

31 May 2016

## **INSTRUCTION 1-2016**

**On 17 June 2016, revisions to two rules in the Swedish Corporate Governance Code ("the Code") will be applicable. The changes are a result of the EU Audit Package, which comprises a regulation on auditors and audits (Auditor Regulation)<sup>1</sup> and a directive<sup>2</sup> amending the 2006 Auditor Directive, which comes into force and is to be implemented in Swedish law on 17 June 2016.**

### **Election of auditors**

The Auditor Regulation requires audit committees to submit proposals for election of auditors in the manner prescribed therein, including a requirement that the proposal be preceded by a tendering procedure. Some public-interest entities, however, are not required to apply the tendering procedure the Regulation prescribes. The Auditor Regulation also states that Member States may permit companies' nomination committees to perform the task. Through the Companies Act Chapter 8. 49 b § 6, second paragraph, the possibility for those companies that wish to continue to allow the nomination committee express its opinion on the issue of the appointment of the auditor and submit its proposal to the shareholders' meeting will be introduced into Swedish law.

According to the Auditor Regulation, (article 16.5, first paragraph), the board of directors' proposal to the shareholders' meeting on the election of statutory auditors or audit firms is to contain the recommendation and preference of the audit committee or body with similar tasks (under the terms of point 2 in the Regulation). Further, it stipulates (in article 16.5, second paragraph) that if the proposal differs from the alternative preferred by the audit committee, the reasons for not following the committee's recommendation are to be stated in the proposal. The auditor or auditors recommended by the Board are however to have participated in the selection procedure described in article 16.3 of the Auditor Regulation.

The third paragraph of Code rule 2.1 is therefore to remain in place, but be supplemented by provisions equivalent to the requirements placed by the Auditor Regulation on boards' proposals for the position of auditor in cases where the company does not have a nomination committee. Those (smaller) companies which are not obliged by the Auditor

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<sup>1</sup> Regulation (EU) no 537/2014 of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC

<sup>2</sup> Directive 2014/56/EU of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

Regulation to apply the tender procedure are exempted from the obligation to propose auditors who have participated in such a procedure.

The revised rule is shown below. Newly inserted text is underlined in blue.

## Rule 2.1

The company is to have a nomination committee.

The nomination committee is to propose candidates for the post of chair and other members of the board, as well as fees and other remuneration to each member of the board. In its assessment of the board's evaluation and in its proposals in accordance with rule 4.1, the nomination committee is to give particular consideration to the requirements regarding breadth and versatility on the board, as well as the requirement to strive for gender balance.

The nomination committee is also to present proposals on the election and remuneration of the statutory auditor. The nomination committee's proposal to the shareholders' meeting on the election of the auditor is to include the audit committee's recommendation (or that of the board of directors if it does not have an audit committee).<sup>3</sup> If the proposal differs from the alternative preferred by the audit committee, the reasons for not following the committee's recommendation are to be stated in the proposal. The auditor or auditors proposed by the nomination committee must have participated in the audit committee's selection process if the company is obliged to have such a procedure.<sup>4</sup>

## **Composition of the audit committee**

The audit package regulates the audit committee and its tasks in law. As such, the second paragraph of Code rule 7.2 is now redundant.

The revised rule is shown below. Deleted text is shown in *red italics*.

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<sup>3</sup> This rule corresponds to the requirements regarding the board's proposal for the post of auditor if the company does not have a nomination committee, see article 16.5 of the European Parliament and Council Regulation (EU) No. 537/2014 of 16 April 2014 on specific requirements regarding statutory audit of public interest entities and repealing Commission Decision 2005/909/EC, in its original version.

<sup>4</sup> Those companies which according to their latest annual or consolidated accounts fulfil at least two of the following three criteria: an average number of employees during the financial year of less than 250; a total balance sheet not exceeding EUR 43 million; and an annual net turnover not exceeding EUR 50 million. Also, listed companies that have an average market capitalization of less than EUR 100 million based on the closing price for the previous three calendar years are exempted from the requirement that the auditor or auditors proposed must have participated in the audit committee selection process.

## Rule 7.2

If the board establishes special committees to prepare its decisions on specific issues, its Rules of Procedure are to specify the duties and decision-making powers that the board has delegated to these committees and how the committees are to report to the board. Committees are to keep minutes of their meetings and the minutes are to be made available to the board.

~~An audit committee<sup>5</sup> is to comprise no fewer than three board members. The majority of the members of the committee are to be independent of the company and its executive management. At least one of the committee members who are independent of the company and its executive management is also to be independent of the company's major shareholders<sup>6</sup>~~

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<sup>5</sup> Stipulations on the appointment of an audit committee and the tasks of the committee are to be found in chapter 8, sections 49 a-b of the Swedish Companies Act (2006:551). Chapter 8, section 49a, paragraph 2 of the Act states that the entire board may perform the tasks of the audit committee.

<sup>6</sup> ~~Chapter 8, section 49a, paragraph 1 of the Swedish Companies Act (2006:551) states that members of the committee may not be employees of the company, and that at least one committee member is to be independent of the company and its executive management, as well as the company's major shareholders. This member must also have auditing or accounting competence. For assessment of independence, see 4.4 and 4.5.~~