



Office of the Director
of Corporate Enforcement

*Oifig an Stiúrthóra um
Fhorfheidhmiú Corparáideach*

Decision Notice D/2006/1

ODCE Guidance on **Audit Committees**

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Audit Committees

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1.0 Introduction

The Companies Acts outline how the affairs of companies are to be conducted. The Acts describe the respective duties and obligations of various forms of company and outline the responsibilities and rights of the various participants in company affairs. Certain companies by virtue of their size or structure have additional obligations in order to protect and defend the rights of participants.

Section 12(1)(b) of the Company Law Enforcement Act 2001 (“the 2001 Act”) specifies that a function of the Director of Corporate Enforcement is “to encourage compliance with the Companies Acts”. Consistent with this remit, the Director has prepared this Guidance setting out the principal duties and responsibilities of audit committees in Irish company law. Although some companies will have had audit committees for some time, Section 42 of the Companies (Auditing and Accounting) Act 2003 (“the 2003 Act”) has introduced provisions on audit committees into Irish company law for the first time.¹ As Section 42 has inserted a new Section 205B into the Companies Act 1990 (“the 1990 Act”), this Guidance discusses its impact by reference to the new requirements of Section 205B. The text of Section 205B is attached at **Appendix 1** to this Guidance in the form as subsequently amended by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005 (S.I. No. 116 of 2005)) (“the 2005 Regulations”). A decision on the commencement date for Section 205B (as amended) is awaited at the time of writing.

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts² (“the Directive”) is relevant to this Guidance. It provides that public interest entities (which include listed companies, credit institutions

and insurance undertakings) are required to have an audit committee with specified functions. In general, the provisions relating to audit committees in the Directive are consistent with those in Section 205B, although there are differences in language and emphasis. The relevant provisions are contained in **Appendix 2** to this Guidance. It is a matter for Government to determine if these differences warrant an amendment of Section 205B when it transposes the Directive into Irish law by the stipulated deadline of 29 June 2008. In the interim, Boards of Directors and audit committee members in particular may wish to take the new EU law into account in defining the role of their audit committees. Footnote references are made in this Guidance where Section 205B(2) identifies audit committee responsibilities which are also specified in the Directive.

The Director does not intend that this Guidance will comprehend all aspects of best practice with respect to audit committees. A current recognised standard is the publication entitled “Audit Committees – Combined Code Guidance”, also known as the Smith Report, which was published by the Financial Reporting Council in the UK³ in 2003. While much of the Smith Report is consistent with Section 205B, it is important to point out that there are a few notable differences where the requirements of Section 205B must prevail. These include:

- the requirement in Section 205B(2)(b) that the audit committee express an opinion on whether the accounts give a true and fair view. No such requirement is contained in the Smith Report;
- the requirement under Section 205B(9)(c) that the full board review the audit committee’s terms of reference each year. The Smith Report allocates this responsibility to the audit committee itself.

1 Section 42 was substantially influenced by the recommendations of the Report of the Review Group on Auditing (July 2000) which proposed the inclusion of audit committee provisions in Irish company law. Chapter 13 (pages 195-206) of the Report is available at <http://www.entemp.ie/publications/commerce/2000/auditing/report.pdf>.

2 9.6.2006, L 157/103, Official Journal of the European Union EN. The full text of the Directive is available at <http://europa.eu.int/eur-lex/lex/Notice.do?val=427746:cs&lang=en&list=427746:cs&pos=1&page=1&nbl=1&pgs=10&hwords=amending%20council%20directives%2078/660/eec%20and%2083/349/eec%20and%20repealing%20council%20directive%2084/253/eec-&checktext=chec>

3 The Smith Report is available at <http://www.frc.org.uk/images/uploaded/documents/ACReport.pdf>.

While Section 2 of this Guidance is focused on the applicable law, Section 3 below does provide some additional information on certain key aspects of best practice which are consistent with Section 205B. The Guidance is not however intended to be a definitive guide for all affected companies on how best to implement the requirements. Subject to complying with the applicable law, each company or undertaking is expected to determine the most appropriate approach for itself and act accordingly. Companies and undertakings can of course obtain further guidance on best practice with respect to audit committees from professional sources.

The Director also wishes to make clear that this Guidance cannot be construed as a definitive legal interpretation of the relevant provisions. The law on occasion is open to more than one interpretation, particularly when it is applied to the specific circumstances of companies and individuals. Accordingly, readers should be aware that a definitive legal interpretation of particular provisions may have to await Court interpretation of the law.

Finally, the Director wishes to express his appreciation to all those who contributed comments and advice during his Office's consultations on the draft Guidance.

2.0 Principal Duties and Powers of Audit Committees under the Law

2.1 What is an Audit Committee?

An audit committee is a committee of directors which is required by law to regularly assess the validity of the company's or undertaking's financial and other reporting arrangements, as well as overseeing its internal and external audit processes. The Committee may also have further responsibilities assigned to it by the Board of Directors (e.g. responsibilities with respect to interim financial statements in the case of listed companies). However at all times, the ultimate responsibility for ensuring that the company or undertaking complies with its legal requirements remains with the full Board.

2.2 What is the value of an Audit Committee?

An audit committee helps to minimise financial, operational and compliance risks for the company or undertaking. It independently scrutinises the financial and other information made available to the Board of Directors and assists the Board in determining the validity of a company's or undertaking's financial statements and in enhancing the quality of financial reporting. It also monitors the ongoing value of the external audit in the interests of shareholders in particular and keeps under review the performance of any internal audit function within the company or undertaking.

2.3 What companies and undertakings are required to have or consider establishing an Audit Committee?

Section 205B requires that all Irish-registered public limited companies, whether listed or not, establish and adequately resource an audit committee with certain responsibilities as defined in the Act⁴ unless it is a wholly owned subsidiary undertaking of another Irish-registered public limited company⁵.

In addition, qualifying 'large private companies' and 'relevant undertakings' must either establish an audit committee with all or some of the defined responsibilities, or decide not to do so.⁶

A qualifying 'large private company' is defined⁷ as either:

- (a) an Irish-registered private company limited by shares whose balance sheet total⁸ exceeds €25 million **and** whose amount of turnover⁹ exceeds €50 million in **both** the most recent financial year and the immediately preceding financial year, or
- (b) an Irish-registered private company limited by shares if the company and all of its subsidiary undertakings together meet the above balance sheet and turnover criteria.

A qualifying 'relevant undertaking' is defined¹⁰ as either:

- (c) an Irish-registered unlimited company or partnership whose balance sheet total exceeds €25 million **and** whose amount of turnover exceeds €50 million in **both** the most recent financial year and the immediately preceding financial year, where all the members who do not have a limit on their liability are:
 - (i) Irish-registered companies limited by shares or by guarantee or equivalent bodies not governed by Irish law or a combination of both these categories of body, or
 - (ii) bodies of a type referred to in subparagraph (i) that are governed by the laws of an EU Member State or are equivalent bodies with a comparable legal form that are governed by the laws of a Member State, or
 - (iii) a combination of the categories of body mentioned in the preceding subparagraphs (i) and (ii),
 or
- (d) an Irish-registered unlimited company or partnership of the type described in paragraph (c) if the company or partnership and all of its subsidiary undertakings together meet the above balance sheet and turnover criteria.

⁴ Section 205B(2) of the 1990 Act.

⁵ Section 205B(16)(a) of the 1990 Act.

⁶ Section 205B(3) of the 1990 Act.

⁷ Section 205B(1) of the 1990 Act.

⁸ The term 'balance sheet total' comprises the fixed and current assets of the body and where the company prepares IFRS individual accounts, the aggregate of the amounts shown as assets in the balance sheet. The definition is derived from Section 8(4) of the Companies (Amendment) Act 1986 (as amended by Regulation 5(e) of the 2005 Regulations).

⁹ See Section 8(5) of the Companies (Amendment) Act 1986 for the complete definition.

¹⁰ Section 205B(1) of the 1990 Act together with Regulation 6 of the European Communities (Accounts) Regulations 1993.

2.4 What companies and undertakings are not required to consider establishing an Audit Committee?

In addition to those large private companies and relevant undertakings which elect not to do so and any classes of qualifying companies and undertakings which come to be exempted by Ministerial regulation, the following types of corporate body are also not required to establish audit committees:

- (a) every private company limited by shares whose balance sheet total is equal to or less than €25 million **or** whose turnover is equal to or less than €50 million in the year in question **or** in the immediately preceding financial year, **unless** it is a private company limited by shares as defined in 2.3(b) above;
- (b) every unlimited company or partnership of the type described in 2.3(c) above whose balance sheet total is equal to or less than €25 million **or** whose turnover is equal to or less than €50 million in the year in question **or** in the immediately preceding financial year, **unless** it is an unlimited company or partnership as defined in 2.3(d) above;
- (c) all other forms of corporate body not included in 2.3, 2.4(a) and 2.4(b) above, e.g. private companies limited by guarantee and all forms of company registered in a non-EU Member State.

In addition, the requirement to establish and resource an audit committee is not in practice applicable to any company or undertaking which is in liquidation, because control has effectively passed from the directors to the liquidator. However, the directors of a company or undertaking in receivership, in examinership and under administration legally retain their powers.

2.5 What are the Audit Committees of public limited companies required to do?¹¹

Under Section 205B(2) (as amended)¹², the audit committee of every qualifying public limited company must discharge all of the following functions:

- (a) *reviewing, before they are presented to the board of directors for approval—*
 - (i) *the company's individual accounts, and*
 - (ii) *if the company is a parent undertaking, the group accounts of the group of undertakings of which the company is the parent undertaking*¹³

Every set of accounts which is laid before the members of a public limited company at the company's Annual General Meeting must be approved by its Board of Directors beforehand. Section 205B(2) introduces an additional step whereby the audit committee must first consider the accounts before the full Board reviews the accounts.

The audit committee of a parent company must also review the group accounts before the full Board considers them.

¹¹ In addition to the responsibilities of audit committees specified in Section 205B, Article 41 of the Directive requires that public interest entities (including listed companies, credit institutions and insurance undertakings) have an audit committee with certain functions. Footnote references are made in this Guidance where functions related to those outlined in Section 205B(2) are included in the Directive. A copy of Article 41 is at **Appendix 2** to this Guidance for comparison purposes. Member States are required to implement the Directive by 29 June 2008.

¹² Section 205B(2)(a), (b) and (d) was amended by Schedule 1, Part 4, Item No. 8 of the 2005 Regulations. The quoted text of Section 205B(2) is the text as amended.

¹³ The Directive requires the audit committee to "monitor the financial reporting process". This function is broadly equivalent to paragraphs (a) to (c) of Section 205B(2).

- (b) *determining whether the individual accounts so reviewed comply with section 205A(2) and whether, in the committee's opinion, they give at the end of the financial year a true and fair view of—*
- (i) *the state of affairs of the company, and*
 - (ii) *the profit or loss of the company, even if, by virtue of section 7(1A) of the Companies (Amendment) Act 1986 or section 148(8) of the Act of 1963, it is not laid before the members in annual general meeting;*
- (c) *determining whether the group accounts so reviewed comply with section 205A(2) and whether, in the committee's opinion, they give at the end of the financial year a true and fair view of—*
- (i) *the state of affairs of the group of undertakings of which the company is the parent undertaking, and*
 - (ii) *the profit or loss of that group*

The essence of these paragraphs is that the audit committee should determine if the individual accounts and, where applicable, the group accounts have been prepared, in all material respects, in accordance with an applicable financial reporting framework and if, in the committee's opinion, the accounts give a true and fair view of the company's or group's profit and loss account and balance sheet. However, this requirement to prepare accounts that give a true and fair view remains a continuing responsibility of the full Board of Directors¹⁴.

The audit committee's decision will be informed by its discussion with the external auditor about any issues which may have an impact on the auditor's report. This, combined with their own knowledge of the business, should allow the committee to come to a considered judgement as to whether or not the accounts give a true and fair view.

The reference to Section 205A(2) above¹⁵ refers to the obligation to ensure that the accounts have been prepared in accordance with applicable accounting standards and that where any material departure from those standards occurs, the effect of the departure and the reasons for it are noted in the individual or group accounts as appropriate.

Section 7(1A) of the 1986 Act¹⁶ above refers to the exemption applicable to a parent undertaking in certain defined circumstances under which its profit and loss account or income statement need not be annexed to the company's annual return filed with the Registrar of Companies.

Section 148(8) of the 1963 Act¹⁷ refers to the exemption applicable to a parent company in certain defined circumstances under which its profit and loss account or income statement need not be laid before the annual general meeting of the company within nine months of its balance sheet date.

The effect of the above references to Section 7(1A) of the 1986 Act and Section 148(8) of the 1963 Act is that even if the above exemptions are availed of, the audit committee is still required to form an opinion as to whether the relevant accounts give a true and fair view.

¹⁴ Section 149(2) of the Companies Act 1963.

¹⁵ It is anticipated that Section 205A will be commenced in conjunction with Section 205B.

¹⁶ Section 7(1A) of the 1986 Act was inserted by Regulation 5(d)(ii) of the 2005 Regulations.

¹⁷ Section 148 was replaced in its entirety by Regulation 4 of the 2005 Regulations.

(d) recommending to the board of directors whether or not to approve the individual accounts and group accounts so reviewed

Following the work outlined above, the audit committee is required to give a formal recommendation to the full Board of Directors as to whether the accounts should be approved. Although the Board is not bound by this recommendation, it would need to carefully consider the matter before it would take any decision not to follow the committee's recommendation having regard to the nature of the deliberations that preceded this recommendation.

(e) determining, at least annually, whether in the committee's opinion, the company has kept proper books of account in accordance with section 202

Under Section 202(1) of the 1990 Act (as amended)¹⁸, "every company shall cause to be kept proper books of account". These books must:

- a) correctly record and explain the transactions of the company;
- b) at any time enable the financial position of the company to be determined with reasonable accuracy;
- c) enable the directors to ensure that any annual accounts of the company comply with the requirements of the Companies Acts, and, where applicable, Article 4 of the IAS Regulations¹⁹, and
- d) enable the annual accounts of the company to be readily and properly audited.

In addition, the Section imposes a number of further requirements including *inter alia* that the books of account be kept on a continuous and consistent basis (Section 202(2)), that they contain specified information (Section 202(3)) and that they give a true and fair view of the state of affairs of the company and explain its transactions (Section 202(4)).

In order to form the required opinion with respect to Section 202, the audit committee should be fully conversant with all the requirements of the Section. It should, for instance, be satisfied that the information provided by management is accurate, timely and complete. In addition, the Committee's opinion will be informed by the audit work of the external auditor and by its review of any internal audit reports. Alternatively, it may task the internal audit function (where such a function exists) to carry out further specific work to assist the committee in its deliberations.

(f) reviewing, before its approval by the board of directors, the statement required to be made under section 205E(5) and (6)

(g) determining whether, in the committee's opinion, the statement so reviewed—

(i) complies with section 205E(5) and (6), and

(ii) is fair and reasonable and is based on due and careful enquiry

(h) recommending to the board of directors whether or not to approve a statement reviewed under paragraph (f)

¹⁸ Section 202 was amended by Schedule 1, Part 4, Item No. 6 of the 2005 Regulations.

¹⁹ Article 4 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards states:

"For each financial year starting on or after 1 January 2005, companies governed by the law of a Member State shall prepare their consolidated accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2), if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field."

These paragraphs relate to the requirement in Section 45 of the 2003 Act that directors include in their annual directors' report a statement of the company's compliance with its 'relevant obligations'²⁰. Section 45 is not legally in effect, and in December 2005, the Government decided to replace it with a less prescriptive provision. As this will require amending primary legislation, these particular duties of the audit committee will not be operative for the time being.

- (i) *advising the board of directors as to the recommendation to be made by the board to the shareholders concerning the appointment of the company's auditor*

At the Annual General Meeting, the shareholders of the company may have an opportunity to vote on the appointment of its auditor for the following year. Normally, the auditor is reappointed automatically unless a resolution has been passed appointing someone else or providing expressly that he or she not be reappointed²¹. In such circumstances, the Board of Directors would recommend to the shareholders whether they believe that it is in the interests of the shareholders that the current auditor be re-appointed or that a new auditor be appointed. The audit committee will now be required to formally advise the Board on that question, and that advice should take into account the value for money to be obtained from both options.²²

Although the committee's recommendation is not binding, the board would be expected to give it due and careful consideration before determining its own recommendation on the matter.

- (j) *monitoring the performance and quality of the auditor's work and the auditor's independence from the company*²³
- (k) *obtaining from the auditor up to date information to enable the committee to monitor the company's relationship with the auditor, including, but not limited to, information relating to the auditor's affiliates*
- (l) *recommending whether or not to award contracts to the auditor or an affiliate of the auditor for non-audit work*

The audit committee is required to monitor the annual external audit process. The committee will be acting from the perspective of protecting the interests of the company or undertaking and its shareholders. To that end, it will wish to satisfy itself that the auditor's work is of a sufficient quality to properly support their opinion as to whether or not the company's accounts give a true and fair view and where relevant, identify material risks and weaknesses in its financial reporting arrangements.

The audit committee should seek to satisfy itself as to the quality of the auditor's work. To that end, its tasks would be expected to include:

- reviewing the audit plan devised by the auditor;
- reviewing the validity of the risk assessment contained in the audit plan;
- considering the audit timetable and the auditor's proposed staffing;

20 For more information, see the ODCE's Revised Guidance on Directors' Compliance Statements (December 2004) which is available on our website at <http://www.odce.ie>. The Report of the Company Law Review Group (July 2005) which recommended a change in Section 45 is available at <http://www.clrg.org>.

21 Section 160(2) of the Companies Act 1963.

22 This is broadly consistent with Article 41.3 of the Directive which provides that the Board's proposal for the appointment of the auditor shall be based on the audit committee's recommendation.

23 The Directive requires the audit committee to "monitor the statutory audit of the annual and consolidated accounts" and to "review and monitor the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity". These functions are broadly equivalent to paragraphs (j) to (l) of Section 205B(2).

- meeting with the audit engagement partner during the course of the audit work;
- discussing with the auditor any issues of significance in the context of the audit report;
- considering the manner in which the auditor deals with management on contentious issues.²⁴

Under International Standards on Auditing, the auditor is also under an obligation to disclose the audit engagement letter to the audit committee, as well as information on the conduct of the audit, risks and exposures identified, audit adjustments, uncertainties and disagreements with management and information concerning governance, including internal control weaknesses, questions of management integrity and any fraud involving management.²⁵

The independence of the auditor is a key issue in the context of ensuring audit quality. The auditor must be, and be seen to be, independent of the company being audited. The audit committee would be expected to include a regular review of the relationship between the company or undertaking and the auditor, including the extent to which:

- personnel from the auditor are now in the employment of the company or any group company (or vice versa) and any attendant independence risks associated with the roles occupied by the persons involved;
- the auditor or an affiliate²⁶ of the audit firm is undertaking non-audit work for the company or another group entity and the relative levels of fee being earned, or potentially on offer, for audit and non-audit work;
- the nature of the non-audit work previously provided, or being provided, by the auditor or an affiliate of the audit firm involves an effective self-review of aspects of the company's reporting arrangements;
- the auditor and/or the audit partner has been assigned to the company for a long time and is performing a sufficiently critical review of the adequacy of its reporting arrangements in its present commercial circumstances.²⁷

The Auditing Practices Board has issued Ethical Standards on audit that include the requirement that the audit engagement partner disclose any potential threats to independence to those charged with governance, typically the audit committee²⁸. Such threats and the steps taken to address them, as well as the audit firm's general policy on protecting independence and objectivity should be disclosed.

In order to assist the audit committee evaluate the independence of the auditor on an ongoing basis, paragraph (k) requires that the risks posed to independence by the provision of non-audit services or other relationships be documented and regularly updated. Such information could include information covering the areas outlined in the preceding paragraphs.

²⁴ Article 41.4 of the Directive similarly requires that the auditor report to the audit committee on key matters arising from the audit, including in particular material weaknesses in internal control relevant to the financial reporting process.

²⁵ ISA (UK & Ireland) 260 – Communication of Audit Matters with Those Charged with Governance.

²⁶ An affiliate of an auditor includes a company, partnership or other body corporate that shares a common parent, is part of the same group or uses a common name or corporate identity at any time during the financial year in question. For a fuller definition of affiliate, see Section 182(2) of the 1990 Act (as inserted by Section 34(c) of the 2003 Act).

²⁷ Article 42 of the Directive (copy at **Appendix 2**) also provides that the auditor should make certain statements and disclosures to the audit committee annually in respect of matters that could affect the independence of the statutory audit. It also provides for rotation of the audit engagement partner at least every seven years and for the prohibition on the auditor assuming a key management position in the audited entity within two years after his resignation from the audit engagement. These additional requirements will require to be addressed by Government in developing the regulations transposing the Directive.

²⁸ Auditing Practices Board, Ethical Standard 1, Integrity, Objectivity and Independence, paragraphs 49-53.

In the interests of safeguarding the auditor's independence and impartiality, the audit committee is also required under paragraph (l) to consider carefully if the company should award any additional contracts for which the auditor and/or its affiliate have tendered. The information collated by the committee on the relationship between the company and the auditor and/or its affiliate will inform it in forming its recommendation. It may be necessary for the committee to refuse to recommend a competitive tender from the auditor and/or its affiliate or alternatively to recommend acceptance of their tender on the basis that the auditor's assignment will be discontinued at an early date, where the committee is of the opinion that no satisfactory arrangements can be put in place to safeguard the independence and quality of the external audit.

(m) *satisfying itself that the arrangements made and the resources available for internal audits are in the committee's opinion suitable*²⁹

Internal audit is potentially a key resource for the audit committee in properly discharging its functions. Where internal audit is not already available, the committee should keep under review the need for such arrangements. Where there is an internal audit function, the committee is required to satisfy itself that the function is suitably resourced, that its focus is directed at areas of actual and potential financial and operational risk for the company, that the arrangements to carry out its work are appropriate and that it is effective. Resources here mean not just staff but also I.T. support, skills and training, financial resources and any other assistance that the committee deems necessary.

In addition, the committee must satisfy itself that management is favourably disposed to the work of internal audit. This would mean, for example, that management and staff at all levels make themselves available to the internal audit team when required. Similarly, internal audit staff should not be restricted in carrying out work in any area of the company's operations³⁰. Management should also be positively disposed to implementing any recommendations of internal audit with respect to areas of actual or potential risk.

(n) *reporting, as part of the report under section 158 of the Principal Act, on the committee's activities for the year, including, but not limited to, the discharge of its responsibilities under paragraph (j)*

The reference to section 158³¹ is a reference to the requirement that the Board of Directors prepare and present an annual report on the state of affairs of the company to its shareholders. This paragraph requires that the audit committee should include a short statement as part of the directors' report detailing:

- the committee's activities in the financial year, including in particular its work under paragraph (j) above in monitoring the performance and quality of the auditor's work and the auditor's independence. However, the report would also be expected to summarise the outcome of its review of the company's records and of its accounts (paragraphs (a) to (e) above);
- any other matters of note that the committee feels should be notified to the shareholders.

²⁹ The Directive requires the audit committee to "monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems". This function is relevant to paragraph (m) of Section 205B(2).

³⁰ For best practice in the area of internal audit, audit committees should refer to the Code of Ethics and International Standards for the Professional Practice of Internal Auditing, issued by The Institute of Internal Auditors – UK and Ireland.

³¹ Section 158 of the Companies Act 1963 (as amended by Section 90 of the 2001 Act).

In the latter context, the committee might, for instance, wish to report to the shareholders that a recommendation to which it attaches importance has not been implemented to its satisfaction.

- (o) ***performing any additional duties prescribed by regulation under section 48(1)(m) of the Act of 2003***
- (p) ***performing any other functions relating to the company's audit and financial management that are delegated to it by the board of directors***

The reference to Section 48(1)(m) is a reference to regulations which may be made by the Minister prescribing *inter alia* additional functions to be performed by audit committees. At this time, the ODCE has no knowledge that the Minister has an immediate intention to prescribe additional functions, and accordingly, it seems likely that no requirement under paragraph (o) will arise for the audit committee at present, but the Minister may need to consider broadening the functions of the audit committee in transposing the requirements of the Directive into Irish law.

The committee can also be assigned additional duties by the Board of Directors, where the Board believes that the committee is best placed to undertake them. Where this arises, paragraph (p) requires that the committee discharges those additional duties.

2.6 What are large private companies and relevant undertakings required to do in relation to Audit Committees?

As indicated earlier, the Board of Directors of large private companies and relevant undertakings may establish an audit committee to carry out some or all of the functions specified in Section 2.5 (a) to (p) above, or it may elect not to do so. In taking this decision, the Board will consider if the merits of an audit committee of the indicated scope (in whole or in part) is appropriate to the company or undertaking in question having regard to the nature and scope of its business.

The nature of this decision must be disclosed in their annual directors' report. Specifically, this means that the report must state:

- if an audit committee has been established or if it has been decided not to do so;
- if the audit committee has only some of the specified functions;
- the reasons for any decision not to establish an audit committee.³²

Where a qualifying large private company or relevant undertaking establishes an audit committee with some of the specified functions, every reference in Section 205B(2) to a public limited company shall be construed as a reference to a large private company or relevant undertaking as the case may be with any necessary modifications for that purpose.³³

³² Section 205B(4) of the 1990 Act.

³³ Section 205B(5) of the 1990 Act.

2.7 Who should be on the Audit Committee?

The audit committee must have at least two members who are directors on the full Board, but any such director cannot be a member of the audit committee if s/he is:

- a current employee of the qualifying company or relevant undertaking or of a subsidiary of the company or undertaking or
- a person who was an employee of the qualifying company or relevant undertaking or of any subsidiary of the company or undertaking at any time in the three years preceding his/her appointment to the committee;
- the chairperson of the Board of Directors.³⁴

However, these requirements do not apply where:

- only one member of the Board of Directors meets all of the preceding criteria and
- s/he is appointed as the sole member of the audit committee or as the Chairperson of an audit committee comprising no more than two members (including the Chairperson) and has the casting vote in the event of a tie and
- any additional conditions prescribed by Ministerial regulation are met and
- the annual directors' report discloses the reasons for the exemption from those requirements.³⁵

Where none of the current directors meet the required criteria, at least one qualifying director will need to be newly appointed to the Board in order to be assigned to serve on the audit committee.³⁶

2.8 Audit Committee Terms of Reference?

The Board of Directors must prepare and approve written terms of reference concerning the audit committee's role in the audit and financial management of the qualifying company or relevant undertaking. These terms of reference must be submitted for the information of the shareholders at the Annual General Meeting and must be reviewed annually by the Board.³⁷ Although not required by law, consideration could also be given to making available for inspection a copy of the current terms of reference at the company's or undertaking's registered office or website.

Should there be any change in the terms of reference, these amended terms of reference must also be approved by the Board, be submitted for the information of the shareholders and reviewed annually by the Board.³⁸

The terms of reference must, at a minimum, specify how the audit committee will discharge its responsibilities, as well as providing for a programme of separate and joint meetings with the management, the external auditor and the internal auditor of the company or undertaking concerned.³⁹ The audit committee should, at least annually, meet the external and internal auditors, without management being present, to discuss issues arising from the audit.

³⁴ Section 205B(6) and (7) of the 1990 Act.

³⁵ Section 205B(8) of the 1990 Act.

³⁶ This conclusion is also consistent with Article 41.1 of the Directive which provides *inter alia* that at least one member of the audit committee shall be independent.

³⁷ Section 205B(9) of the 1990 Act.

³⁸ Section 205B(11) of the 1990 Act.

³⁹ Section 205B(10) of the 1990 Act.

2.9 Partnerships?

Where a partnership is a 'relevant undertaking', Section 205B applies as though the partnership were a company formed and registered under the Companies Acts with all the necessary modifications. Specifically, all references to the annual directors' report under Section 158 of the Companies Act 1963 shall be construed to mean a report of the partners under Regulation 14 of the 1993 Regulations.⁴⁰

2.10 Ministerial Regulations?

The Minister may by regulation exempt companies engaged in securitisation which qualify under Section 110 of the Taxes Consolidation Act 1997 (as amended). He may also exempt classes of other companies or undertakings if he is of the opinion that their current or prospective regulation makes it unnecessary or inappropriate to apply the audit committee requirement to them⁴¹. No such regulations have yet been made, although there is an expectation that the Minister will do so to coincide with the commencement of Section 205B. Under Section 49 of the 2003 Act, any regulation exempting classes of companies or undertakings cannot be effective until a draft of the proposed regulation has been laid before the Houses of the Oireachtas and a resolution approving the draft has been passed by each House.

The Minister may also vary by regulation the qualifying balance sheet and turnover thresholds for application of the audit committee requirement⁴². No such regulations have yet been made, and the ODCE is not aware of any plans by the Minister to do so. Under Section 48(3) of the 2003 Act, any Ministerial intention to vary the qualifying balance sheet and turnover thresholds must be the subject of prior consultation with the Irish Auditing and Accounting Supervisory Authority. Any regulation in this area is also subject to the requirements of Section 49. This means that it cannot be effective until a draft of the proposed regulation has been laid before the Houses of the Oireachtas and a resolution approving the draft has been passed by each House.

In addition, the Minister may prescribe additional functions to be discharged by audit committees. He may also supplement the conditions relating to the composition of audit committees and the qualification of their members which may vary those identified in Section 2.7 above. He may also prescribe supplementary rules governing the operation of those committees⁴³. No such regulations or rules have yet been made. The implementation of any such regulation is subject to Section 50 of the 2003 Act which means that it may be annulled by a resolution passed by either House of the Oireachtas within 21 sitting days after the day on which the regulation is laid before it. Any annulment will not however affect the validity of anything done under the regulation before the passing of the resolution.

⁴⁰ Section 205B(15) of the 1990 Act. The reference to the 1993 Regulations is to the European Communities (Accounts) Regulations 1993. Regulation 14 has been amended by Regulation 7(d) of the 2005 Regulations.

⁴¹ Section 48(1)(j) of the 2003 Act.

⁴² Section 48(1)(l) of the 2003 Act.

⁴³ Section 48(1)(m) of the 2003 Act.

3.0 Further Guidance on Audit Committees⁴⁴

3.1 How often should the Audit Committee meet?

It is for the Chairman of the audit committee, in consultation with the Company Secretary, to decide the frequency and timing of the committee's meetings. There should be as many meetings as the audit committee's role and responsibilities require. It is recommended there should be not fewer than three meetings during the year, held to coincide with key dates within the financial reporting and audit cycle.

3.2 Who should attend?

The Chairman and members of the audit committee should normally be present at its meetings. The audit committee may decide to invite one or more non-members to attend all meetings, a particular meeting or meetings or to be present for a particular agenda item at a meeting. It is to be expected that the Company Secretary, the Finance Director, the Head of Internal Audit and the audit engagement partner of the external auditor will be regularly invited to attend audit committee meetings.

3.3 What resources does the Committee need?

The audit committee should have access to the services and resources of the Company Secretary in:

- assisting the Chairman in planning the audit committee's work,
- drawing up meeting agendas,
- maintaining minutes of audit committee meetings,

- drafting material about its activities for the annual report,
- collecting and distributing information and
- providing any necessary practical support.

The Company Secretary should ensure that the audit committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues for consideration by the Committee.

The Board should make funds available to the audit committee to enable it to take independent legal, accounting or other advice when the Committee reasonably believes that it is necessary to do so.

3.4 What remuneration should Audit Committee members receive?

In addition to the remuneration paid to all non-executive directors, each company or undertaking should consider the further remuneration that should be paid to members of the audit committee to recompense them for the additional responsibilities of membership. Consideration should be given to the time members are required to give to audit committee business, the skills they bring to bear and the onerous duties they take on, as well as the value of their work to the company or undertaking. The level of remuneration paid to the members of the audit committee should take into account the level of fees paid to other members of the Board. The Chairman's responsibilities and time demands will generally be heavier than the other members of the audit committee, and this should be reflected in his or her remuneration.

⁴⁴ Certain of the text set out in this section has been adapted from "Audit Committees – Combined Code Guidance", also known as the Smith Report, which is published by the Financial Reporting Council in the UK. The full text of the Report can be downloaded at <http://www.frc.org.uk/images/uploaded/documents/ACReport.pdf>.

3.5 What skills, experience and training should members of the Committee have?

At least one member of the audit committee should have significant, recent and relevant financial experience. The need for a degree of financial literacy among the other members will vary according to the nature of the company or undertaking, but experience of corporate financial matters will normally be required. The availability of appropriate financial expertise will be particularly important where the business involves specialised financial activities.

The company or undertaking should provide an induction programme for new audit committee members. This should cover:

- the role of the audit committee, including its terms of reference and expected time commitment by members, and
- an overview of the company's or undertaking's business, identifying the main business and financial dynamics and risks. Ideally, it should also include meeting some of its staff.

Training should also be provided to members of the audit committee on an ongoing and timely basis and should include an understanding of the principles of and developments in financial reporting and the related provisions in company law dealing with accounts and audit. In appropriate cases, it may also include, for example, understanding financial statements, applicable accounting standards and recommended practice, the regulatory framework for the company's or undertaking's business, the role of internal and external auditing and risk management.

3.6 How often should Audit Committee membership change?

The Board should ensure a planned and progressive renewal of the Board and of the audit committee. All directors should accordingly be put forward for re-election at regular intervals, subject to continued satisfactory performance.

3.7 Further Guidance?

In addition to the Smith Report referred to earlier, a European Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board discusses in Annex I of the Recommendation the composition, role and operation of an audit committee⁴⁵.

Also, Audit Committee Institute Ireland prepared a report entitled 'Shaping the Irish Audit Committee Agenda' (May 2005). This report combines the requirements of Section 205B with the recommendations of the Combined Code on Corporate Governance (Financial Reporting Council, July 2003). It gives extensive guidance on current best practice, discusses the current and emerging issues in relation to audit committees and contains in its Appendices a number of examples and templates that companies may find useful in ensuring compliance.⁴⁶

Many professional firms also provide guidance on best practice with respect to audit committees.

⁴⁵ The text of the Recommendation is available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/l_052/l_05220050225en00510063.pdf.

⁴⁶ This report is available on the Audit Committee Institute Ireland website at <http://www.auditcommitteeinstitute.ie>.

4.0 Penalties

4.1 Criminal Offences

The following new criminal offences are created by Section 205B:

- where the Board of Directors of a public limited company fails to establish an audit committee constituted in accordance with the Section, any director to whom the failure is attributable is guilty of an offence;⁴⁷
- where a director of a large private company or relevant undertaking fails to take all reasonable steps to comply with the disclosure provisions in Section 205B(4), that director is guilty of an offence.⁴⁸

Both of the above offences are indictable which means that they may be prosecuted on a summary basis before a Judge of the District Court or tried in the Circuit Court on indictment, i.e. before a judge and jury. The Director of Corporate Enforcement may prosecute these offences summarily. Any decision to proceed on indictment in respect of these offences will be made by the Director of Public Prosecutions following an investigation by the Director of Corporate Enforcement.

Under Section 240(1) of the 1990 Act (as amended), the maximum penalties are:

- on summary conviction, €1,905 or 12 months' imprisonment or both and
- on indictment, €12,697 or five years' imprisonment or both.

4.2 Civil Remedies and Sanctions

In evaluating any case of non-compliance, the Director of Corporate Enforcement has a number of civil legal options.

These include:

- requiring a company or company officer to remedy a default in complying with Section 205B within 14 days of the receipt of a notice from the Director;
- seeking an Order of the High Court to compel the directors to rectify the default pursuant to Section 371 of the Companies Act 1963 (as amended by Section 96 of the 2001 Act and Section 63 of the Investment Funds, Companies and Miscellaneous Provisions Act 2005).

In cases of repeated or serious non-compliance with the provisions of Section 205B, the Director could seek an order of the High Court disqualifying one or more persons from acting as company officers in the future. Further information on disqualification is contained in Appendix B to the ODCE Information Book 2 – Duties of Company Directors.⁴⁹

⁴⁷ Section 205B(12) of the 1990 Act.

⁴⁸ Section 205B(13) of the 1990 Act.

⁴⁹ A copy of the Information Book is available on our website at <http://www.odce.ie>.

5.0 Useful Addresses

Office of the Director of Corporate Enforcement

16 Parnell Square
Dublin 1

Tel: **01 858 5800**

Web: <http://www.odce.ie>

Department of Enterprise, Trade & Employment

Kildare Street
Dublin 2

Tel: **01 631 2121**

Web: <http://www.entemp.ie>

Company Law Review Group

Earlsfort Centre
Hatch Street Lower
Dublin 2

Tel: **01 631 2763**

Web: <http://www.clrg.org>

Companies Registration Office

14 Parnell Square
Dublin 1

Tel: **01 804 5200**

Web: <http://www.cro.ie>

BASIS (Business Access to State Information & Services)

Web: <http://www.basis.ie>

Office of the Director of Corporate Enforcement

November 2006

Appendix 1

Section 205B of the Companies Act 1990

(as inserted by Section 42 of the Companies (Auditing and Accounting) Act 2003 and as subsequently amended by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005 (S.I. No. 116 of 2005))

Audit Committee

205B (1) In this section—

‘affiliate’ in relation to an auditor, means a firm, body corporate or partnership considered under section 182(2) to be an affiliate of the auditor at the relevant time;

‘amount of turnover’ and ‘balance sheet total’ have the same meanings as in section 8 of the Companies (Amendment) Act 1986;

‘internal audit’ means an examination of the internal control system of a public limited company, a large private company or a relevant undertaking that is conducted within the public limited company, large private company or undertaking or otherwise at the request of its audit committee, directors or other officers;

‘internal auditor’ means a person who conducts an internal audit;

‘large private company’ means either of the following:

- (a) a private company limited by shares 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 for the year—
 - (A) €25,000,000, or
 - (B) if an amount is prescribed under section 48(1)(l) of the Act of 2003 for the purpose of this provision, the prescribed amount;
 - (ii) the amount of turnover of that company exceeds for the year—
 - (A) €50,000,000, or
 - (B) if an amount is prescribed under section 48(1)(l) of the Act of 2003 for the purpose of this provision, the prescribed amount;
- (b) a private company limited by shares if the company and all its subsidiary undertakings together, in both the most recent financial year of that company and the immediately preceding financial year, meet the criteria in paragraph (a);

‘parent undertaking’ and ‘subsidiary undertaking’ have the same meaning as in the 1992 Regulations;

‘relevant undertaking’ means either of the following:

- (a) an undertaking referred to in Regulation 6 of the 1993 Regulations that, in both the most recent financial year and the immediately preceding financial year of the undertaking, meets the following criteria:
 - (i) the balance sheet total of that undertaking exceeds for the year—
 - (A) €25,000,000, or
 - (B) if an amount is prescribed under section 48(1)(l) of the Act of 2003 for the purpose of this provision, the prescribed amount;
 - (ii) the amount of turnover of that undertaking exceeds for the year—
 - (A) €50,000,000, or
 - (B) if an amount is prescribed under section 48(1)(l) of the Act of 2003 for the purpose of this provision, the prescribed amount;
 - (b) an undertaking referred to in Regulation 6 of the 1993 Regulations if that undertaking and all of its subsidiary undertakings together, in both the most recent financial year and the immediately preceding financial year of the parent undertaking, meet the criteria in paragraph (a).
- (2) Subject to subsection (16), the board of directors of a public limited company (whether listed or unlisted) shall establish and adequately resource a committee of directors, to be known as the audit committee, with the following responsibilities:
- (a) reviewing, before they are presented to the board of directors for approval—
 - (i) the company’s individual accounts, and
 - (ii) if the company is a parent undertaking, the group accounts of the group of undertakings of which the company is the parent undertaking;
 - (b) determining whether the individual accounts so reviewed comply with section 205A(2) and whether, in the committee’s opinion, they give at the end of the financial year a true and fair view of—
 - (i) the state of affairs of the company, and
 - (ii) the profit or loss of the company, even if, by virtue of section 7(1A) of the Companies (Amendment) Act 1986 or section 148(8) of the Act of 1963, it is not laid before the members in annual general meeting;
 - (c) determining whether the group accounts so reviewed comply with section 205A(2) and whether, in the committee’s opinion, they give at the end of the financial year a true and fair view of—
 - (i) the state of affairs of the group of undertakings of which the company is the parent undertaking, and
 - (ii) the profit or loss of that group;

- (d) recommending to the board of directors whether or not to approve the individual accounts and group accounts so reviewed;
 - (e) determining, at least annually, whether in the committee's opinion, the company has kept proper books of account in accordance with section 202;
 - (f) reviewing, before its approval by the board of directors, the statement required to be made under section 205E(5) and (6);
 - (g) determining whether, in the committee's opinion, the statement so reviewed—
 - (i) complies with section 205E(5) and (6), and
 - (ii) is fair and reasonable and is based on due and careful enquiry;
 - (h) recommending to the board of directors whether or not to approve a statement reviewed under paragraph (f);
 - (i) advising the board of directors as to the recommendation to be made by the board to the shareholders concerning the appointment of the company's auditor;
 - (j) monitoring the performance and quality of the auditor's work and the auditor's independence from the company;
 - (k) obtaining from the auditor up to date information to enable the committee to monitor the company's relationship with the auditor, including, but not limited to, information relating to the auditor's affiliates;
 - (l) recommending whether or not to award contracts to the auditor or an affiliate of the auditor for non-audit work;
 - (m) satisfying itself that the arrangements made and the resources available for internal audits are in the committee's opinion suitable;
 - (n) reporting, as part of the report under section 158 of the Principal Act, on the committee's activities for the year, including, but not limited to, the discharge of its responsibilities under paragraph (j);
 - (o) performing any additional functions prescribed by regulation under section 48(1)(m) of the Act of 2003;
 - (p) performing any other functions relating to the company's audit and financial management that are delegated to it by the board of directors.
- (3) Subject to subsection (16), the board of directors of each large private company and of each relevant undertaking shall either—
- (a) establish an audit committee that—
 - (i) has all or some of the responsibilities specified in subsection (2), and
 - (ii) subject to subsection (8), otherwise meets the requirements of this section, or
 - (b) decide not to establish an audit committee.

- (4) The board of directors of each large private company and of each relevant undertaking to which subsection (3) applies shall state in their report under section 158 of the Principal Act—
 - (a) whether the company or undertaking, as the case may be, has established an audit committee or decided not to do so,
 - (b) if the company or undertaking, as the case may be, has established an audit committee, whether it has only some of the responsibilities specified in subsection (2), and
 - (c) if the company or undertaking, as the case may be, has decided not to establish an audit committee, the reasons for that decision.
- (5) For the purpose of applying subsection (2) to a large private company or relevant undertaking that decides under subsection (3)(a) to establish an audit committee with some or all of the responsibilities specified in subsection (2)—
 - (a) a reference in any applicable paragraph of subsection (2) to a public limited company or the company is to be construed as a reference to the large private company or relevant undertaking, as the case may be, and
 - (b) subsection (2) applies to the extent specified by the large private company or the relevant undertaking with any other modifications necessary for that purpose.
- (6) The audit committee is to consist of such directors as the board of directors concerned thinks fit, provided, subject to subsection (8), both of the following requirements are met:
 - (a) the committee consists of not fewer than 2 members;
 - (b) all those appointed to the committee qualify under subsection (7).
- (7) A director qualifies for appointment to the audit committee unless he or she—
 - (a) is, or was at any time during the 3 years preceding appointment to the committee—
 - (i) an employee of the company or undertaking concerned, or
 - (ii) an employee of any subsidiary of the company concerned or of a subsidiary undertaking of the undertaking concerned, or
 - (b) is the chairperson of the board of directors.
- (8) The requirements specified in paragraphs (a) and (b) of subsection (6) do not apply if—
 - (a) only one director on the board of directors of the company or undertaking concerned qualifies under subsection (7),
 - (b) that director—
 - (i) is appointed as the sole member of the audit committee, or
 - (ii) is appointed as the chairperson of an audit committee consisting of not more than 2 members (including the chairperson) and has, in the case of an equal division of votes, a second or casting vote,

- (c) any conditions prescribed under section 48(1)(m) of the Act of 2003 are met, and
 - (d) the directors of the company or undertaking concerned state in their report under section 158 of the Principal Act the reasons for the company's or undertaking's exemption from those requirements.
- (9) Written terms of reference concerning the audit committee's role in the audit and financial management of the company or relevant undertaking concerned shall—
 - (a) be prepared and approved by the board of directors,
 - (b) be submitted for the information of the shareholders of the company or undertaking concerned at its annual general meeting, and
 - (c) be reviewed each year by the board of directors.
- (10) Without limiting the matters that may be included under subsection (9), the terms of reference must—
 - (a) specify how the audit committee will discharge its responsibilities, and
 - (b) provide for a programme of separate and joint meetings with the management, auditor and internal auditor of the company or undertaking concerned.
- (11) Subsection (9) applies also in relation to any amendments of the audit committee's terms of reference.
- (12) Where the board of directors of a public limited company to which subsection (2) applies fails to establish an audit committee that is constituted in accordance with this section, each director to whom the failure is attributable is guilty of an offence.
- (13) Where a director of a large private company or relevant undertaking to which subsection (3) applies fails to take all reasonable steps to comply with the requirements of subsection (4), the director is guilty of an offence.
- (14) A reference in this section to the directors of a relevant undertaking is to be construed in the case of an undertaking that does not have a board of directors as a reference to the corresponding persons appropriate to that undertaking.
- (15) For the purpose of applying this section to a partnership that is referred to in Regulation 6 of the 1993 Regulations and that is a relevant undertaking—
 - (a) the partnership is to be treated as though it were a company formed and registered under the Companies Acts,
 - (b) a reference in this section to a report under section 158 of the Principal Act is to be construed as a reference to a report under Regulation 14 of the 1993 Regulations, and
 - (c) this section applies with any other modifications necessary for that purpose.
- (16) This section does not apply to—
 - (a) a public limited company that is a wholly owned subsidiary undertaking of another public limited company, or
 - (b) any company or undertaking of a class exempted under section 48(1)(j) of the Act of 2003 from the application of this section.

Appendix 2

Extracts from Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts⁵⁰

Article 41

Audit Committee

1. Each public-interest entity⁵¹ shall have an audit committee. The Member State shall determine whether audit committees are to be composed of non-executive members of the administrative body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of shareholders of the audited entity. At least one member of the audit committee shall be independent and shall have competence in accounting and/or auditing.

In public-interest entities which meet the criteria of Article 2(1), point (f) of Directive 2003/71/EC⁵², Member States may permit the functions assigned to the audit committee to be performed by the administrative or supervisory body as a whole, provided at least that when the chairman of such a body is an executive member, he or she is not the chairman of the audit committee.
2. Without prejudice to the responsibility of the members of the administrative, management or supervisory bodies, or of other members who are appointed by the general meeting of shareholders of the audited entity, the audit committee shall, *inter alia*:
 - (a) monitor the financial reporting process;
 - (b) monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems;
 - (c) monitor the statutory audit of the annual and consolidated accounts;
 - (d) review and monitor the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity.
3. In a public-interest entity, the proposal of the administrative or supervisory body for the appointment of a statutory auditor or audit firm shall be based on a recommendation made by the audit committee.
4. The statutory auditor or audit firm shall report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process.

⁵⁰ 9.6.2006 L 157/103 Official Journal of the European Union EN. The full text of the Directive is available at <http://europa.eu.int/eur-lex/lex/Notice.do?val=427746:cs&lang=en&list=427746:cs,&pos=1&page=1&nbl=1&pgs=10&hwords=amending%20council%20directives%2078/660/eecc%20and%2083/349/eecc%20and%20repealing%20council%20directive%2084/253/eecc-&checktexte=chec>

⁵¹ Article 2 of the Directive defines public-interest entities as including listed companies, credit institutions, insurance undertakings and any other entities designated by Member States.

⁵² Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (OJ L 345, 31.12.2003, p. 64).

5. Member States may allow or decide that the provisions laid down in paragraphs 1 to 4 shall not apply to any public-interest entity that has a body performing equivalent functions to an audit committee, established and functioning according to provisions in place in the Member State in which the entity to be audited is registered. In such a case the entity shall disclose which body carries out these functions and how it is composed.
6. Member States may exempt from the obligation to have an audit committee:
 - (a) any public-interest entity which is a subsidiary undertaking within the meaning of Article 1 of Directive 83/349/EEC if the entity complies with the requirements in paragraphs 1 to 4 of this Article at group level;
 - (b) any public-interest entity which is a collective investment undertaking as defined in Article 1(2) of Directive 85/611/EEC. Member States may also exempt public-interest entities the sole object of which is the collective investment of capital provided by the public, which operate on the principle of risk spreading and which do not seek to take legal or management control over any of the issuers of its underlying investments, provided that those collective investment undertakings are authorised and subject to supervision by competent authorities and that they have a depositary exercising functions equivalent to those under Directive 85/611/EEC;
 - (c) any public-interest entity the sole business of which is to act as issuer of asset-backed securities as defined in Article 2(5) of Commission Regulation (EC) No 809/2004⁵³. In such instances, the Member State shall require the entity to explain to the public the reasons for which it considers it not appropriate to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee;
 - (d) any credit institution within the meaning of Article 1(1) of Directive 2000/12/EC whose shares are not 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 and which has, in a continuous or repeated manner, issued only debt securities, provided that the total nominal amount of all such debt securities remains below €100,000,000 and that it has not published a prospectus under Directive 2003/71/EC.

Article 42

Independence

1. In addition to the provisions laid down in Articles 22 and 24⁵⁴, Member States shall ensure that statutory auditors or audit firms that carry out the statutory audit of a public-interest entity:
 - (a) confirm annually in writing to the audit committee their independence from the audited public-interest entity;
 - (b) disclose annually to the audit committee any additional services provided to the audited entity; and
 - (c) discuss with the audit committee the threats to their independence and the safeguards applied to mitigate those threats as documented by them pursuant to Article 22(3).
2. Member States shall ensure that the key audit partner(s) responsible for carrying out a statutory audit rotate(s) from the audit engagement within a maximum period of seven years from the date of appointment and is/are allowed to participate in the audit of the audited entity again after a period of at least two years.
3. The statutory auditor or the key audit partner who carries out a statutory audit on behalf of an audit firm shall not be allowed to take up a key management position in the audited entity before a period of at least two years has elapsed since he or she resigned as a statutory auditor or key audit partner from the audit engagement.

⁵⁴ Articles 22 and 24 stipulate the requirements of independence and objectivity for external auditors in carrying out the annual statutory audit.

