

'Compliance Statements' & New 'Audit Exemption' Limits

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Adrian Kelly BA, discusses the extensive new restrictions imposed on companies by virtue of the new COMPANIES (AUDITING & ACCOUNTING) ACT 2003

INTRODUCTION

With the advent of the Companies (Auditing & Accounting) Act 2003 ('the 2003 Act'), in late December 2003, it comes at a time of great uncertainty for companies and their legal advisors. This is primarily due to the fact that the 2001 Company Law Enforcement Act ('the 2001 Act') sent shock waves through the foundations of company law in this country imposing a company law régime described by commentators as the strictest in the world.

The uncertainty created by the 2001 Act deepened significantly with the publication of the Companies (Auditing & Accounting) Bill 2003 ('the 2003 Bill'). The 2003 Bill proposed that the directors of nearly all companies must prepare a Compliance Statement, to be submitted with the Director's Report in the Annual Return of the company. The Compliance Statement among other things was designed to confirm compliance with 'Relevant Obligations' a term defined neither by the 2003 Bill nor the 2003 Act. 'Relevant Obligations' has been interpreted by commentators to include, compliance with legislation in areas such as Employment Law, Health & Safety Law, Tax Laws and other general legislation affecting the particular business in question. In addition, under the 2003 Bill Auditors would have been obliged to Audit this Compliance Statement.

The obligations introduced by the 2003 Act however, focus the restrictions generally on medium to large private companies and public companies. This is somewhat of a reprieve for small private companies and companies limited by guarantee however, as the following analysis will show, they too, still exist in a dangerous environment fraught with financial penalties.

COMPANIES AUDITING & ACCOUNTING ACT 2003

Commencement of the 2003 Act

The 2003 act is **not** currently a part of Irish Law. It will be introduced into Irish Law via 'Commencement Order(s)' which will be signed into law under the authority of the Minister of Enterprise Trade and Employment. According to a Senior Company Law Officer in the Department of Enterprise Trade and Employment, the 2003 Act will be introduced into Irish law in stages and the 2003 Act is expected to be fully implemented by the end of 2004. In addition, the source stated that obligations such as company 'Compliance Statements' and other measures targeting company directors are not expected to be among the first stages of the 2003 Act to be introduced. The Department is planning to issue guidelines to the directors of companies prior to these onerous sections of 2003 Act being introduced probably during summer 2004.

Nature of the 2003 Act

Unlike the 2003 Bill (which is only a proposal of the provisions which may be brought into law) the 2003 Act brought many of the new provisions into law in December 2003. As a result of pressure however, from the Accountancy bodies, IBEC, the Small Firms Association, the Company Law Review Group and other relevant bodies, it seems the government finally bowed to pressure. The result was that the 2003 Act, when introduced, separated the requirement of Compliance Statements (a new concept in Irish company law, created by the 2003 Act) altogether from the concept of Audit Exemption.

Compliance Statements

All companies are now obliged to prepare Compliance Statements, with the principal exception of private companies which have a balance sheet total of less than €7,618,428.00 and a turnover of not more than €15,236,856.00. Those companies will **not** be obliged to prepare Compliance Statements. This financial test may seem like a lot of money, however many medium to small sized construction companies for example **may not** be able to meet this financial exemption test and thus be able to prepare Compliance Statements. This leaves a situation where Auditors of public companies and large private companies will have to certify the reasonableness of such statements made by the Company Directors of those companies. This is a reprieve for small and medium sized companies, which were obliged to prepare such statements under the 2003 Bill. In addition, under the 2003 Bill the test to determine whether the company was obliged to prepare a Compliance Statement or not was relative to whether the company was Audit exempt. The amount proposed in the 2003 Bill was €317,000 exemption 'yard stick' (which was also raised in the Act).

Audit Exemptions

Audit Exemptions are now available for companies with a turnover of less than €1.5m. This still leaves Ireland well below England which has a €2.5m sterling audit exemption and the rest of Europe which has an average exemption of approximately €5m. Guarantee companies however remain unable to avail of the Audit Exemption as do companies which have filed their Annual Return late this year, or in the previous year, courtesy of a new Section 32A of the Companies (Amendment) No. 2 Act 1999 as amended by Section 53 of the 2003 Act. This relatively low Audit Exemption limit is particularly significant when one considers that the Auditor is obliged to report all company law discrepancies, including minor ones which are punished severely in the 2001 Act, that they come across in the course of an Audit. This is a reporting obligation, which may not be apparent if discovered by an accountant in circumstances other than in an Audit situation.

Separation

With the separation of the thresholds of Compliance Statements and Audit Exemptions, the following types of companies are **not** obliged to submit a Compliance Statements with their Directors Reports.

1. Guarantee companies
2. Unlimited companies
3. Companies which have filed a late Return in the current year or previous year (provided they meet the financial exemption tests set out above)
4. Medium sized private companies with a Turnover in excess of €1.5m (see new test above for Compliance Statement)

The Financial Strain Of Compliance Statements

Companies affected by the Compliance Statements provision are faced with an additional financial strain and the possibility of paying extra professional advisors such as Barristers and Solicitors to examine and perhaps draft the Compliance Statement. In addition Auditors of those companies must certify the reasonableness of such Compliance Statements prior to submission. This is a dangerous task for the Auditor and will require a careful examination of the statement and professional advice in many cases. The ultimate cost of all of this will be passed on to the company.

The effect of this obligation may drive some companies to disregard the privileges of Limited Liability altogether. For example, this could be one of the reasons why Irish Food Processors Limited, Larry Goodman's principal trading company made a timely transition from a company limited by shares to an unlimited company in December 2003.

ACCOUNTING STANDARDS, AUDIT COMMITTEES AND AUDIT INDEPENDENCE

All Irish companies will be required to state in their Annual Accounts (and where relevant Group Accounts exist) whether applicable accounts standards issued by prescribed bodies have been adopted.

All Irish companies will be required to disclose in their Annual Accounts all of the Accounting Policies (including those related to asset depreciation) applied in their preparation.

All Directors of Irish public limited companies (excluding certain plcs which are not the ultimate parent of their Corporate Groups) will be required to establish an Audit Committee with wide ranging duties related to the Annual Accounts, Audit and Financial Management. In addition, large private companies will be required to set up such Committees or explain why they have not set up such Committees in their Directors Annual Report.

All Irish companies will be required annually to disclose details of the remuneration paid to their Auditors and their affiliates, giving subtotals for audit work, audit related work and non-audit work and particulars of the nature of any non audit work where the remuneration for non audit work exceeds the remuneration for audit work plus audit related work, officers statements will be required in the Annual Report related to the independence of the Auditors and the reasons for their engagement on the non audit work.

DANGEROUS CLIMATE FOR SMALL AND MEDIUM SIZED COMPANIES DESPITE FINANCIAL THRESHOLD HIKES

Ownership of a small to medium sized limited Company still creates great obligations on the Directors of those companies. Harsh fines and even jail sentences exist for the most minor breaches under the 2001 Act. For example

- Late filing – This offence is generally limited to a maximum fine of €1,330.00 per late filing of each individual Annual Return. If there are more than 3 outstanding returns then this may amount to €3,990.00 plus a fine of approximately €30.00 for each additional year. For example, if returns have not been submitted for six years - €3,990.00 plus €90.00 = €4,080.00. Further, the company itself and every officer of the company who is in default and in addition, any person in accordance with whose instructions the directors acted thus causing default, shall be guilty of an offence, which may be prosecuted by the Registrar of Companies.
- Failure to notify change of the Registered Office address. The Company and every officer in default may be liable to a fine not exceeding €634.87 for failing to notify the Companies Registration Office ('the CRO') of a change in its Registered Office address. In the case of a company with two Directors this could amount to €1,904.61. In addition to such a fine, the Company could be struck off the Companies Register without any Director or member of the company being aware, due to the fact that all CRO correspondence is generally addressed to the registered office address of the company only.
- Failure to notify the Companies Registration Office of resignation of a Director Very significant fines exist for the failure to notify the CRO within 14 days of the resignation of Directors. These fines (specified in Section 195 (12) of the Companies Act 1963 as amended by Section 51 of the Companies Act 1990) can amount to a fine not exceeding €1,269.74 for each Officer of the Company and a fine not exceeding €63.49 for (every day) the Company is in default after the 14 days have elapsed. For example, a one year delay in notifying the CRO could amount to an massive financial penalty for the company.

GET REGISTERED WITH A COMPLIANCE PROVIDER

There is only one way of ensuring peace of mind and that is to register with a **Company Law Compliance** provider. This service is provided by Morgan McManus Solicitors and we guarantee to keep your Company fully compliant.

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