KPMG

Audit Committee Institute

Directors' Compliance Statement

Directors' reports for years ending on or after 31 May 2016 will see the first compliance statements under the Companies Act 2014 (the "2014 Act"). In these statements, directors must acknowledge their responsibility for complying with all relevant obligations under the 2014 Act and tax law, in addition to providing confirmation, on a comply or explain basis, that appropriate arrangements are in place to support material compliance with those obligations. Action is needed now to ensure that boards are in a position to provide the necessary statements.

Background:

The directors' compliance statement was first established by the Companies (Auditing and Accounting) Act 2003 but was never enacted due to its onerous requirements. The 2014 Act reintroduces a more targeted and proportionate approach to compliance statements. The obligation demonstrates, in a compliance statement, the company's commitment to obeying the laws to which it is already subject. This obligation is meant to clarify the extent of the directors' corporate responsibility and improve accountability.

Application:

Under section 225 of the 2014 Act, the directors of an Irish incorporated company shall include in their directors' report a compliance statement confirming:

a. that they are responsible for securing the company's compliance with its relevant obligations; and

b. that the items in subsection 3 have been done or if not done, then an explanation on why they have not been done.

The items in subsection 3 are referred to as assurance measures in this document and are discussed in more detail below

The requirements under section 225 of the 2014 Act are applicable to reporting periods beginning on or after 1 June 2015 for:

i. All public limited companies (PLCs); and

ii. Private limited companies (LTDs), designated activity companies (DACs), and guarantee companies (CLGs) that have:

  - A balance sheet total for the year that exceeds €12.5 million, and

  - Turnover for the year that exceeds €25 million

The prescribed thresholds are applied on an individual company basis as opposed to a group basis.

The requirements under section 225 of the 2014 Act are not applicable to unlimited companies or investment companies (Part 24 of the 2014 companies).

Relevant Obligations: Practical Considerations

Directors are to acknowledge that they are responsible for securing the company's compliance with its relevant obligations.

Relevant obligations refer to certain obligations under the 2014 Act, which if breached would either be a category 1 or a category 2 offence or be a serious market abuse offence (as defined in section 1368 of the 2014 Act) or a serious prospectus offence (as defined in section 1356 of the 2014 Act).

Relevant obligations also includes a company's obligations under tax law which is defined comprehensively in subsection 1b of section 225 as:

a. the Customs Acts;

b. the statutes relating to the duties of excise and to the management of those duties;

c. the Tax Acts;

d. the Capital Gains Tax Acts;

e. the Value-Added Tax Acts;

f. the Capital Acquisitions Tax Consolidation Act 2003 and the enactments amending or extending that Act;

g. the Stamp Duties Consolidation Act 1999 and the enactments amending or extending that Act;

h. any instruments made under an enactment referred to in any of the paragraphs (a) to (g) or made under any other enactment and relating to tax. This is generally understood to mean Irish enactments of tax measures or those such as EU regulations which take direct effect in Ireland.

It is important for directors to obtain a complete list of the relevant legal obligations cited under the 2014 Act. The 2014 Act does not include a complete list of the relevant tax obligations and not all relevant tax obligations will be applicable to every company. We recommend that directors consult with the company's legal and tax advisors, who have the appropriate knowledge and experience to advise the company on the relevant obligations which are applicable to the company. Views may also be sought from the company's auditors.

Category 1 and 2 offences are noted throughout the 2014 Act. It is important to note that the 2014 Act contains new and revised offences as compared to the previous Act. Directors should pay particular attention to the following new and revised offences:

i. Section 324(6) provides that every director of a company who is party to the approval of the statutory financial statements must ensure that the financial statements give a true and fair view.
ii. Section 330 requires directors to state that as far as they are aware, there is no relevant audit information of which the statutory auditor is unaware.
iii. Sections 286 requires directors to ensure compliance with sections 281 to 285 which are related to accounting records.
iv. Section 387 requires that any employee or director of the company must provide statutory auditors with any information or explanations they require within 2 days or as soon as is reasonably possible thereafter.

Assurance Measures: Practical Considerations

Directors are to confirm that each of the three assurance measures have been implemented and if they have not been implemented then give an explanation specifying the reasons why.

The three assurance measures refer to the following:

a. Drawing up a compliance policy statement that sets out the company's policies respecting compliance by the company with its relevant obligations;
b. Putting in place appropriate arrangements or structures that are designed to secure material compliance with the company's relevant obligations; and
c. Conducting an annual review during the financial year of any arrangements or structures referred to in (b) that have been put into place.

The arrangements or structures mentioned in (b) shall be regarded as being designed to secure material compliance by the company if they provide a reasonable assurance of compliance in all material respects with those obligations.

It should be noted that the 2014 Act does not absolutely require the three assurance measures to be put into place as the obligation is on a comply or explain basis. For example, in the course their annual review of arrangements, the directors may identify, a need for changes to existing processes which are not feasible to make within time and cost constraints prior to making their report. If that is the case, the directors must specify the reasons why these measures have not been put into place. However, such an admission is likely to convey a negative message to investors and others that have interests in the company. In the case of tax related obligations, it may increase the perceived risk by Revenue of non-compliance by the company and affect Revenue's approach to audit and other interventions in the company's case.

The compliance policy statement should detail the company's policies on how compliance is met over all applicable relevant obligations.

Most companies are likely to already have existing corporate governance arrangements in place to secure compliance with applicable laws and regulations so therefore it is important for the directors to review existing arrangements in place. The directors should then determine if there are any gaps to ensure compliance with the applicable relevant obligations.

The directors will need to implement an annual review process to review the arrangements and structures. The form of the review process is not specified in the 2014 Act and is therefore up to the judgement of the directors and the specific circumstances of the company. For example, a private limited company at the minimum balance sheet and turnover threshold may have a less formal review process than a large public limited company. A large public limited company may seek to implement formal internal controls with additional oversight from internal audit to ensure compliance. In any case, the directors should adequately document their process and findings.

Regardless of the review form taken, the directors need to be able to state that they have obtained reasonable assurance that arrangements and structures are in place and that they are sufficient to ensure material compliance with the company's relevant obligations.

The terms ‘reasonable assurance’ and ‘material compliance’ are not defined in the 2014 Act: directors therefore must apply judgement based on the circumstances for their company. In this context, the directors should be able to demonstrate the steps they took to understand, and if needs be interrogate, the structures and arrangements in place. This might be achieved by means of periodic reports to the board of directors on the design and effectiveness of the arrangements / structures in place and any identified gaps and planned remedial actions. Merely stating that the directors confirmed there were appropriate arrangements / structures in place with the person responsible for the process, be that management or outsourced to a third party, is unlikely to be sufficient. The litmus test might be whether a director could, unaided by management, explain what arrangements and structures are in place and what evidence was reviewed to ensure those were fit for purpose.

Directors should actively consider the proportionate level of reasonable assurance required to maintain material compliance.

Suggested Action for Directors:

1. Obtain a list of the relevant obligations applicable to the company under the 2014 Act.
   - Directors should be aware that the 2014 Act contains new and revised relevant obligations as compared to the previous Act.
   - We recommend that directors consult with advisors who have the appropriate knowledge and experience to advise the company on the relevant obligations which are applicable to the company and compliance therewith (e.g. legal, tax, audit, etc.).
2. Understand the company’s current corporate governance compliance arrangements and structures.
   - Most companies are likely to already have existing corporate governance arrangements in place to secure compliance with laws and regulations so therefore it is important for the directors to first review existing arrangements.
3. Perform a gap analysis to identify any additional arrangements and structures that need to be implemented to ensure compliance with the company’s relevant obligations under the 2014 Act.
4. Prepare a compliance policy statement that sets out the company’s policies regarding compliance with its relevant obligations. Communicate this policy to all employees of the company.
   - The directors should actively consider the proportionate level of reasonable assurance required to maintain material compliance.
5. Implement a process to review arrangements and structures on an annual basis.
   - It is up to the judgment of the directors on who should perform the review but the directors should ensure that the reviewer is independent, objective and competent. For example, a company’s finance director may not be a suitable reviewer as they may be too close to the process to be able to perform an independent review.
   - The annual review process is to be performed during the financial year and meant to cover off on compliance over the company’s full fiscal year. For example, the first review will be required for a company with a 31 May 2016 year-end and will cover compliance for the full year from 1 June 2015 to 31 May 2016. If the directors cannot support compliance for the full year then they will need to disclose the reason why (e.g. perhaps it was due to lack of resources, or a delay in implementation of new processes given this is the first year of the requirement).
6. Prepare a compliance statement to be included in the directors’ report.
   - We expect that, in most cases, the compliance statement in the directors’ report will be a short statement that acknowledges the directors are responsible for securing material compliance with relevant obligations and a confirmation that each of the three assurance measures have been implemented.

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