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Technical Release

TR 02/2017 - Irish Company Law Requirements: Audit Committees

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Introduction and legislative framework

1.The requirements in Irish company law regarding the establishment of audit committees are included in:

- Statutory Instrument 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 (“S.I. 312 of 2016”) for public interest entities (“PIEs”), and
- Companies Act 2014 (“CA 2014”) for certain large companies.

This Technical Release deals separately with the relevant requirements for PIEs at paragraph 4 to 15 and for large companies at paragraphs 16 to 26.

2.The purpose of this Technical Release is to provide information to members of the accountancy bodies of Consultative Committee of Accountancy Bodies – Ireland (“CCAB-I”) regarding the legal requirements in relation to audit committees in Ireland. The Technical Release does not provide any information in relation to the requirements for audit committees to comply with appropriate codes of corporate governance. This Technical Release intends to be of interest to:

- Accountants who are invited to join a board of directors;
- Accountants who are invited to become a member of an audit committee;
- Accountants assisting a company understand when the company should establish an audit committee;
- Accountants who work with or advise companies which are establishing an audit committee for the first time due to growth or become a PIE.

This Technical Release sets out the requirements of the audit committee and its members as set out in Irish Law. Legal advice should be sought on interpretation matters relating to these requirements.

3.In general an audit committee is a sub-committee of the board of directors and it is usually comprised of a number of board members. The audit committee reports to the board of directors. The board usually delegates responsibility to its audit committee for the oversight of the controls and processes employed by management in financial reporting and oversight of the company’s relationship with its external auditors. The audit committee often has a role in the oversight of the risk management and internal control functions of the company. The size of an effective audit committee and its exact remit will vary depending on the size, complexity and risk profile of the company. There are very specific requirements in law regarding the establishment of audit committees and their responsibilities. These requirements are described below.

Public interest entities (“PIEs”)

4.Companies meeting the definition of PIE (with some exceptions) have been required to have an audit committee since 2010 as a consequence of S.I. 220 of 2010¹ which transposed EU Directive 2006/43/EC into Irish law. In June 2016, S.I. 312 of 2016 revoked those 2010 provisions, replacing them with those set out in Regulation 115 of S.I. 312 of 2016.

5.A PIE, in accordance with S.I. 312 of 2016, is an entity listed on an EU regulated market², a credit institution or an insurance undertaking³.

6.Regulation 115 of S.I. 312 of 2016 requires the directors of a PIE to establish an audit committee. There are some limited exceptions to this requirement as some specified PIEs are exempt from this requirement. The PIEs to whom regulation 115 of S.I. 312 of 2016 does not apply⁴ are:

- Subsidiaries which fulfil the requirements in relation to audit committees at group level;
- Undertakings for Collective Investment in Transferable Securities (“UCITS”);
- Alternative Investment Funds (“AIFs”);
- Credit institutions whose shares are not traded on an EU regulated market and which have only issued debt securities admitted to trading in a regulated market provided that the total nominal amount of all such debt remains below €100,000 and no prospectus has been published;
- A PIE whose sole business is to act as an issuer of asset-backed securities – in this case only, the entity availing of this exemption must include a statement in its published annual report or in an annual return or other periodic statement delivered by the entity to the Registrar of Companies or to the Central Bank of Ireland. The required statement⁵ sets out the reasons why the entity does not consider the establishment of an audit committee appropriate, and accordingly, why it has availed itself of the exemption from the requirement to establish an audit committee. It is an offence for a PIE whose sole business is to act as an issuer of asset backed securities, to fail, without reasonable excuse, to make the required statement.

Effective date of requirements of S.I. 312 of 2016 regarding audit committees

7.The provisions of S.I. 312 of 2016 affecting audit committees, including regulation 115, came into operation on 17 June 2016. PIEs had already been required to establish audit committees prior to that date pursuant to S.I. 220 of 2010. Where a PIE already had an audit committee in place at 17 June 2016 the relevant provisions of S.I. 312 of 2016 in relation to audit committees apply from 17 June 2016.

8.Where an audit committee of a PIE is established after 17 June 2016, the provisions of S.I. 312 of 2016 in relation to the performance of any function by the PIE’s audit committee apply with respect to financial statements of the PIE for financial years beginning on or after the establishment of the audit committee. The provision regarding the making of a recommendation with respect to the appointment of statutory auditors or audit firm applies to any proposal in this regard made at any time after the establishment of the audit committee.

9.The additional requirements introduced through S.I. 312 of 2016 are highlighted in paragraph 28 as underlined text under the column for PIE requirements.

Membership of the audit committee of a PIE

10.Regulation 115 of S.I. 312 of 2016 requires the majority of the members of the audit committee of a PIE to be non-executive directors (“NEDs”). A NED is a “*director who is not engaged in the daily management of the PIE or body concerned, as the case may be*”⁶. It is essential that those NEDs possess the necessary degree of independence to enable them to contribute effectively to the audit committee’s functions. A NED cannot have, or have had during the period of three years preceding his or her appointment to the audit committee,

- A position of employment in the PIE, or
- Any material business relationship with the entity, either directly, or as a partner, shareholder, director (other than as a NED) or senior employee of a body that has a material business relationship with the PIE⁷.

11.A person cannot take up a position on an audit committee of a PIE if he or she has been the statutory auditor who carried out a statutory audit of the PIE or was the key audit partner who carried out, on behalf of an audit firm, a statutory audit of the PIE until a period of at least 2 years has elapsed since the day following the end of his or her direct involvement as a statutory auditor or key audit partner on the audit engagement⁸.

12.At least one of the NEDs who are members of the audit committee of the PIE is required to have competence in accounting or auditing⁹.

13.The audit committee of a PIE, as a whole, is required to have competence in relation to the sector in which the entity operates¹⁰.

14.The members of the audit committee of a PIE appoint a chairperson for the committee. The chairperson must be a NED.¹¹

Responsibilities of the audit committee of a PIE

15.The legal responsibilities of the audit committee of a PIE are¹²:

- (a) To inform the 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 Irish Auditing and Accounting Supervisory Authority ("IAASA") pursuant to article 26(6)¹³ of Regulation (EU) No 537/2014 ("the EU Audit Regulation");
- (e) To review and monitor the independence of the statutory auditors or the audit firms in accordance with regulations 93 to 98 of S.I. 312 of 2016 and article 6 of the EU Audit Regulation, and, in particular, the appropriateness of the provision of non-audit services to the audited entity in accordance with article 5 of the EU Audit Regulation;
- (f) To be responsible for the procedure for the selection of a statutory auditor or audit firm and recommend, to the board of the directors, the statutory auditor or audit firm to be appointed in accordance with article 16 of the EU Audit Regulation, except when article 16(8) of that EU Audit Regulation is applied;
- (g) The receiving of reports from the statutory auditor or audit firm on key matters arising from the statutory audit of the company, and, in particular, on material weaknesses in internal control in relation to the financial reporting process; and,
- (h) To issue guidelines, at such times as it thinks it appropriate to do so, with regard to the provision of non-audit services referred to in regulation 106(1) of S.I. 312 of 2016¹⁴.

Large companies in accordance with Companies Act 2014

16. A large company is defined¹⁵, for the purposes of section 167 of CA 2014, as either:

- (a) A company that, in both the most recent financial year of the company and the immediately preceding financial year, meets the following criteria:
 - (i) balance sheet total for the year exceeds €25,000,000; and
 - (ii) amount of turnover for the year exceeds €50,000,000¹⁶.

or

- (b) A company which has one or more subsidiary undertakings, if the company and all those subsidiary undertakings together, in both the most recent financial year of the company and the immediately preceding financial year, meet the criteria at (a) above.

17. Section 167 of CA 2014, requires a large company to actively consider whether it should have an audit committee and either establish an audit committee that meets the requirements of CA 2014 or decide not to establish such a committee.

18. When the directors of a large company decide to establish an audit committee they disclose that fact in the annual directors' report. When a decision is taken by the directors of a large company not to establish an audit committee the fact of that decision and the reasons for it are required to be disclosed in the directors' report¹⁷. A director of a large company who fails to take all reasonable steps to comply with the requirement to make the appropriate statement in the directors' report is guilty of a category 3 offence under CA 2014¹⁸.

19. Section 1097 of CA 2014 makes it clear that the requirement to establish an audit committee under section 167 of that Act applies to any public limited company¹⁹ ("PLC") that does not fall within regulation 115 of S.I. 312 of 2016. In such a case section 167 shall apply to a PLC irrespective of the balance sheet amount or the amount of turnover of the PLC.

Effective date of requirements of CA 2014 regarding audit committees

20. Companies subject to section 167 of CA 2014 are required to fulfil their responsibility in relation to an audit committee in respect of financial years commencing on or after 1 June 2015²⁰.

Membership of the audit committee of a large company

21. CA 2014 does not set out any requirements in relation to the size of the audit committee but does require²¹ that at least one member of the audit committee is a NED. A NED is defined in as “*a director who is not engaged in the daily management of the company or body concerned, as the case may be*”²². A NED cannot have, or have had during the period of three years preceding his or her appointment to the audit committee,

- A position of employment in the company, or,
- Any material business relationship with the company, either directly, or as a partner, shareholder, director (other than as a NED) or senior employee of a body that has a material business relationship with the company²³.

22. The NED is required to have competence in accounting or auditing²⁴.

23. For some large companies which are establishing an audit committee for the first time the company may also find itself having to appoint a NED for the first time in order to be able to meet the requirements in relation to the membership of the audit committee.

24. A person cannot take up a position on an audit committee of a large company if he or she has been the statutory auditor who carried out a statutory audit of the company or the key audit partner who carried out, on behalf of an audit firm, a statutory audit of the company until a period of at least one year has elapsed since the day following the end of his or her direct involvement as a statutory auditor or key audit partner from the audit engagement²⁵.

25. There is no requirement in law in relation to the appointment of a chairperson for the audit committee of a large company. However it is good practice for a chairperson to be appointed to facilitate the effective operation and reporting of the committee.

Responsibilities of the audit committee of a large company

26. The legal responsibilities of the audit committee of a large company include:

- (a) The monitoring of the financial reporting process;
- (b) The monitoring of the effectiveness of the large company’s systems of internal control, internal audit and risk management;
- (c) The monitoring of the statutory audit of the large company’s statutory financial statements;
- (d) The review and monitoring of the independence of the statutory auditors and in particular the provision of additional services to the large company;
- (e) The receiving of reports from the statutory auditors on key matters arising from the statutory audit of the company, and, in particular, on material weaknesses in internal control in relation to the financial reporting process; and,
- (f) The making of recommendation to the board of directors with respect to the appointment of statutory auditors when appropriate. The proposal of the board of directors to the members of the company in that regard is based on the recommendation of the audit committee.

Comparison of the requirements for audit committees for PIEs and for large companies

27. The table below provides a useful summary of the different requirements for PIEs compared to large companies with regard to audit committees. Those parts underlined under the responsibilities of audit committees of PIEs reflect amendments to the previously stated legal responsibilities of audit committees, as was set out in S.I. 220 of 2010.

	Large companies (as defined by section 167 of CA 2014)	PIEs
Relevant legislation	CA 2014	S.I. 312
Requirement to have an audit committee	<p>Large Company either establishes an audit committee or decides not to have one</p> <p>Comply or explain approach</p> <p>Must state in the annual report whether they have formed an audit committee or decided not to do so</p>	<p>Directors of each PIE shall establish an audit committee, with certain exemptions</p> <p>Exemptions set out in Regulation 115(10)</p>
Conditions for exemption	<p>If no audit committee established must indicate reason for that decision.</p> <p>Comply or explain approach</p>	<p>If exemption claimed under regulation 115(10)(c) shall state that fact in any annual report published by it or in an annual return or other periodic statement delivered by it to the Registrar of Companies or Central Bank of Ireland, and state 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.</p>
Composition of audit committee members	<p>Members of the Audit Committee shall include <i>at least one</i> independent director of the large company</p>	<p><i>Majority</i> of the members of the audit committee shall be non-executive directors of the PIE</p>
Non-Executive directors	<p>Details of what constitutes a non-executive director is set out in Section 167(4)(a) and (b) and 167 (10)</p>	<p>Details of what constitutes a non-executive director set out in Regulation 115 (2)(a) and (b) and 115 (5)</p>
Qualifications of members	<p>At least one of the non-executive directors shall have competence in accounting or auditing</p>	<p>At least one of the non-executive directors shall have competence in accounting or auditing</p> <p>Members of the audit committee as a whole shall have competence relevant to the sector in which the audited entity is operating</p>
Requirements regarding chairperson of the audit committee		<p>The chairperson of the audit committee shall be appointed by its members and shall be independent of the audited entity</p>

	Large companies (as defined by section 167 of CA 2014)	PIEs
Responsibilities		
		To inform the 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
	Monitoring of the financial reporting process	Monitor the financial reporting process <u>and submit recommendations or proposals to the directors of the entity to ensure its integrity</u>
	Monitoring of the effectiveness of the large company's systems of internal control, internal audit and risk management	Monitor the effectiveness of the entity's internal quality control and risk management systems <u>and where applicable its internal audit regarding the financial reporting of the entity, without breaching its independence</u>
	The monitoring of the statutory audit of the large company's statutory financial statements	To monitor the statutory audit of the annual and consolidated financial statements, <u>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</u>
	Review and monitoring of the independence of the statutory auditor and in particular the provision of additional services to the Company	To review and monitor the independence of the statutory auditors or the audit firms in accordance with Regulation 93 and 98 and Article 6 of Regulation (EU) No 537/2014 <u>and in particular the appropriateness of non-audit services to the audited entity in accordance with Article 5 of that Regulation</u>
		<u>To be responsible for the procedures 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</u>
	Any proposal of the board of directors of the large company with respect to the appointment of statutory auditors to the	Any proposal of the directors of a PIE with respect to the appointment of a statutory auditor or audit firm to the entity shall be based on a

	Large companies (as defined by section 167 of CA 2014)	PIEs
	company shall be based on a recommendation made to the board by the audit committee	recommendation made to the directors by the audit committee
	The statutory auditors shall report to the audit committee of the large company on key matters arising from the statutory audit of the company, and, in particular on material weaknesses in internal control in relation to the financial reporting process	The statutory auditor or audit firm shall report to the audit committee of the PIE 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

The Role of the Irish Auditing and Accounting Supervisory Authority (“IAASA”) with regard to Irish audit committees

IAASA Monitoring Role

28.SI 312 of 2016, by virtue of the Regulation (EU) No 537/2014, requires IAASA to monitor developments in the market for providing statutory audit services to PIEs. The Regulation sets out particular matters to be assessed by IAASA in monitoring such developments, including the assessment of the performance of audit committees in PIEs. As at the date of the issuance of this Technical Release, IAASA has not published any details of how it plans to assess the performance of the PIE audit committees.

IAASA to approve extension of PIE’s statutory auditor tenure

29.SI 312 of 2016 permits the audit committee of a PIE to extend the tenure of its statutory auditor/audit firm by a maximum of two years, for exceptional circumstances, subject to the approval of IAASA. The request for approval for such extension is to be made in the form and manner prescribed by IAASA.

The form and manner of request to IAASA has been published on the IAASA website and is as follows:

A letter from the chairperson of the audit committee to:

- (a) Confirm which category the PIE falls into (i.e. listed on an EU regulated market, a credit institution or an insurance undertaking);
- (b) Confirm the name of the statutory auditor or audit firm the PIE wishes to re-appoint;
- (c) Confirm the original date of appointment of said statutory auditor or audit firm;
- (d) Set out the exceptional circumstances relevant to the request for extension; and
- (e) Confirm how long the PIE requests the extension for (maximum permitted request being two years) and the reason(s) for that period.

Any commercially sensitive information should be clearly indicated.

30.IAASA states that the application should further set out clearly how the particular circumstances will impact on audit quality should the request for extension approval be unsuccessful.

31.IAASA also requires that the letter from the chairperson of the audit committee should be accompanied by a letter from the existing statutory auditor or audit firm confirming that:

- (a) The applicant is a PIE within the meaning of Regulation 4(1) of SI 312 of 2016; and,
- (b) The exceptional circumstances as set out in the letter from the chairperson of the audit committee exist as at the time of the making of the application.

1 S.I. 220 of 2010, the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010, was amended by S.I. 685 of 2011 in relation to its requirements for independent audit committee membership.

2 A list of EU regulated markets is available from the European Securities and Markets Authority at https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_rma#

3 Public interest entities are defined by S.I. 312 of 2016 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 within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EC;

(b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (but excluding credit institutions referred to in Article 2 of Directive 2013/36/EU), and

(c) insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings.

4 Regulation 115 (10) of S.I. 312 of 2016

5 Regulation 115(11) of S.I. 312 of 2016

6 Regulation 115(5) of S.I. 312 of 2016

7 Regulation 115(3) of S.I. 312 of 2016

8 Regulation 103(3) and 103(4) of S.I. 312 of 2016

9 Regulation 115(4) of S.I. 312 of 2016

10 Regulation 115(6) of S.I. 312 of 2016

11 Regulation 115(7) of S.I. 312 of 2016

12 Regulation 115(12) of S.I. 312 of 2016

13 Article 26(6) of Regulation (EU) No 537/2014 sets out the scope for quality assurance reviews by IAASA of statutory auditors and audit firms that carry out statutory audits of PIEs.

14 Regulation 106(3) of S.I. of 2016

15 Section 167(1) of CA 2014

16 “balance sheet total” and “amount of turnover” here both have the meaning attributed to them in section 350 of CA 2014

17 Section 167(3) of CA 2014

18 Section 167(11) of CA 2014

[19](#) A public limited company is defined in section 1000 of CA 2014

[20](#) Companies Act 2014 (Commencement) Order 2015 – S.I. 169 of 2015

[21](#) Section 167(4) of CA 2014

[22](#) Section 167(10) of CA 2104

[23](#) Section 167(5) of CA 2014

[24](#) Section 167(6) of CA 2014

[25](#) Regulation 103(1) and 103(2) of S.I. 312 of 2016