

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

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### **Circular 02/08 to all Company Secretaries of listed entities**

**6 October 2008**

**Subject: Requirement for public interest entities to have an audit committee under Directive 2006/43/EC (Statutory Audit Directive).**

#### **[1.0 Introduction]**

In September 2008 the Listing Authority approved the amendments to the Listing Rules required to fully transpose the requirements of article 41 of the Statutory Audit Directive. The attached document, marked as 'Appendix A', includes the amendments to Chapter 8 of the Listing Rules that were approved by the Listing Authority and that will come into force immediately upon publication.

The amendments to Listing Rules 8.56 to 8.64 were drafted in consultation with the Working Committee set up by the Listing Authority to review the Listing Rules. This Working Committee includes representatives from the Malta Stock Exchange, the Financial Services Consultation Council, the College of Stockbrokers and the Forum of Company Secretaries of Listed entities. The proposed amendments to the Listing Rules were issued for public consultation and were further revised to take into account the feedback received during the consultation period. This circular explains the main issues which are involved in transposing the requirements of article 41 of Directive 2006/43/EC.

#### **[2.0 Statutory Audit Directive]**

##### **[2.1 Audit Committee]**

Article 41(1) of Directive 2006/43/EC (hereinafter referred to as the "Statutory Audit Directive") requires public interest entities to have an audit committee. Under article 2(13) of the Statutory Audit Directive, public interest entities are defined as:-

- a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State;
- b) credit institutions as defined in point 1 of Article 1 of Directive 2000/12/EC; and
- c) insurance undertakings as defined in Article 2(1) of Directive 91/674/EEC.

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Article 2(13) of the Statutory Audit Directive also allows Member States to designate other entities as public-interest entities such as, for instance, those entities that are of significant public relevance owing to the nature of their business, their size or the number of their employees.

## **[2.2 Compositional and functional requirements of Audit Committee]**

### **[2.2.1 Composition of the audit committee]**

According to Article 41(1) of the Statutory Audit Directive, at least one member of the audit committee of public interest entities has to be independent and shall have competence in accounting and/or auditing.

Listing Rule 8.56 has been amended so as to clearly stipulate that all the members of the audit committee must be directors and that at least one member of the audit committee must be an independent non-executive director and must be competent in accounting and/or auditing.

Furthermore, a new Listing Rule 8.56a has been introduced stipulating that it is up to the board of each listed company to determine what constitutes competence in accounting and/or auditing. Moreover, the said Listing Rule requires the board of directors of a listed entity to identify, in its corporate governance statement, that independent non-executive director who is considered to be competent in accounting and/or auditing together with the reasons why it deems the chosen director to possess the said competence.

### **[2.2.2 Transitional period]**

In view of the newly-introduced requirement that at least one independent non-executive director has to be competent in accounting/or auditing, the Listing Authority has decided that those entities already listed be granted a transitional period to comply with this requirement. Any changes that would need to be carried out so that the audit committee of these issuers complies with the new Listing Rule 8.56 would need to be approved by not later than the next annual general meeting due to be held in 2009.

### **[2.2.3 Functions of the audit committee]**

According to Article 41(2) of the Statutory Audit Directive, the functions of the audit committee are to:

- monitor the financial reporting process;

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- monitor the effectiveness of the company's internal control, internal audit where applicable and risk management systems;
- monitor the statutory audit of the annual and consolidated accounts; and
- review and monitor the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity.

The provisions of Article 41(2) of the Statutory Audit Directive have been transposed in Listing Rule 8.58 as re-numbered.

Article 41(3) of the Statutory Audit Directive also provides that the proposal of the board of directors for the appointment of a statutory auditor or audit firm should be based on the recommendation of the audit committee. This provision is implemented by new Listing Rule 8.58.5.

Moreover, the statutory auditor or audit firm of a listed entity is required by Article 41(4) of the Statutory Audit Directive to report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process. A new Listing Rule 8.60 has been introduced so as to transpose this provision of the Statutory Audit Directive into the Listing Rules.

### **[3.0 Exemption from the obligation to have an audit committee]**

Article 43(6) of the Statutory Audit Directive provides that Member States may exempt from the obligation to have an audit committee:

“(a) any public-interest entity which is a subsidiary undertaking within the meaning of Article 1 of Directive 83/349/EEC if the entity complies with the requirements in paragraphs 1 to 4 of this Article at group level;

(b) any public-interest entity which is a collective investment undertaking as defined in Article 1(2) of Directive 85/611/EEC. Member States may also exempt public-interest entities the sole object of which is the collective investment of capital provided by the public, which operate on the principle of risk spreading and which do not seek to take legal or management control over any of the issuers of its underlying investments, provided that those collective investment undertakings are authorised and subject to supervision by competent authorities and that they have a depositary exercising functions equivalent to those under Directive 85/611/EEC;

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(c) any public-interest entity the sole business of which is to act as issuer of asset-backed securities as defined in Article 2(5) of Commission Regulation (EC) No 809/2004 [21]. In such instances, the Member State shall require the entity to explain to the public the reasons for which it considers it not appropriate to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee;

(d) any credit institution within the meaning of Article 1(1) of Directive 2000/12/EC 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, provided that the total nominal amount of all such debt securities remains below EUR 100000000 and that it has not published a prospectus under Directive 2003/71/EC."

The Listing Authority has decided to take up the exemptions referred to in paragraphs (a) to (c) of article 41(6) of the Statutory Audit Directive, which exemptions have been inserted by means of new Listing Rule 8.56b.

New Listing Rule 8.56c has been introduced so as to define the term 'asset-backed securities', which definition is based on the definition contained in Article 2(5) of Regulation 809/2004. According to this definition, asset-backed securities are securities which:

- a) represent an interest in assets, including any rights intended to assure servicing, or the receipt or timeliness of receipts by holders of assets, of amounts payable thereunder; or
- b) are secured by assets and the terms of which provide for payments which relate to payments or reasonable projections of payments calculated by reference to identified or identifiable assets.

Since the Listing Authority decided to take up the exemption granted by Article 39 of the Statutory Audit Directive, the exemption contained in paragraph (d) of Article 41(6) of the Statutory Audit Directive has not been taken up since credit institutions whose shares are not admitted to trading on a regulated market would already be covered by the exemption found in article 39 of the Statutory Audit Directive.

Furthermore, the newly introduced Listing Rule 8.56d provides that in the case of issuers whose securities are already admitted to listing on a regulated market in Malta, the exemptions referred to in new Listing Rule 8.56b would not be automatically operative but such issuers would have to apply in writing to the Listing Authority within two months from the coming into force of Listing Rule 8.56d, setting out the reasons why they qualify for any of the said exemptions. The Listing

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Authority may refuse or accept such application and, if the Listing Authority accepts an application submitted by a listed entity that qualifies for one or more of the exemptions mentioned in Listing Rule 8.56b, it will be entitled to impose any condition that it considers appropriate.

## **[4.0 Other amendments to the Listing Rules]**

Listing Rule 8.62 has been amended so as to stipulate that the audit committee should meet at least four times a year and not six times a year.

As a result of an amendment to Listing Rule 8.64, when informing the Listing Authority of the composition of the audit committee, issuers will now have to clearly identify the independent member of the audit committee who is competent in accounting and/or auditing, apart from providing the Authority with the terms of reference of such committee.

**P J Spiteri**  
**Chairman of Listing Committee**

*Audit Committee*

- 8.56 The Issuer shall establish and maintain an audit committee of at least three (3) members all of whom shall be directors. The majority of such members shall be non-executive Directors. At least one member of the audit committee shall be independent and shall be competent in accounting and/or auditing. The committee shall be chaired by a non-executive Director.
- 8.56a It shall be the responsibility of the Board to determine who of the independent members of the audit committee directors is competent in accounting and/or auditing and such director shall be identified in the corporate governance statement that is required to be made under Listing Rule 8.37. In the said corporate governance statement the Board shall also include the reasons why it considers the chosen director to be competent in accounting and/or auditing.
- 8.56b The obligation to establish an audit committee shall not apply to:
- 8.56b.1 an Issuer of Debt Securities which is a Subsidiary Undertaking provided that an audit committee which is compliant with these Listing Rules and which the Listing Authority considers to be satisfactory is set up at the ultimate Parent Undertaking;
  - 8.56b.2 an Issuer which is a UCITS in terms of article 1(2) of Directive 85/611/EEC;
  - 8.56b.3 an Issuer the sole object of which is the collective investment of capital provided by the public, which operates on the principle of risk spreading and which does not seek to take legal or management control over any of the issuers of its underlying investments, provided that such collective investment undertaking is authorised and subject to supervision by competent authorities and it has a depositary exercising functions equivalent to those under Directive 85/611/EEC;
  - 8.56b.4 an Issuer the sole business of which is to issue asset backed securities, provided that the Issuer explains to the public, by means of a Company Announcement, the reasons for which it considers it inappropriate to have an audit committee;
- 8.56c For the purposes of Listing Rule 8.56b.4, “asset backed securities” means securities which:
- 8.56e.1 represent an interest in assets, including any rights intended to assure servicing, or the receipt or timeliness of receipts by holders of assets, of amounts payable thereunder; or
  - 8.56e.2 are secured by assets and the terms of which provide for payments which relate to payments or reasonable projections of payments calculated by reference to identified or identifiable assets.
- 8.56d In the case of Issuers whose securities are already admitted to listing on a Regulated

Market in Malta, the exemptions referred to in Listing Rule 8.56b shall not be automatically operative. Such Issuers may, within two months from the coming into force of this Listing Rule, apply in writing to the Listing Authority setting out the reasons why it qualifies for one or more of the said exemptions. The Listing Authority may accept or dismiss an application submitted to it in terms of this Listing Rule and, when accepting such application, the Listing Authority may subject it to such conditions as it may deem appropriate.

- 8.57 The primary purpose of the audit committee is to protect the interests of the company's shareholders and assist the Directors in conducting their role effectively so that the company's decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times.
- 8.58 Without prejudice to Listing Rule 8.56, the Issuer shall determine the terms of reference, life span, composition, role and function of such committee and shall establish, maintain and develop appropriate reporting procedures, provided that the main role and responsibilities of the audit committee shall include:
- 8.58.1 the monitoring of the financial reporting process;
  - 8.58.2 the monitoring of the effectiveness of the company's internal control, internal audit where applicable, and risk management systems;
  - 8.58.3 the monitoring of the audit of the annual and consolidated accounts;
  - 8.58.4 the maintenance of communication on such matters between the Board, management, the independent Auditors and the internal Auditors;
  - 8.58.5 the making of recommendations to the Board in relation to the appointment of the external Auditor and the approval of the remuneration and terms of engagement of the external Auditor following appointment by the shareholders in general meeting;
  - 8.58.6 the monitoring and reviewing of the external Auditor's independence, and in particular the provision of additional services to the Issuer.
  - 8.58.7 the development and implementation of a policy on the engagement of the external Auditor to supply non-audit services.
- 8.59 The Issuer shall ensure that the Audit Committee establishes internal procedures and shall monitor these on a regular basis.
- 8.60 The external Auditor shall report to the audit committee on key matters arising from the audit, and in particular on material weaknesses in internal control in relation to the financial reporting process.
- 8.61 The audit committee shall establish and maintain access between the internal and external Auditors of the Company and shall ensure that this is open and constructive.
- 8.62 The audit committee shall meet at least four times a year. The head of Internal Audit should attend the meetings of this Committee.
- 8.63 When the audit committee's monitoring and review activities reveal cause for concern or scope for improvement, it shall make recommendations to the Board on

action needed to address the issue or make improvements. The Board shall satisfy itself that any issues raised by the audit committee and the external Auditor and communicated to the Board have been adequately addressed.

- 8.64 The Issuer shall inform the Listing Authority how the audit committee is constituted, identifying clearly that independent member of the committee who is competent in accounting and/or auditing as required by Listing Rule 8.56 and shall provide the Listing Authority with the terms of reference of the audit committee. The Issuer shall inform the Listing Authority, without delay, of any changes to the above.