

COMMENTARY ON THE RULING OF THE FEDERAL HIGH COURT ON QUALIFICATION FOR APPOINTMENT AS CHAIRMAN OF AUDIT COMMITTEE OF A PUBLIC COMPANY



The Federal High Court in Lagos, ruling on Suit No FHC/L/CS/1026/16, recently declared null and void a rule issued by the Financial Reporting Council of Nigeria (FRCN) to the effect that persons attesting as Chairmen of audit committees of public companies must be professional members of statutorily established accounting bodies.

The rule in dispute was a part of the FRCN Rules made public by the FRCN on 15th March 2016 pursuant to sections 7, 8, 30, 41, 42 and 44 of the FRCN Act No. 6 of 2011.

Rule 2(c) provides: *“Any person attesting, as Chairman of Audit Committee, to annual report, financial statements, accounts, financial report, returns and other documents of a financial nature, shall be a professional member of an accounting body established by Act of the National Assembly in Nigeria.”*

The application of the rule meant that only persons who were members of either the Institute of Chartered Accountants of Nigeria (ICAN), the Association of National Accountants of Nigeria (ANAN) or the Institute of Finance & Control of Nigeria (IFCN) could be appointed to head audit committees of public companies.

The Independent Shareholders Association of Nigeria (ISAN) in particular challenged the validity of the rule in court, raising germane questions about the seeming inconsistency of Rule 2(c) with the provisions of Section 359 of the Companies and Allied Matters Act (CAMA) and the absence of a board of the FRCN at the time it purported to make the rule.

Many shareholders similarly argued that the rule was restrictive and capable of excluding some shareholders from being appointed into audit committees. This is for not being members of accounting bodies even though there



was no similar requirement for the purchase of shares. The argument of the shareholders clearly finds merit in the provision of Section 40 of the Constitution of the Federal Republic of Nigeria (CFRN) 1999 which guarantees the freedom of association.

Concerning the alleged inconsistency of the FRCN rules with CAMA provisions, it is instructive at this juncture to briefly consider the statutory provision on the composition of the audit committee as laid down in CAMA. The duty of a public company to establish an audit committee is contained in Section 359(3) of CAMA while Section 359(4) specifies that the committee shall consist of "an equal number of directors and representatives of the shareholders of the company (subject to a maximum number of six numbers)." By the provision of the latter section, the primary duty of the audit committee is to examine the auditors' report and make recommendations to the annual general meeting as the committee deems fit.

Some other duties statutorily entrusted on the audit committee are contained in Section 359(6). Such duties include the obligation to ensure that the accounting and reporting principles of the company are in accordance with the provisions of Sections 52, 53, Guidance on Audit Committee of the Financial Reporting Council of Nigeria and other attendant legal requirements; reviewing the scope and planning of audit requirements; reviewing the findings on management matters in conjunction with the external auditor; continuous review of the company's system of accounting to ensure effectiveness; making

recommendations to the Board with regard to the appointment, removal and remuneration of external auditors; and authorizing the internal auditor to carry out investigations into any activities of the company that may be of interest or concern to the committee.

Without a doubt, the chairman of the audit committee is expected to supervise the activities of the committee in performing its obligations as highlighted above. It is however doubtful that becoming a professional member of an accounting body is the only possible way of acquiring the requisite competence to oversee the activities of the audit committee. Lawyers, for instance, are sufficiently trained to perform similar tasks but would stand exempted from occupying the position of the audit committee chairman where they are shareholders or directors of a public company. The same argument may be canvassed for a number of other professions. In addition, CAMA does not impose professional membership of an accounting body as a requirement for nomination into the audit committee to perform the stated duties.

It is worthy of note that the Securities and Exchange Commission (SEC) which also plays an important role in regulating public companies, in its 2014 Amended Code of Corporate Governance for Public Companies ("SEC Corporate Governance Code") similarly makes prescriptions relating to the composition of the audit committee.

By the provisions of Article 30(2) the SEC Code of Corporate Governance, it is sufficient that at least one member of the

audit committee be financially literate even though all other members are required to have basic financial literacy and should be able to read financial statements. A member of the committee is similarly required to have knowledge of accounting or financial management while due note must also be taken of the prescription in Article 30(4) which empowers the committee to seek external professional advice when necessary.

In view of all of the above, the FRCN Rule 2(c) is considerably excessive and a possible clog in the wheels of easing business processes in the country. It also needs be pointed out that waivers granted by the Council at the cost of N600,000 (Six Hundred Thousand Naira) to allow non-members of accounting bodies be appointed audit committee chairmen underscore the superfluity of the rules. Granting such waivers suggest that a revenue drive may have motivated the formulation of the rules as opposed to the need to ensure higher reporting standards. We are therefore constrained to agree with the position of the ISAN in challenging the necessity of the FRCN's Rule 2(c).

We further consider it of great significance that the Honourable Justice A. O. Faji in his ruling held that in the absence of the board of the FRCN which is charged with its overall control under Section 2(1) of the Financial Reporting Council of Nigeria Act, neither the Executive Secretary of the FRCN nor any other persons could constitute themselves into the FRCN or act in the name of the FRCN to make decisions that affect the legal rights and obligations of any person outside of the FRCN.

The Board of the FRCN was only inaugurated by the Honourable Minister for Trade and Investment, Dr Okechukwu Enelamah in May 2017 whereas the FRCN had purported to issue a document of significant impact on

public companies in March 2016. It is therefore clear that having already failed the test of consistency with extant laws enacted by the National Assembly, the FRCN Rules also fails the test of competence having emerged from what may not be considered a properly constituted authority.

Conclusion

We consider the decision of the Federal High Court in Suit No FHC/L/ CS/1026/16 as being in perfect accord with the extant law and reassuring to the business community in Nigeria. The decision protects the rights of investors and shareholders of public companies in deciding upon persons to be appointed chairmen of audit committees. The judgment as delivered by Honourable Justice Faji may also have curtailed the abuse of office for financial benefit regulatory bodies.

While we may reasonably expect the FRCN to appeal the decision, as it is constitutionally entitled to, we are also of the firm conviction that the case has shed light on the need to harmonise the rules and regulations on corporate governance in the country for the sake of clarity and certainty. It will therefore be important for all stakeholders to pay attention to the developments in the case in the event it progresses to the appellate courts. Nonetheless, the Federal Ministry of Trade and Investment may do well to liaise with the Federal Ministry of Finance to facilitate a combined effort by agencies under the oversight of the ministries to harmonise their positions on issues of corporate governance. The outcome of such joint effort may thereafter be reflected in an updated National Code of Corporate Governance with input from all relevant stakeholders.