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Audit Committees under the Companies Act 2014

Introduction

In 2010, the European Communities (Statutory Audits) (Directive 2006/43/EC) (the “**Regulations**”) obliged certain ‘public interest entities’ to establish an audit committee.

The Regulations were replaced by the European Union (Statutory Audits) (Directive 2006/43/EC), as amended by the Directive 2014/56/EU, and Regulation (EU) No 537/2014 Regulations 2016 (the “**2016 Regulations**”) which came into effect on the 17 June 2016. The following ‘public interest entities’ are still obliged to establish an audit committee:

- (a) Companies with shares quoted on a stock exchange;
- (b) Banks and certain other credit institutions
- (c) Insurance companies.

Following the enactment of the Companies Act 2014 (the “**Act**”) on 1 June 2015, the boards of directors of all large private limited companies are required, in respect of financial years commencing post 1 June 2015, to either:

- 1) Establish an audit committee which meets certain requirements under the Act; or
- 2) Decide not to establish such a committee and give reasons for

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For further information on any of the issues discussed in this article please contact:



Lorcan Tiernan

DD: + 353 (0)1 673 1736

lorcan.tiernan@dilloneustace.ie



Adrian Benson

DD: + 353 (0)1 673 1736

adrian.benson@dilloneustace.ie

that decision in its annual directors' report.

This note explains the requirements which apply to private companies and what the board of directors of those companies must do in order to satisfy the requirements.

■ **Obligation on certain private companies under the Act to establish an Audit Committee, or explain their decision not to do so**

Under Section 167 of the Act the obligation to establish an audit committee, or explain the decision not to establish such a committee, applies to “large companies”. A large company is defined as:

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

or

- 2) If the company has one or more subsidiaries, then it will be a “large company” if it and all of its subsidiaries together, in both the most recent financial year of that company and the immediately preceding financial year, meet the criteria set out at i. and ii. above.

The “balance sheet total” means the aggregate of the amounts shown as assets in the company’s balance sheet. The “amount of turnover” means the amount of turnover shown in the company’s profit and loss account.

The Act provides that the requirement to establish an audit committee only applies to the financial year which commenced post 1 June 2015.

■ **What must the Board of Directors of a Large Company Do?**

As stated in the introduction, the board of directors of a large company must either:

- 1) Establish an audit committee which meets certain requirements under the Act; or
- 2) Decide not to establish such a committee and give reasons for that decision in its annual

directors' report¹.

Failure to comply with this requirement is a category 3 offence under the Act².

■ What are the responsibilities of the Audit Committee?

Notwithstanding the overall responsibility of the board of directors, the responsibilities of the audit committee shall include:

- 1) the monitoring of the financial reporting process;
- 2) the monitoring of the effectiveness of the large company's systems of internal control, internal audit, and risk management;
- 3) the monitoring of the statutory audit of the large company's statutory financial statements; and
- 4) reviewing and monitoring of the independence of the statutory auditors and in particular the provision of additional services to the large company.

Any proposal of the board of directors in relation to the appointment of statutory auditors to the large company shall be based on a recommendation made to the board by the audit committee.

The statutory auditors of the Company shall report to the audit committee on key matters arising from the statutory audit of the large company and, in particular, on material weaknesses in internal control in relation to the financial reporting process.

■ Who Shall Comprise the Members of the Audit Committee?

The membership of the audit committee must include at least one independent director of the company; that is a person who:

- 1) is a non-executive director of the large company; and
- 2) otherwise possesses the requisite degree of independence so as to be able to contribute effectively to the committee's functions.

In order to be considered an independent director, the director must not, at any time during the 3 years preceding his or her appointment to the committee, had:

¹ Under section 325 of the Act the directors of a company must prepare a report for each financial year dealing with certain matters which are set out in that section.

² Under section 871(3) of the Act a person guilty of a category 3 offence shall be liable, on summary conviction, to a class A fine or imprisonment for a term not exceeding 6 months or both.

- 1) a material business relationship with the large company, either directly, or as a shareholder, partner, director (other than as a non-executive director) or senior employee of a body that has such a relationship with the large company; or
- 2) a position of employment with the large company.

The independent director(s) is also required to have competence in accounting or auditing.

Conclusion

If your company meets the definition of a large company, then the board of directors must, for each financial year commencing post 1 June 2015, either establish an audit committee or state in its directors' report the reasons why it has decided not to do so.

If you require any further information on this topic, or any assistance in meeting your obligations under the Act, please don't hesitate to contact Lorcan Tiernan, Adrian Benson, or your usual Dillon Eustace contact.

Dillon Eustace
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DILLON EUSTACE

Dublin

33 Sir John Rogerson's Quay, Dublin 2, Ireland. Tel: +353 1 667 0022 Fax: +353 1 667 0042.

Cayman Islands

Landmark Square, West Bay Road, PO Box 775, Grand Cayman KY1-9006, Cayman Islands. Tel: +1 345 949 0022 Fax: +1 345 945 0042.

New York

245 Park Avenue, 39th Floor, New York, NY 10167, U.S.A. Tel: +1 212 792 4166 Fax: +1 212 792 4167.

Tokyo

12th Floor, Yurakucho Itocia Building, 2-7-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan. Tel: +813 6860 4885 Fax: +813 6860 4501.

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