confirmation that the audit opinion is consistent with the auditor's report to the audit committee;
- e) A declaration that the prohibited non-audit services were not provided and that the statutory auditor remained independent of the audited entity; and
- f) An indication of any services, in addition to the statutory audit, which were provided by the statutory auditor to the audited entity and its controlled undertaking(s), and which have not been disclosed in the management report or financial statements.

## How can Deloitte Help

The implications of audit reform rules on PIE's will impact on who can act as your audit firm, your provider of non-audit services such as tax services and the operation of your audit committee. These changes require careful planning in order to ensure that your fund satisfies the new requirements. Our Deloitte team is available to advise Fund Boards and investment managers with assessing the implications of the audit reform on your business.

# Endnotes

1. A regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC
2. Period for which auditor must not provide service includes 1 year cooling in period.
3. (10) Without prejudice to paragraph (1), this Regulation shall not apply to a public-interest entity if it is —
  - (a) a public-interest entity which is a subsidiary undertaking within the meaning of point 10 of Article 2 of Directive 2013/34/EU if that entity fulfils the requirements set out in paragraphs (1) and (2) and Articles 11(1) and (2) and 16(5) of Regulation (EU) No 537/2014 at group level,
  - (b) any public-interest entity which is an UCITS as defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009<sup>11</sup> on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) or an alternative investment fund (AIF) as defined in Article 4(1)(a) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011<sup>12</sup> on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010,
  - (c) subject to paragraph (11), any public-interest entity the sole business of which is to act as an issuer of asset backed securities as defined in point 5 of Article 2 of Commission Regulation (EC) No 809/2004 of 29 April 2004<sup>13</sup> implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, or
  - (d) any credit institution within the meaning of point 1 of Article 3(1) of Directive 2013/36/EU whose shares are not admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC and which has, in a continuous or repeated manner, issued only debt securities admitted to trading in a regulated market, provided that the total nominal amount of all such debt securities remains below €100,000,000 and that it has not published a prospectus under Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003<sup>14</sup> on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

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