

AUDIT COMMITTEE INSTITUTE IRELAND

Audit Committee Institute Breakfast Seminar

24 January 2007

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Welcome
Kevin O'Donovan
Chairman, Audit Committee Institute Ireland

ODCE Guidance for Audit Committees

*Paul Appleby,
Director of Corporate Enforcement*

Overview

- Introduction to Audit Committee Provision
- Impact on Public Limited Companies
- Impact on Large Private Companies, etc.
- Committee Composition and Terms of Reference
- Impact of Eighth Directive and Commencement
- Conclusion



Introduction

- PAC's DIRT Inquiry Report led to recommendations on audit committees by the Auditing Review Group in 2000
- Section 205B was inserted into the 1990 Act by Section 42 of the 2003 Act but is not yet commenced
- ODCE published Draft Guidance in April 2006 and asked for views on various matters for Ministerial decision
- ODCE published revised Guidance in November 2006
- ODCE also made recommendations to Minister Ahern in November 2006 on the commencement of the provision



Impact on Public Limited Companies

- Section 205B, as enacted, is mandatory for all Irish-registered plcs (whether listed or not), except
 - for those wholly owned by another Irish plc
 - for any additional plcs that may be exempted by the Minister
- ODCE has proposed that the Minister also exempt:
 - every Irish-registered plc which is a wholly owned subsidiary of a foreign-registered plc which has a constituted audit committee
 - every unlisted plc not meeting a €25m. balance sheet total or a €50m. turnover threshold in any of the last two financial years



Impact on Public Limited Companies

- Minister is expected too to address exemptions for
 - securitisation vehicles, subject to a ‘comply or explain’ regime
 - certain supervised collective investment undertakings which spread risk and don’t seek control of issuers and
 - certain credit institutions not listed on an EU regulated market which have only issued debt securities totalling below €100 million and have not issued a prospectus



Impact on Public Limited Companies

- Audit committees in plcs will be required to:
 - review the accounts, determine if they give a true and fair view and recommend their approval (or not)
 - advise on auditor's appointment, monitor its work and independence and recommend award of non-audit work
 - be satisfied as to internal audit arrangements/resources
 - report on the committee's work in the directors' report



Impact on Private Companies

- Private companies limited by shares exceeding a €25m. balance sheet total and a €50m. turnover threshold in both of the last two financial years will be free to form (or not) an audit committee with all or some of the above duties
- However, directors must disclose their decision in the annual report and give reasons if they do not form one
- Duty also applies to a parent if it and its subsidiaries combined meet the above balance sheet/turnover criteria



Impact on ‘Relevant Undertakings’

- Same framework applies as for private companies
- A ‘relevant undertaking’ is:
 - a large Irish-registered unlimited company/partnership subject to certain qualifying conditions, including the above balance sheet total and turnover criteria
 - a large parent Irish-registered unlimited company or partnership and all of its subsidiaries subject to the same qualifying conditions



Composition of Audit Committees

- The eligibility and other conditions below apply to the audit committees of all entities within scope
- Minimum of two directors, but no director can be:
 - a current employee of the company/undertaking or of a subsidiary, or
 - an employee of either in the preceding three years, or
 - the Chairperson of the Board



Composition of Audit Committees

- One eligible director can serve as the sole member of the audit committee or as its Chair if it has only two members and s/he has the casting vote and if:
 - the Directors' Report discloses the reasons for availing of this exemption and
 - any additional Ministerial requirements are met
- If none qualifies, one eligible director must be newly appointed to serve on the Board/committee



Audit Committee's Terms of Reference

- They (and any amendments thereto) must be:
 - prepared, approved and reviewed annually by the Board
 - submitted for shareholders' information at the AGM
- They must also specify how the committee will discharge its responsibilities and provide for a programme of joint and separate meetings with management and the external and internal auditors



Impact of Revised Eighth Directive

- Section 205B meets many Directive requirements. The Directive states that every ‘public interest entity’ must have an audit committee. These are:
 - listed companies
 - credit institutions
 - insurance undertakings and
 - any other entities designated by Member States



Impact of Revised Eighth Directive

- Vis-à-vis Section 205B, the Directive provides for certain company exemptions (above) but also says:
 - one audit committee member must have accounting and/or auditing competence and
 - audit committee must monitor effectiveness of internal control, internal audit and risk management systems
- Implementation deadline is 29 June 2008



ODCE Proposals to Minister Ahern

- Commencement for all financial years starting on or after 1 April 2007 (but likely to be later). Have urged single date for implementation of Section 205B and the related Eighth Directive elements
- Company exemptions on above lines (likely)
- No change in balance sheet/turnover thresholds
- Role/qualification changes on above lines (likely)



Conclusion

ODCE Guidance on Audit Committees and
ODCE Proposals to Minister Ahern are available at
www.odce.ie





Directors' Indemnity Insurance
*John Barry, Director of Corporate Broking,
Coyle Hamilton Willis*



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LIABILITY

- **PERSONAL** → **JOINT & SEVERAL**
- **UNLIMITED** → **LONG TAIL**



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INDEMNITY TO DIRECTORS

Section 200 - Companies Act 1963

Makes void any agreement by the company to indemnify the Directors unless and until they have been proven innocent



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INDEMNITY TO DIRECTORS

Section 56 Companies (Auditing & Accounting) Act 2003

“Notwithstanding Section 200, a company may purchase and maintain for any of it’s officers or auditors, insurance in respect of any liability referred to”



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DIRECTORS & OFFICERS LIABILITY INSURANCE

Personal Protection Policy For:

- **Claims for actual or alleged breach of duty, breach of trust, breach of warranty of authority, error, misstatement, misleading statement, act, omission or neglect in their capacity as Directors and Officers of the Company**
- **Any matter claimed against them solely because of their status as a Director or Officer of the Company**



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SIDE A

Covers the personal liability of the Directors

SIDE B

Cover for reimbursement where the company has indemnified the Directors

SIDE C

Cover for the company for Securities Clause



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STANDARD EXCLUSIONS IN A D&O POLICY

- Dishonest or fraudulent actions (once proven)
- Non entitled personal profit
- Fines penalties and punitive damages (although punitive damages can be covered where insurable)
- Liability from management of pension funds
- Bodily injury / property damage
- Pollution exclusion, can be amended to provide a sub-limit for defence costs and claims by shareholders



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Insured v Insured Exclusion

Excludes any claim taken by any Insured or the company other than shareholder derivative actions.

- **Direct or derivative claims taken by a Liquidator or receiver?**
- **Claims for contribution or indemnity**
- **Claims by former directors or officers**



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WHAT TO WATCH OUT FOR

- **Claims made**
- **Insured Persons**
- **Indemnity Provision**
- **Definition of Claims**
 - **Civil Actions**
 - **Criminal Proceedings**
 - **Regulatory Actions including any appeals therefrom**
 - **Applications of Deductibles**



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WHAT TO WATCH OUT FOR

Claims Reporting

- **Becoming aware of any circumstances that might give rise to a claim or**
- **Receipt of a written demand for compensation or other relief or**
- **Civil Proceedings commenced by the service of a writ or summons.**

Right to report circumstances.



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WHAT TO WATCH OUT FOR

- **Duty to Defend**
- **Severability**
- **Outside Directorships Extension**
- **Pollution**
- **Cancellation Clause**
- **Exclusions - allegations or upon adjudication**
- **Entity Cover - application of policy limits/BIK**



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WHAT TO WATCH OUT FOR

- **Specific non-Executive Director cover**
- **Retired Directors**
- **Non renewal**
- **Main Board**
- **Emergency costs**
- **Priority of payments**
- **Limit of Indemnity**
- **Run off cover**
- **Insurance purchaser**



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The Managing Director of a property company sold shares in the company, which then fell in value by over 50%. He was accused of knowing of the possible fall when he sold the shares and was prosecuted in the Dublin Circuit Criminal Court for insider trading, facing maximum penalties of a 12 month prison sentence and a €250,000 fine. He was acquitted at the end of a 12 day trial.

Defence Costs came to around €260,000

The Director of a Financial Institute was investigated by regulators for allegedly disclosing confidential and price - sensitive information to the marketplace. This led to Civil Court Proceedings. Although the matter was settled with no liability to the Director, over €156,000 was spent in defending the proceedings



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Following dismissal from his job, a company employee not only sued the company for unfair dismissal, but also sued the company and its general manager for defamation.

€468,000 in damages was awarded. Defence Costs reached €156,000

An investment company sold a large stake in a European Group a few weeks before the group issued a profits warning. The investment company's chief executive, who was also a non-executive director of the European Group, is alleged to have been well aware of the financial position and to have used his knowledge to procure the investment company's sale. The group is suing the investment company and the chief executive for insider trading under Ireland's Companies Act 1990.

Damages of €85,000,000 are sought and defence costs may run to hundreds of thousands of Euros



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A director of a large trading company was sued, along with his company for allegedly misappropriating trade secrets.

This led to a settlement of €2,000,000 following €1,000,000 spent on defence costs

The buyers of a company sued it's principal directors, alleging negligent and / or fraudulent misrepresentation of the company's financial standing. The amount claims represented the entire purchase price of the company. Following lengthy and expensive case preparation, the action was settled with damages and defence costs amounting to over €5,000,000

A managing director and several technical managers faced criminal prosecution for alleged breaches of health and safety legislation, which sought separate legal representation and the costs incurred in their defence amounted to €1,388,000



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Executive of a company traded on the Dublin and New York stock exchanges are the subject of class actions in the USA. This followed an article in the Wall Street Journal highlighting the company's complex accounting practices and comment by the company that, without those practices, it's earnings would have been much lower, all of which drove down the company's share price by over 60%

Damages sought appear to be around €1,140,000 with millions of dollars in defence costs likely.

A company appointed one of it's managers to the board of a French company, in which it was involved. The French company went into liquidation. The Paris Court of Appeal held all the directors, including the board representative, jointly and severally liable to contribute the equivalent of €62,000,000 to the assets of the French company. The representative's share was about €6,864,000



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A leading global e-learning company with its head office in Ireland was sued in a class action for alleged improper revenue recognition and other accounting irregularities.

This case was settled for €35m

An Oireachtas enquiry for alleged collusion/price fixing into an Irish semi-state body resulted in a Director being obliged to attend the enquiry and incurring costs to defend themselves.

Claimed for €250,000, €154,000 paid to date

A minority shareholder of a foreign company in joint venture with an Irish company tried to gain commercial advantage by accusing a majority shareholder of repressing their rights. The minority shareholder brought criminal proceedings against an individual director.

€110,000 in defence costs



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A case of wrongful dismissal against an individual director in the US.

This resulted in payment of €74,000

An individual employee accused directors of an Irish company of unfair dismissal. He made various non-sensical allegations against the individual directors in regard to their professional and personal conduct. Because the claimant remained a lay litigant, the courts were reluctant to dismiss his claim for a significant period of time and

This resulted in the legal bill rising to over €30,000

A Shareholder action in the US against the individual directors/officers of an Irish subsidiary accusing them of trading whilst insolvent

This resulted in a pay out of €963,000



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A High Court action in Ireland claiming (among other things) breach of contract, negligent misstatement and misrepresentation. The defendant allegedly represented that they were going to purchase a web portal from the plaintiffs. The defendants later did not proceed with the purchase with the result that the plaintiff company became insolvent.

The claim is for in excess of €1,600,000

An Irish drugs company was sued in a class action for alleged accounting irregularities.

The case was settled for €75 million

An Irish food company director was sued for breach of confidentiality after providing a reference for an ex-employee, even though the terms of the ex-employees departure from the company were subject to a confidentiality agreement.

Claim for €900k, €35k settlement agreed with €250k costs



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An Irish software company was sued in a class action for revenue recognition irregularities.

Sued for €20m



Questions?

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