

# Expert

## Audit law

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## Auditors, be aware!

There are new rules on the establishment of audit committees and limits on the services auditing firms can provide

The new act on statutory auditors came into force in June 2017 and implements the law of the European Union, namely Statutory Audit Directive 2001/4/56/UE. The act contains very important regulations for the entire corporate system of companies which are public interest entities, including listed companies. In addition, the new regulations will cover such entities as payment institutions, brokerage houses and banks (yet, not the companies listed on the alternative stock exchange, New-Connect). The act also limits the capacity of auditing firms to provide continuous services.

### What and when?

When it comes to audit committees and the requirements for the supervisory board members, the basic change concerns audit committees and the obligation to create them. Previous regulations stipulated that public interest entities should have an audit committee if the number of supervisory board members exceeded five. After the changes, these entities will have to set up audit committees irrespective of the number of supervisory board members, but depending on the size of the company.

The requirement to form a separate corporate authority—the audit committee—applies to public companies subject to trading on the Warsaw Stock Exchange that exceeds two of the following values: PLN 17,000,000 of the sum of the balance sheet assets at the end of the financial year; PLN 34,000,000 of net revenue from the sales of goods and products for the financial year; annually supports fifty full-time jobs.

The committee should consist of no less than three persons, with the majority of the audit committee, including its chair, to be appointed by the Supervisory

Board or another relevant supervising corporate authority, from the existing members of this supervising corporate authority.

As a result, changes may be necessary in the composition of the supervisory board, from which an audit committee may be set up. Then we have to check whether we need to set up an audit committee, or maybe we are a smaller company where the audit committee function within the meaning of the new regulation can be carried out directly by the entire supervisory board. Companies that do not exceed two from the stated list of value are not required to form an audit committee, however, their supervisory board members and other relevant supervising authority members must meet the following requirements applicable to the members of the audit committee: the board must compose of at least three persons; at least one of them must have knowledge and skills in accounting or auditing of the financial statements; most members, including its chairman, must be independent of the company.

### Who's in?

In comparison to the old regulation, the act describes in more detail who can be classified as independent of the company. A member, is considered independent of the company, if he/she meets the following criteria (related to the company and any of its affiliated entities):

a) was not a member of the management board nor senior management (over the last five years), neither is related to any of the corporate authority members.

b) was not an employee of the company in past three years (exception: employee elected to the supervisory board as employee representative);

c) does not control or does not represent the persons or entities

exercising control over the company;

d) has not received any significant remuneration (exception: remuneration for the position of supervisory board member or audit committee member);

e) has not maintained a significant economic relationship (directly or indirectly) with the company or its affiliated entity,

f) has not been in the last two years in any way related to the firm carrying out an audit of a financial statement of the company or its affiliated entity as the owner, member of any corporate authority, an employee or manager, etc.

g) has not been a member-member of the supervisory board for more than 12 years.

It is worth noting that at least one member must have the knowledge and skills in the industry in which the company operates. Yet, the act does not specify what qualifications are sufficient to determine whether a person meets the above criteria. The failure to specify the minimum requirements of knowledge and skills in the industry in which the company operates and in accounting and auditing of the financial statements will inevitably cause problems in practice. Due to such criteria, companies may have trouble finding suitable candidates. Consequently, they should already start forming audit committees, since they only have time till November this year to adapt to the new regulations.

The new regulations should be compared with the current statute. It may be necessary to change its provisions to match the existing regulations. If there are no detailed regulations in the statute, the rules of the supervisory board must be verified. According to the new regulations, members of audit committees are appointed by the supervisory

board or the general meeting, so it is necessary to clearly specify which governing body makes the selection.

### Limitations of auditors

Other significant changes beyond those of the audit committees are related to the tasks of this committee. So far, in principle, an important task of the committee was to monitor the company's reporting system, internal control, internal audit and risk management. These tasks have expanded and require an audit committee to play a much more active role. With the new act, the possibility to provide some of the other services by audit firms performing the annual audit in a particular company has been significantly reduced. For example, tax advice, consulting and other services are excluded, in so far as they are relevant to the financial statements. Moreover, any other service provided by an audit firm will need to be approved by an audit committee.

There are further tasks for the committees which need to develop procedures for an audit firm to provide any other services. Although supervisory board committees in Polish two-tier board system only play an advisory role, the new audit committee role is a step toward a one-tier board system, especially in area of statutory auditor appointment. This could be useful for companies in case of a dual listing. A breach of the rules governing the appointment, composition and functioning of the audit committee, as well as influencing the outcome of the audit is penalized with a fine of up to 10% of the company's turnover. In the case of a natural person, the fine is capped at PLN 250,000 and another penalty may be a ban on serving as a member of the management or supervisory board for a period of up to three years.

