

## **Chartered Accountants Ireland or CCAB-I material**

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### **Technical Alerts**

#### **TA 03/2016 - Transposition of the EU Audit Regulation and Directive in Ireland - Information for Members (Reviewed 2022)**

##### ***Reviewed in 2022***

***This document was reviewed in 2022. The content remains the same as issued in 2016 and does not require updating in 2022.***

#### **Representation and Technical Policy**

**September 2016**

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#### **Contents**

[Introduction](#)

[Auditing Standards and Ethical Standards applying to all statutory audits](#)

[Audit reports \(for periods commencing on or after 17 June 2016\)](#)

[Key independence requirements for PIE audits](#)

[Mandatory audit firm rotation for PIE audits](#)

[Scope of Services restriction on auditing PIEs](#)

[70% cap on non-audit fees](#)

[Audit committee requirements](#)

[Appendix 1 – Article 5 of the Audit Regulation \(NAS Prohibition\)](#)

[Appendix 2 – Regulation 115 of SI 312 \(Audit Committees\)](#)

## Introduction

1. On 16 April 2014 the European Union issued its Audit Reform package comprising a Regulation and a Directive (together referred to as the Audit Regulation and Directive – 'ARD'). The Audit Directive, as amended, applies to all statutory audits. Directives must be transposed into the national law of Member States.

2. [Regulation \(EU\) No 537 of 2014 \('the Audit Regulation'\)](#) applies solely to the statutory audits of Public Interest Entities ('PIEs'). EU Regulations have direct legislative effect in Member States, though national legislation is required to transpose Member State options/derogations.

3. The Audit Regulation took effect from 17 June 2016 and EU Member States were required to adopt the appropriate legislative provisions to ensure that the Audit Directive and the relevant provisions of the Audit Regulation were in place and effective from 17 June 2016.

## Transposition in Ireland

4. [Statutory Instrument No 312 of 2016 - European Union \(Statutory Audits\) \(Directive 2006/43/EC, as amended by Directive 2014/56/EU, and Regulation \(EU\) No 537/2014\) Regulations 2016 - \('SI 312'\)](#) - was signed into law on 15 June 2016 and gives effect in Ireland to the ARD.

5. SI 312 transposes both the Audit Directive as amended and the relevant Member State options and derogations contained in the Audit Regulation, as adopted by the Irish Government. It includes requirements in relation to the auditing and ethical standards applicable to auditors, additional independence requirements in relation to PIE auditors as well provisions relating to the new regulatory regime and other regulatory aspects.

## Technical Alert 03/2016

6. This Technical Alert ('TA') focuses on a number of key aspects of the ARD transposition, namely:

- Auditing standards and ethical standards applying to all statutory audits;
- Audit report requirements;
- Key independence requirements for PIE audits; and
- Some new Audit Committee requirements.

The TA does not consider regulatory aspects of the legislation.

## Auditing Standards and Ethical Standards applying to all statutory audits

7. SI 312 requires the Irish Auditing and Accounting Supervisory Authority ('IAASA') to assume responsibility for the adoption of auditing and ethical standards applying to statutory audits in Ireland from 17 June 2016. The FRC continues, under the new regime, to be auditing and ethical standard setter for the UK. As such, there will no longer be common standards, issued by the FRC, for both Ireland and the UK.

8. For statutory audits in relation to **financial periods beginning before 17 June 2016**, the [International Standards on Auditing \(UK and Ireland\)](#) and [Ethical Standards \(ES\) 1 to 5 and the ES Provisions for Small Entities \('ES PASE'\)](#) will continue to be applicable (click on relevant link for access to the relevant standards).

9. For statutory audits in relation to **financial periods beginning on or after 17 June 2016**, we understand that IAASA is planning to temporarily adopt the FRC's Revised Ethical Standard 2016 ('ES 2016'), as amended for use in Ireland, soon, whilst also consulting on the longer term approach to be adopted in terms of Irish auditing and ethical standards. We also understand from IAASA that, until the revised standard is temporarily adopted, the existing Ethical Standards applicable in Ireland are given effect in Ireland via the regulatory requirements of the various accountancy

bodies, with new independence measures in the Audit Regulation also applying to the auditors of PIEs.

10. IAASA published its approach to this adoption process on 14 July which indicated the publication of a consultation in Quarter 3 2016. The proposed approach and timetable can be accessed by [clicking on this link](#).

### **Audit reports (for periods commencing on or after 17 June 2016 )**

11. SI 312<sup>1</sup> contains changes to the content and format of the audit report. These will apply to audit reports for **financial periods beginning on or after 17 June 2016**. Typically, therefore, these changes will apply to audit reports on financial statements for years ending 30 June 2017 and later.

**12. Members should, however, be aware that the requirements would apply to audit reports for short accounting periods beginning on or after 17 June 2016.**

13. Changes include:

- The insertion of a legal requirement to "identify the place of establishment of the statutory auditors who made the report";
- Changes to the wording of the opinion regarding consistency of the directors' report with the financial statements; and
- The insertion of a legal requirement for a statement on any "material uncertainty relating to events or conditions that may cause significant doubt about the entity's ability to continue as a going concern".

14. There are also new requirements with regard to **PIE audit reports** contained in Article 10 of the Audit Regulation, which include the requirement to

- State by whom the appointment of statutory auditor or audit firm was made (e.g. members of the company or Board of Directors);
- Indicate the date of appointment;
- Describe the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud and, where relevant, key observations with regard to those risks;
- Explain to what extent the statutory audit was considered capable of detecting irregularities, including fraud;
- Confirm that the audit opinion is consistent with the auditor's report to the audit committee;
- Declare that prohibited NAS were not provided and that the statutory auditor or audit firm remained independent of the PIE in conducting the audit;
- Indicate any services, in addition to the statutory audit, which were provided by the statutory auditor or audit firm to the PIE and its controlled undertakings, which have not been disclosed in the management report or financial statements.

15. Chartered Accountants Ireland will prepare further guidance on the revised audit report requirements in due course.

### **Key independence requirements for PIE audits**

#### **Mandatory audit firm rotation for PIE audits**

16. The Irish and UK Governments have adopted different positions on mandatory audit firm rotation (MAFR) for PIE audits. The Audit Regulation sets a maximum period for audit tenure of 10 years (where joint auditors are not appointed), but with a Member State option that this period can be increased to a maximum of 20 years, subject to a public mandatory tendering process being conducted (Article 17). Whilst the UK has taken up the Member State option to extend the period to 20 years under Article 17(4), Ireland has decided not to apply the derogation available and to implement a 10 year maximum period.

17. Article 41 of the Audit Regulation sets out the transition arrangements for audit/client relationships existing at 16 June 2014<sup>2</sup>. The transposition provisions differ depending on the length of the existing audit/client relationships at that date.

#### **Key rotation dates**

18. For Irish PIEs, the following table sets out the rotation requirements depending on the length of their pre-existing audit/client relationships.

19. Of particular note is that **PIEs whose audit/client relationships reached the maximum 10 years permitted between 16 June 2014 and 17 June 2016 must undertake the required public tendering process (see Regulation**

**58 of SI 312) to appoint a new auditor for the first financial year commencing on or after 17 June 2016.**

Rotation required for F/Y commencing on/after:	Audit tenure at 16 June 2014	Commencement of audit/client relationship		Comment
		After:	Before:	
17 June 2016	Less than 11 years	17 June 2003	16 June 2006	Maximum 10 year tenure reached between 16 June 2014 and 17 June 2016 – Article 41(3)
To be determined based on start date	Less than 11 years	17 June 2006	16 June 2014	10 years from the first audit of the PIE – Article 41(3)
17 June 2023	Between 11 and 20 years	17 June 1994	16 June 2003	Article 41(2)
17 June 2020	20 years or more		16 June 1994	Article 41(1)

**20.Examples:**

**A PIE whose audit/client relationship:**

**•Reached 10 years for the audit of the financial statements for the year ended 30 June 2015. The incumbent auditor would be permitted to complete the audit of the financial statements for the year ended 30 June 2016, but the public tender process would have to be completed to appoint a new auditor to undertake the audit of the financial statements for the year ended 30 June 2017.**

**•Commenced in relation to the year ended 30 June 1994 may continue to engage the same auditor until the completion of the audit of the financial statements for the year ended 30 June 2020.**

**•Commenced in relation to the year ended 30 June 1995 may continue to engage the same auditor until the completion of the audit of the financial statements for the year ended 30 June 2023.**

21.Regulation 104 of SI 312 provides that a PIE may apply to IAASA under exceptional circumstances requesting an extension to reappoint a statutory auditor or audit firm for a period of up to 2 years on an exceptional basis, pursuant to Article 17(6) of Audit Regulation:

**Scope of Services restriction on auditing PIEs**

22.Article 5 of the Audit Regulation sets out the non-audit services ('NAS') which, from 17 June 2016, **auditors of PIEs, and the network of such auditors**, are no longer permitted to provide to **a PIE, its parent undertaking or to its controlled undertakings within the European Union**. This prohibition applies to:

- a)The period between the beginning of the period audited and the issuing of the audit report; and
- b)The financial year immediately preceding the period referred to in point (a) in relation to 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.

23.Article 5, containing the full list of prohibited services, is reproduced in [Appendix 1](#) to this TA.

24.Some concerns have been raised as to the interpretation of the phrase "...a PIE, its parent undertaking or to its controlled undertakings within the European Union" in an Irish legal context. The European Commission Q&As on statutory audit reform indicate that the intention of the Commission was to prohibit the provision of certain non-audit services to *EU PIEs, EU parents and EU subsidiaries*. The concerns raised are that the phrase could be interpreted in an Irish context to include non-EU parents.

Chartered Accountants Ireland has written to the Department of Jobs, Enterprise and Innovation to seek clarity on the issue.

25. There is derogation for the provision of certain of those services, as provided for in Regulation 106 of SI 312, provided that:

- The services have ***no direct or have immaterial effect***, separately or in the aggregate, on the audited financial statements;
- The estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee; and
- The principles of independence set out in SI 312 are complied with by the auditor.

26. Members should note that the UK derogation has been transposed differently to the Irish derogation - see paragraph 5.168R of the FRC's Revised Ethical Standard 2016.

27. Per Regulation 106, this derogation may be applied to the following NAS:

- Tax services relating to—
  - (i) Preparation of tax forms,
  - (ii) Identification of public subsidies and tax incentives unless support from the statutory auditor or audit firm in respect of such services is required by law,
  - (iii) Support regarding tax inspections by tax authorities unless support from the statutory auditor or audit firm in respect of such inspections is required by law,
  - (iv) Calculation of direct and indirect tax and deferred tax, or
  - (v) Provision of tax advice;
- Valuation services, including valuations performed in connection with actuarial services or litigation support services.

**28. If the intention is to continue as auditor to a PIE client, PIE auditors and their network firms will need to cease providing those services which are prohibited, and for which there is no derogation, with effect from the first financial year beginning on or after 17 June 2016 (and as noted above, not have provided any services in relation to 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 in the preceding financial year).**

29. In accordance with Article 5(5) of the Audit Regulation, for services provided by the network to *controlled undertakings outside the EU*, a 'threats and safeguards' approach is required, although there are a limited number of prohibitions which still apply:

- Bookkeeping and preparing accounting records and financial statements;
- 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; and
- Services that involve playing any part in the management of decision making of the audited entity.

#### **70% cap on non-audit fees**

30. Article 4(2) of the Audit Regulation provides that, where the ***statutory auditor or audit firm*** provides ***a PIE, its parent undertaking or its controlled undertakings***, for a period of three or more consecutive years, permitted NAS, the total fees for such services must be limited to no more than 70% of the fees paid in the last three years for the statutory audit(s) of the audited entity, and where applicable, of its parent undertaking, or its controlled undertakings and of the consolidated financial statements of that group of undertakings.

**31. In Ireland, this cap applies to the statutory auditor or audit firm and does not apply to permitted services provided by members of the statutory audit firm's network.**

32. NAS, other than those specifically prohibited, are excluded from the calculation of the cap where they are required by EU law or Irish law.

33. The cap does not appear to be retrospective, such that it only applies from the first financial year beginning on or after 17 June 2016.

34. **However, PIE auditors will need to consider if the level of fees for NAS being provided to PIE audit clients is such that the 70% cap is likely to be breached after three years of consecutively auditing the PIE client.**

35. **This would also be an issue that needs careful consideration by the audit committees of such PIEs.**

36. Members should be aware that the UK, in transposing the requirements of Article 4(2), has extended this restriction beyond the statutory auditor or audit firm to also include a member of the network of the statutory audit firm. Thus, in the UK, fees for NAS provided to the PIE and its controlled undertakings by network firms are included in the calculation of the 70% cap - see paragraphs 4.34R and 4.35R of ES 2016.

#### **Audit committee requirements**

37. Regulation 115 of SI 312 sets out certain requirements for audit committees for PIEs. Of particular note is that as from 17 June 2016::

- The members of the audit committee as a whole shall have **competence relevant to the sector** in which the PIE is operating (Regulation 115(6)); and
- The chairman of the audit committee shall be appointed **by its members** and shall be independent of the audited entity (Regulation 115(7)).

38. A limited number of PIEs are exempted from these requirements, including certain UCITS and AIFs – please see Regulation 115(10) for details of the PIEs exempted. Regulation 115 is reproduced in [Appendix 2](#) to this TA.

#### **Appendix 1 – Article 5 of the Audit Regulation (NAS Prohibition)**

##### **Article 5 Prohibition of the provision of non-audit services**

1. A statutory auditor or an audit firm carrying out the statutory audit of a public-interest entity, or any member of the network to which the statutory auditor or the audit firm belongs, shall not directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertakings within the Union any prohibited non-audit services in:

- (a) the period between the beginning of the period audited and the issuing of the audit report; and
- (b) the financial year immediately preceding the period referred to in point (a) in relation to the services listed in point (e) of the second subparagraph.

For the purposes of this Article, prohibited non-audit services shall mean:

- (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;
- (f) valuation services, including valuations performed in connection with actuarial services or litigation support services;
- (g) legal services, with respect to:
  - (i) the provision of general counsel;
  - (ii) negotiating on behalf of the audited entity; and
  - (iii) acting in an advocacy role in the resolution of litigation;
- (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) human resources services, with respect to:

(i) management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:

– searching for or seeking out candidates for such position; or

– undertaking reference checks of candidates for such positions;

(ii) structuring the organisation design; and

(iii) cost control.

2. Member States may prohibit services other than those listed in [paragraph 1](#) where they consider that those services represent a threat to independence. Member States shall communicate to the Commission any additions to the list in [paragraph 1](#).

3. By way of derogation from the second subparagraph of [paragraph 1](#), Member States may allow the provision of the services referred to in points (a) (i), (a) (iv) to (a) (vii) and (f), provided that the following requirements are complied with:

(a) they have no direct or have immaterial effect, separately or in the aggregate on the audited financial statements;

(b) the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee referred to in Article 11; and

(c) the principles of independence laid down in Directive 2006/43/EC are complied with by the statutory auditor or the audit firm.

4. A statutory auditor or an audit firm carrying out statutory audits of public-interest entities and, where the statutory auditor or the audit firm belongs to a network, any member of such network, may provide to the audited entity, to its parent undertaking or to its controlled undertakings non-audit services other than the prohibited non-audit services referred to in [paragraphs 1](#) and [2](#) subject to the approval of the audit committee after it has properly assessed threats to independence and the safeguards applied in accordance with Article 22b of Directive 2006/43/EC. The audit committee shall, where applicable, issue guidelines with regard to the services referred to in [paragraph 3](#).

Member States may establish stricter rules setting out the conditions under which a statutory auditor, an audit firm or a member of a network to which the statutory auditor or audit firm belongs may provide to the audited entity, to its parent undertaking or to its controlled undertakings non-audit services other than the prohibited non-audit services referred to in [paragraph 1](#).

5. When a member of a network to which the statutory auditor or the audit firm carrying out a statutory audit of a public-interest entity belongs provides any of the non-audit services, referred to in [paragraphs 1](#) and [2](#) of this Article, to an undertaking incorporated in a third country which is controlled by the audited public-interest entity, the statutory auditor or the audit firm concerned shall assess whether his, her or its independence would be compromised by such provision of services by the member of the network.

If his, her or its independence is affected, the statutory auditor or the audit firm shall apply safeguards where applicable in order to mitigate the threats caused by such provision of services in a third country. The statutory auditor or the audit firm may continue to carry out the statutory audit of the public-interest entity only if he, she or it can justify, in accordance with Article 6 of this Regulation and Article 22b of Directive 2006/43/EC, that such provision of services does not affect his, her or its professional judgement and the audit report.

For the purposes of this paragraph:

(a) being involved in the decision-taking of the audited entity and the provision of the services referred to in points (b), (c) and (e) of the second subparagraph of [paragraph 1](#) shall be deemed to affect such independence in all cases and to be incapable of mitigation by any safeguards.

(b) provision of the services referred to in the second subparagraph of [paragraph 1](#) other than points (b), (c) and (e) thereof shall be deemed to affect such independence and therefore to require safeguards to mitigate the threats caused thereby.

## **Appendix 2 – Regulation 115 of SI 312 (Audit Committees)**

## PART 9 AUDIT COMMITTEES

### *Audit committees for public-interest entities*

115.(1)The directors of each public-interest entity shall establish an audit committee for the entity.

(2)The majority of the members of the audit committee shall be non-executive directors of the public-interest entity, that is to say, directors—

(a)the terms of appointment of whom indicate or state that they are being appointed in a non-executive capacity, and

(b)who otherwise possess the requisite degree of independence (particularly with regard to each of them satisfying the condition in [paragraph \(3\)](#)) so as to be able to contribute effectively to the committee's functions.

(3)The condition referred to in [paragraph \(2\)\(b\)](#) is that the director does not have, and at no time during the period of 3 years preceding his or her appointment to the committee did have—

(a)a material business relationship with the public-interest entity, either directly, or as a partner, shareholder, director (other than as a non-executive director) or senior employee of a body that has such a relationship with the entity, or

(b)a position of employment in the public-interest entity.

(4)At least one of the directors referred to in [paragraph \(2\)](#) shall be a person who has competence in accounting or auditing.

(5)For the purposes of [paragraphs \(2\)](#) and [\(3\)\(a\)](#), a non-executive director is a director who is not engaged in the daily management of the public-interest entity or body concerned, as the case may be.

(6)The members of the audit committee as a whole shall have competence relevant to the sector in which the audited entity is operating.

(7)The chairman of the audit committee shall be appointed by its members and shall be independent of the audited entity.

(8)Any proposal of the directors of a public-interest entity with respect to the appointment of a statutory auditor or audit firm to the entity shall be based on a recommendation made to the directors by the audit committee.

(9)The statutory auditor or audit firm shall report to the audit committee of the public-interest entity on key matters arising from the statutory audit of the entity, and, in particular, on material weaknesses in internal control in relation to the financial reporting process.

(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 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.

(11) An entity that avails itself of the exemption under [paragraph \(10\)\(c\)](#) shall, by means of a statement to that effect included—

(a) in any annual report published by it, or

(b) in an annual return or other periodic statement delivered by it to the Registrar of Companies or Central Bank of Ireland,

set forth the reasons for why it considers the establishment of an audit committee by it is not appropriate and, accordingly, why it has availed itself of that exemption.

(12) Without prejudice to the responsibility of the directors of the public interest entity, the responsibilities of the audit committee shall include—

(a) to inform directors of the entity of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process,

(b) to monitor the financial reporting process and submit recommendations or proposals to the directors of the entity to ensure its integrity,

(c) 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,

(d) to monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any findings and conclusions by the Supervisory Authority pursuant to Article 26(6) of Regulation (EU) No 537/2014,

(e) to review and monitor the independence of the statutory auditors or the audit firms in accordance with Regulations 93 to 98 and Article 6 of Regulation (EU) No 537/2014, and, in particular, the appropriateness of the provision of non-audit services to the audited entity in accordance with Article 5 of that Regulation, and

(f) 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 in accordance with Article 16 of Regulation (EU) No 537/2014 except when Article 16(8) of that Regulation is applied.

(13) Paragraph (8) applies to a proposal of the directors (with respect to the appointment of a statutory auditor or audit firm to a public-interest entity) made at any time after the establishment of the audit committee in respect of the entity.

(14) The other provisions of these Regulations with regard to the performance of a function by the audit committee apply with respect to accounts of the public-interest entity for financial years beginning on or after the establishment of the audit committee in respect of the entity.

(15) A public-interest entity which, without reasonable excuse, contravenes [paragraph \(11\)](#) shall be guilty of an offence and shall be liable—

(a) on summary conviction, to a class A fine, or

(b) on conviction on indictment, to a fine not exceeding €12,500.

<sup>1</sup> See Regulation 9, which amends Section 336 of the Companies Act 2014

<sup>2</sup> The date of the Audit Regulation