SUPPLEMENTAL SUBMISSION OF THE LAW SOCIETY OF IRELAND TO THE DEPARTMENT OF ENTERPRISE, TRADE AND EMPLOYMENT ON THE COMPANIES (AUDITING AND ACCOUNTING) BILL 2003 and in particular PROPOSAL FOR DIRECTORS' COMPLIANCE STATEMENTS SUPPLEMENTAL SUBMISSION

5th JUNE 2003

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COMPANIES (AUDITING AND ACCOUNTING) BILL 2003

and in particular

PROPOSAL FOR DIRECTORS' COMPLIANCE STATEMENTS

SUPPLEMENTAL SUBMISSION

OF THE LAW SOCIETY OF IRELAND

5th June 2003

1 In our submission dated 28th May 2003, the Law Society made various proposals regarding the Companies (Auditing and Accounting) Bill 2003. In particular we submitted that the proposed new law requiring directors' compliance statements brought yet another law which distinguishes Irish law from that of peer jurisdictions, and was likely to impose expense.

It also gives rise to the possibility of the proposed law being (legitimately) evaded by the ruse of incorporating a company in another jurisdiction. This would have the effect of either wholly or largely avoiding the new Irish legal cocktail of (i) presumed responsibility of directors (ii) reports to the Director of Corporate Enforcement for even the most minor of trifling non-compliance as well as (iii) the proposed new compliance statement.

2 We note:

- the arguments made in the Senate debates by non-Government speakers for the exclusion from the directors' compliance statement of law other than company law and tax law;

- the suggestion that an increase of the turnover limits for audit exemption might alleviate the difficulties by providing an exclusion for smaller companies.

Both of these approaches, we submit, completely miss the point.

3 At the heart of most of the accounting scandals was ***not*** a breach of law or a failure to sit and reflect as to the level of legal compliance, but rather the wilful avoidance of the plain truth of the finances of the companies concerned.

The accounting rules (in particular the highly technical rules of US accounting principles) available to clients and accountants permitted the perversion of the true financial situation of the companies. If it is proposed to invite directors to sit and reflect on the state of their companies, we submit that they are best invited to read

their responsibilities in the Companies Acts as to the accuracy, truth and fairness of accounts, both management and audited accounts.

4	The proposed compliance statement will increase the cost of audit of Irish-incorporated companies. This gives rise to the serious possibility of companies incorporating in other jurisdictions and trading as branches here, outside the ambit of the new law.

This is a simple matter of euros and cents. If the cost of an audit of an Irish company has an amount added to it for (i) the advice as to compliance and (ii) the auditors' opinion as to the quality of the directors' compliance statement and their digestion of the compliance advice, people will incorporate elsewhere, moving value from the Irish economy.

It also has the possibility of increasing the premiums for directors' and officers' insurance cover, by reason of the creation of a new insurable risk.

5	The proposed exclusion of audit-exempt companies is not the way to deal with the issue. It will have the result of creating on the one hand a class of larger companies, many of which will be non-Irish incorporated and on the other a mass of unaudited companies, merely so as to avoid the imposition of the new compliance statement requirement.

It is in Ireland's interest to present as a compliant jurisdiction. We submit that to create a situation where a great number of companies are exempt from routine audit whilst on the other hand imposing an increased cost on those who do have an audit does not give the right impression of Ireland Inc.

What we would seem to be saying is that we are in favour of good accounting and auditing, but not for small companies.

6	The compliance statement should not be confused with the US Sarbanes-Oxley Act and the proposal from the EU Commission for compliance statements for listed companies. Those existing and proposed laws apply to publicly quoted companies.

In Ireland, the number of publicly quoted companies is less than 100.

The number of unquoted companies is over 140,000.

7	The proposal for directors' compliance statements is being brought forward at a time where the Company Law Review Group has put simplification of the law – hand in hand with the promotion of enterprise – as its main objective in its analysis and proposed reworking of company law. Would it not be absurd for the most serious analysis of company law which is ongoing, to be accompanied by a law which may drive incorporation, even on a small scale, outside the State? Would it not discredit the law generally? How can we promote Ireland if we have an uneven law that has a trend for non-Irish larger companies with branches in Ireland and unaudited Irish companies?

Solution and proposal

The Law Society recognises that there is an appetite for a compliance statement, in order to exorcise the memories of the Irish-registered-non-resident (IRNR) companies era, as well as the various mischiefs that gave rise to the Report of the Review Group on Auditing in 2000.

However, we are strongly of the view that the focus of any such proposal, if it is to be proceeded with, along with those introduced by the Company Law Enforcement Act, 2001 should be towards the integrity and accuracy of the accounts.

In this context, we propose as follows:

1 If the compliance statement is kept, it should be by way of a statement in the report of the directors under section 158 of the Principal Act that the directors have satisfied themselves as to the accuracy in all material respects, and / or internal structures within the company which will take all reasonable steps to procure such accuracy, in all material respects, of:

   (a) the information in the annual accounts;

   (b) financial information returned to the revenue commissioners for the purposes of corporation tax, PAYE, PRSI and VAT;

   (c) information furnished by the company to any regulator for the purpose of the issue of a regulatory licence to conduct the particular business of the company.

2 Section 383 of the Companies Act, 1963, as amended in 2001 should be amended so as to:

   - keep the 2001 law to the extent that it imposes on directors the express duty to keep or to procure the keeping of proper books of account, with presumed default on their part when this is not the case

   - resume the pre-2001 law in relation to other breaches by companies of the Companies Acts

3 The duty of auditors to notify the ODCE of circumstances suggesting indictable offences under the Companies Acts should be focussed on failure to keep proper books of account, or company or officer fraud.

We believe that the refocusing of the proposed law on the genuine issues that have arisen in recent scandals would be a considerable improvement on what is proposed.

5th June 2003