McCann FitzGerald

Briefing

The Role of the Audit Committee

INSTITUTE OF DIRECTORS IN IRELAND

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An audit committee is an essential component of any well-managed company (other than a particularly small entity). As with any committee of a company, the detail of an audit committee's functions, powers and operations are supplied by its terms of reference. For certain sized companies[1] the Companies Act 2014 requires there to be an audit committee or that the company explains in its annual report why it has decided not to appoint such a committee.

Function

A company's audit committee should provide a link between the company's external auditors and its board, as a counter-balance to, and separate from, the relationship between the company's auditors and its executive management. This ensures that the external auditors have access to a group of non-executive directors (who may also be "**independent**" (see below)) who can address concerns that may arise with the accounting rules and procedures that are being applied by the executive management. Corporate governance is enhanced and risks are reduced when such lines of communication are open.

Typically, an audit committee would be tasked to perform functions including:

- monitoring the company's financial reporting process;
- monitoring the effectiveness of the company's systems of internal control, internal audit and risk management;
- monitoring the statutory audit of the statutory financial statements; and
- reviewing and monitoring of the independence of the statutory auditors.

1. Ie those the annual turnover of which exceeds €25 million and the balance sheet total of which exceeds €50 million (these figures can be altered by regulations).

Sometimes an audit committee is also tasked with responsibility for monitoring the adequacy and effectiveness of the company's IT systems.

While noting the functions and role of an audit committee, it should be noted that, in every respect, the board of the company retains the ultimate responsibility for the integrity of the company's financial statements: a director may delegate responsibility but may not abdicate it.

An audit committee will also consider the appropriateness of the reappointment of the external auditor, perhaps in the context of a policy of auditor rotation.

Sometimes an audit committee may also be responsible for monitoring the risks to which the company's business and operations are subject, although the Central Bank requires that a credit institution and an insurance undertaking must have a risk committee separate from the audit committee.

Tone and approach

An audit committee should be respectfully questioning, challenging and sceptical about information provided by the company's management. In terms of corporate governance, this role and approach is important in view of the counter-balance that the audit committee should provide to the power and influence of a company's management over financial information and procedures.

Composition

Considering its purpose and function, an audit committee ought not include any executive directors. Under the Companies Act an audit committee must include at least one independent non-executive director who has competence in auditing or accounting.

Some regulatory codes require an audit committee to be composed of non-executive directors, a majority of which (or, in some cases, at least some) satisfy independence criteria. It is important to consider and comply with any such mandatory requirements, such as those under:

- the UK Corporate Governance Code and the Irish Corporate Governance Annex (listed companies) (normally at least three independent non-executive directors);
- the Statutory Audit Regulations[2] (at least one independent non-executive director); and

2. Now contained in the Companies (Statutory Audits) Act 2018. The audit committee-related aspects apply to "public-interest entities" (principally, companies the transferable securities of which are listed on a regulated market in the EU, credit institutions and insurance undertakings).

- the Corporate Governance Requirements for Credit Institutions and Insurance Undertakings (a majority of members must be independent).

An audit committee should not normally be chaired by the chairperson of the board.

A company should ensure that at least one member of an audit committee has recent and relevant financial experience; in some cases, this is required by regulatory codes.

Meetings

The terms of reference of an audit committee should normally address practical matters such as the quorum for and minimum frequency of meetings. The terms may also set out whether any particular company officer(s) (such as the chief executive/managing director and/or the financial controller) may be required to appear before the committee from time to time. However, the terms should provide that the audit committee may at any time meet without any non-member in attendance.

The terms of reference should also provide for standard reports that must be made to the audit committee, by specific company officers (such as the internal auditor (if any) or the financial controller).

Powers

An audit committee would be empowered to undertake investigations and to call before it any person with whom the committee members believe it is necessary to speak in order that the committee performs its functions.

An audit committee may be empowered to obtain outside legal or independent professional advice, at the company's expense, as the members consider necessary.

Reporting

As mentioned, an audit committee is merely a committee of the board and the board retains ultimate control of, and responsibility for, the matters addressed by an audit committee. However, it is important that a board appreciates and respects the independent view that it is the important responsibility of an audit committee to apply when performing its role.

Issues for audit committees

While many of the functions and duties of an audit committee are relatively static, it is important that such a committee is dynamic and adjusts its inquiries and the range of matters in which it is interested so as to address fully the concerns that arise from time to time from the particular business and regulatory environments.

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