Financial and Accounting Responsibilities of Directors

(Issued November 1996; updated November 2000)

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This statement (formerly statement 1.401) was originally issued in November 1996 by the Council of the Institute of Chartered Accountants in England and Wales concerning the main duties and responsibilities of a financial or

accounting nature owed by directors to their company and its shareholders and others. It sets out, where appropriate, what is considered to be best practice rather than what may be acceptable as the legal minimum required. It is hoped that the statement will be useful to members acting as directors and to members generally in conveying to directors the extent of these responsibilities. It is stressed, however, that the statement is not intended to cover other aspects, however important, of a director's position.

The statement is concerned with companies in England and Wales subject to the provisions of the Companies Act 1985 as amended prior to November 2000, and is an updated version of that originally issued in April 1970 and revised most recently in November 2000. The contents of the original statement had counsel's approval.

Members should note that the statement has not been updated to take account of more recent changes in law, regulation and practice. This statement will be revised once the Companies Bill has been passed by Parliament and an updated version will be available on the website at *www.icaew.co.uk/membershandbook*.

Scope and purpose

1 Directors of companies, whether public or private, have various responsibilities towards their companies, breach of which may not only be detrimental to those companies and their shareholders, but also may lead to civil and criminal liability of the individual director concerned. The aim of this statement is to provide guidance to members who are directors as to their responsibilities in relation to financial and accounting matters.

2 In discussing these responsibilities, companies which are subject to the Companies Act are considered, differentiating between public and private companies as appropriate. Special categories of companies such as those incorporated by Royal Charter, special Act or pursuant to other legislation, for example, building societies or friendly societies, are not dealt with in detail but the responsibilities discussed may usefully be borne in mind in the context of incorporated entities not within the Companies Act.

3 It is to be stressed that the aim is to guide directors and not to provide them with a detailed analysis of the law on the topic under discussion. Interpretation of the law often depends upon the particular circumstances and if directors are in difficulty over interpretation of their duties they should seek independent legal or other professional advice, or contact the Institute's Technical Enquiries helpline or Ethics helpline services. Reference to Section 7.1 'Professional conduct and disclosure in relation to defaults or unlawful acts' and to Code of Ethics 3.4 Part C 'Professional accountants in business' may also be useful.

Directors' status, powers and duties

Who is a director?

4 A director, by whatever title, is one who is in practice responsible for the management of a company's affairs. There is no comprehensive definition of a director in statute, the only guidance given being that the term 'director' includes any person occupying the position of director, by whatever name called (Companies Act 1985, section 741). For example, in some companies management may be entrusted to 'Governors' or 'Council Members'. They will be directors. Further, and separately, the word director in some statutory provisions includes a de facto director, that is a person who acts as a director without having been appointed: see *Re Lo-Line Ltd* [1988] 1 Ch. 477; *Re Richborough Furniture Ltd* [1996] BCC 155. A definition of 'director' for certain taxation purposes is given in the Income and Corporation Taxes Act 1988, section 168(8) and (9).

5 A company must have a minimum of two directors if public, and a minimum of one if private (Companies Act 1985, section 282). The method of appointment of directors will generally be governed by the company's articles of association. Normally the first directors are chosen by the subscribers of the company's memorandum and thereafter by the annual general meeting (Companies (Tables A–F) Regulations 1985, Table A, regulations 73 to 80).[1] At a general meeting of a public company, the appointment of each director must be voted on individually, unless a resolution that a single resolution will suffice has first been agreed by the meeting without opposition (Companies Act 1985, section 292(1)).

Shadow directors

6 Certain legislative provisions concerning directors extend to 'shadow directors'. A 'shadow director' is defined as 'a person in accordance with whose directions or instructions the directors of a company are accustomed to act' (Companies Act 1985, section 741, Company Directors Disqualification Act 1986, section 22 and Insolvency Act 1986, section 251), although it is provided that 'a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity'. Depending on the facts, it is possible for a bank or a 'company doctor' to be a shadow director: see, respectively, *Re M.C. Bacon Ltd* (1988) 4 BCC 425 and [1990] BCC 78, and *Re Tasbian Ltd (No. 3)* [1992] BCC 358. The 'company doctor' in the latter case was a chartered accountant. Further analysis of the term shadow director is to be found in *Re Hydrodan (Corby) Ltd* [1994] BCC 161.

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[1] Throughout this statement where it is considered appropriate to refer to articles of association, reference is made to the relevant articles of the current version of Table A. It by no means follows that the articles of association of any particular company will be in the same form.

Non-executive directors

7 Other than as indicated at paragraph 23(b) below, 'executive' and 'non-executive' directors have the same responsibilities in law. An 'executive director' is merely a director who has separate responsibilities within the company, as an executive. The role of the non-executive director is discussed further in paragraphs 12 and 13 below.

Who cannot be a director?

8 Normally, the company's articles of association will deal with the appointment of the directors (Companies (Tables A–F) Regulations 1985, Table A, regulations 73 to 80), but there are certain statutory restrictions:

- a person cannot be a company's sole director and its secretary at the same time (Companies Act 1985, section 283);
- with certain exceptions, a person who has reached the age of 70 may not be appointed or continue to serve as a director of a public company or of its subsidiary (Companies Act 1985, section 293);
- an undischarged bankrupt may not, without leave of the court, act as a director (Company Directors Disqualification Act 1986, section 11);
- a person subject to a disqualification order from the court may not act as a director (Company Directors Disqualification Act 1986, section 1);
- a person cannot be a company's auditor, or its reporting accountant (see A47 below), and a director at the same time (Companies Act 1989, sections 27 and 28 and Companies Act 1985, section 249D).

Status of directors

9 A director is an officer of the company but is not necessarily an employee. The status of an employee is governed by the contract under which he serves the company. As indicated above, an executive director is both a director and an employee.

10 A director is entrusted with powers by the Articles of Association. He is in some sense an agent of his company and in some sense a trustee of its assets, but he is neither precisely one nor precisely the other.

11 A director owes to his company fiduciary duties of loyalty and good faith, analogous to those owed by a trustee, and duties of care and skill, differing fundamentally from those owed by a trustee (see paragraphs 18 to 23 below).

12 A director may have executive status or operate in a non-executive capacity. The non-executive director has a positive contribution to make in ensuring that the board fulfils its main objectives. He can exercise an impartial influence and bring to bear experience gained from other fields; executive directors would therefore be well advised to consider the appointment of such directors to serve alongside them. The Combined Code issued in 1998 and appended to the Listing Rules emphasises the importance of non-executive directors.

13 Members are well qualified for appointment as non-executive directors

because of the special skills and experience which they have to offer. It is important that, before accepting a board appointment, prospective non-executive directors should be aware that, other than as indicated in paragraph 23(b) below, their responsibilities in law are no different from those of directors holding executive status. They should also ensure that, in applying their skills, they do not act as professional advisers to the board, and should satisfy themselves that the company has access to and gets all the outside professional advice that it needs.

14 The Combined Code provides that a board of directors should establish an audit committee of at least 3 non-executive directors, the majority of whom should be independent non-executive directors.

Powers of directors

15 Directors derive their power from the articles of association and they should study carefully the articles of their particular company. Directors also should have regard to the powers given to the company, which are to be found in the memorandum of association, in particular the objects clause. If the company acts outside these powers the act may be ultra vires and void. The Companies Act 1989, introducing sections 35 to 35B, Companies Act 1985, made fundamental changes in this area intended to give broad relief from the ultra vires rule, while retaining it as a limit on the powers of the directors.

16 The company in general meeting may in certain circumstances exercise powers normally vested in directors, for example where there is deadlock on the board (*Barron v. Potter* [1914] 1 CH.895) or where there are no directors (*Alexander Ward & Co v. Samyang-Navigation Co* [1975] 1 W.L.R.673), but these circumstances will be rare.

17 Directors must exercise their powers collectively and the majority decision will prevail. The articles of association will govern how the directors are to proceed (Companies (Tables A–F) Regulations 1985, Table A, regulations 88 to 98) and will often authorise directors to delegate the exercise of their powers to a committee consisting of one or more directors, or to a managing, or other executive, director (Table A, regulation 72).

Duties of directors

18 The duties of directors are owed to the company as a whole. Their duties and responsibilities arise both out of common law and out of statute and can be classified as follows:

- fiduciary duty to act honestly and in good faith;
- duty to exercise skill and care; and
- statutory duty.

19 Directors and shadow directors should bear in mind that breach of these duties, inter alia, may result in them being judged unfit to be concerned in the management of a company (Company Directors Disqualification Act 1986, section 9) and lead to disqualification (Company Directors Disqualification Act 1986, sections 6 and 8).

Fiduciary duty

20 Four separate rules have emerged.

(a) Directors must act in good faith in what they believe to be the best interests of the company. Generally speaking, the interests of the company are to be equated with the interests of its members as a whole. As between different groups of shareholders, the directors must act fairly. Where there is a possibility that the company will not be able to meet its obligations to its creditors, the interests of the company will include those of its creditors. In any case, the directors must also have regard to the interest of the company's employees (see paragraph 25 below).
(b) Directors must exercise their powers only for the purposes for which they were granted. (*Howard Smith Ltd* v *Ampol Ltd* [1974] AC 821.)
(c) Directors must not place themselves in a position in which there is a conflict between their duties to the company and their personal interests or duties to others. Aspects of this rule include the following:
   (i) They must not, except as authorised by the articles of association, be interested in any contract with the company. If they are, the contract will be avoidable by the company and they will be accountable to the company for any profit. For relevant articles of association see Companies (Tables A–F) Regulations 1985, Table A, regulations 85 and 86. A relevant statutory provision (Companies Act 1985, section 317) is examined later (see paragraph 38 below).
   (ii) They must not, without the informed consent of the shareholders, use the company's assets, opportunities or information for their own profit. If they do, they will be accountable to the company for such profit.
(d) Directors must not fetter their discretion by agreeing, either with one another or with third parties, how to vote at future board meetings. However, that does not prevent them from committing the company to a contract which requires further action at subsequent board meetings.

Duty of skill and care

21 Responsibilities of directors include taking reasonable steps to ensure that the company's assets are properly collected, safeguarded, insured and invested, all as appropriate, and that all payments are supported by proper documentation. In no sense though, are these the only responsibilities of directors.

22 A director is required in the performance of his duties:

(a) to exhibit such a degree of skill as may reasonably be expected from a person with his knowledge and experience, and
(b) to take such care as an ordinary man might be expected to take on his own behalf.

In applying these standards no distinction is to be drawn between executive and non-executive directors. (*Dorchester Finance Co Ltd* v *Stebbing* [1989] BCLC 498, decided in 1977.)

23 The following guidelines can be laid down:

(a) Executive directors should devote their time and energies to company matters in accordance with the terms of their contract. In most cases this will require them to devote all their working time. If they are to act as non-executive directors of other companies, with the corresponding responsibilities which such appointments bring (see paragraphs 7, 12 and 13 above), they should ensure that the contract does not prevent that and allows them the necessary time to do so.
(b) Non-executive directors are not required to give continuous attention to company affairs. However, they should familiarise themselves with the company's affairs, including its financial position, and should attend meetings of the board, and of any committee of the board of which they are members, whenever they are reasonably able to do so. (*Re City Equitable Fire Insurance Co Ltd* [1925] Ch. 407.)
(c) If a director, whether executive or non-executive, has a particular skill, for example he is a qualified accountant, he should exhibit the skill or ability reasonably expected from a person of his experience in that profession. A chartered accountant may face conflict between his duties in that capacity and his commercial position within the company and should at all times have regard to Section 3 'Code of ethics'.
(d) Having regard to the articles of association and the demands of the business, directors may normally entrust many duties to other officials of the company. Where that is so then, in the absence of grounds for suspicion, the directors are justified in trusting those officials to perform those duties honestly. (*Re City Equitable Fire Insurance Co Ltd.*)

Statutory duty
24 Company law imposes a number of duties on directors, such as the preparation of annual accounts, and these are dealt with in the following sections, under subject title. However, two specific duties are examined in the following paragraphs, namely, duties towards employees and duties in relation to auditors.

Duty to employees
25 As an employer, the company must comply with the requirements of employment law. The directors, being charged with the management of the company's affairs, should have this in mind when dealing with employment matters. Consideration of the duties of employers is outside the scope of this text but company law specifically imposes a duty on directors to 'have regard in the performance of their functions [to] the interests of the company's employees in general, as well as the interests of its members' (Companies Act 1985, section 309).

Duties in relation to auditors
26 With the exception of companies exempt from audit (see A47 below), it is the duty of the company in general meeting to appoint its auditors for each financial year (Companies Act 1985, sections 384 and 388A). At any time before a company's first relevant general meeting, the directors may appoint the company's first auditors. Auditors of a private company are deemed to be reappointed each year if an elective resolution not to reappoint auditors annually is in force (Companies Act 1985, section 386).

27 Auditors have a statutory right of access, at all times, to the company's books, accounts and vouchers and to require from officers of the company such information as the auditors think necessary for the performance of their duties. Directors must therefore ensure that the auditors have adequate information for the performance of their duties. Further, the auditors of a holding company may require information and explanations from subsidiary companies and their auditors. Any officer who knowingly or recklessly makes a statement to the auditors in the course of their audit which is misleading, false or deceptive in a material particular is guilty of a criminal offence. (Companies Act 1985, section 389A.)

28 The statutory rights of auditors cannot be restricted in any way. (*Newton* v *Birmingham Small Arms Co* [1906] 2 Ch. 378.)

29 Directors may be asked by the company's auditors to make written representations to confirm information on which the auditors have placed reliance in forming an opinion. Such confirmations are sought as part of the auditors' duty to obtain audit evidence, typically when knowledge of the facts is confined to management or where the matter is principally one of judgement and opinion, and no independent corroborative evidence is available.

30 It is common practice for auditors to report to directors or management after an audit, drawing attention to any weakness in the company's systems that has come to the auditors' attention and making suggestions for possible improvements. While there are no specific legal requirements relating to management reports, directors should consider them with care, since such a report may contain information which should put the directors on enquiry as to inadequacies in systems or personnel. The auditors may request a reply to the points raised in the management report and, in certain cases, may request that the directors' discussion of the report be recorded in the board minutes.

31 There are also occasions when directors need auditors' reports on matters other than the annual accounts, for example when a private company is making a payment out of capital in respect of the purchase of its own shares (Companies Act 1985, section 173) or when a private company is giving financial assistance for the purpose of the acquisition of its own shares (Companies Act 1985, section 156).

Directors' relationship with company

32 A director stands in a fiduciary relationship to his company. He should not therefore place himself in a position where his personal interest or his duty to others could conflict with his duty to the company (see paragraph 20(c) above). If such a conflict does arise, the director will be personally liable to the company for any loss suffered by the company or will have to account for any benefit which has accrued to him. This rule is strictly applied by English courts. (*Regal (Hastings) Ltd* v *Gulliver* [1942] 1 All E.R. 378.)

33 Further, at common law, in the event of a director having an interest in a contract to which his company is a party, the company may in certain circumstances avoid the contract. If, however, the director discloses his interest in the contract to the board of directors and their approval of his involvement is given, the contract will cease to be voidable and the director may retain any profit he has received by virtue of his interest if so authorised by the articles.

34 The articles of association will usually contain provisions concerning contracts between the company and its directors (e.g. Companies (Tables A–F) Regulations 1985, Table A, regulations 85 and 86) and lay down the procedure to be followed. Directors should therefore study the particular provisions of their company's articles of association.

35 Where there is a contract of service with a director, apart from the rights and duties imposed by employment law, company law requires that the contract or a written memorandum of its terms must be kept by the company and be open to inspection by its members. A company must also have available for inspection its directors' contracts with its subsidiaries, or written memoranda (Companies Act 1985, section 318). Directors' contracts of service or for services must have prior approval in general meeting if they may continue for more than five years without being terminable by the company (Companies Act 1985, section 319). Both these requirements also extend to shadow directors.

36 Members carrying out executive functions would be well advised to ensure that they have a written contract with the company. A specimen form of a contract is available from the Institute of Directors. A contract should address duties, pay, holidays, sickness, pension, notice and dismissal procedures, confidentiality, proportion of time spent on company duties and competition. Best practice in the area of remuneration and contracts is addressed in the Combined Code and the Listing Rules of the Financial Services Authority (FSA).

37 Statute has increasingly intervened to lay down rules relating to various types of contracts. These can be divided into:

- contracts in which a director is interested;
- substantial property transactions;
- arrangements of a financial nature;
- directors' emoluments and compensation for loss of office;
- share transactions.

Contracts in which a director is interested

38 Where a director is directly or indirectly interested in a contract or a proposed contract with the company, he must declare his interest at a meeting of directors at the first opportunity (Companies Act 1985, section 317). His duty is to declare the nature of his interest, but a general notice that a director is a member of a specified company or firm and is to be regarded as interested

in any contract which may be made with that company or firm, or that he is to be regarded as being interested in any contract made with a specified person who is connected with him, is deemed by section 317(3) to be sufficient (for a definition of 'connected', see Companies Act 1985, section 346). This provision will not save a contract which is voidable under common law; therefore the contract should also be authorised by the articles of association or by the company in general meeting.

39 Where a director is materially interested in a contract, either directly or indirectly, disclosure must be made in the accounts, whether individual accounts or group accounts. This provision operates to catch not only contracts in the strict sense but also any transactions or arrangements. The Companies Act 1985, section 232 and Schedule 6 should be consulted for the details.

40 Certain contracts are excluded from the above. Examples are, transactions which are purely intra-group and contracts of service between a company and one if its directors. There are also financial limits below which disclosure need not be made in the accounts (Companies Act 1985, section 232 and Schedule 6). In relation to directors' contracts of service see paragraph 35 above.

41 If a contract is one in which a director is materially interested, the principal terms including the following particulars must be disclosed (Companies Act 1985, Schedule 6, paragraph 22):

(a) whether the contract was made or subsisted during the financial year in question;
(b) the name of the person for whom it was made and, if that person was connected with a director, the name of that director;
(c) the name of the director with the material interest and the nature of that interest; and
(d) the value of the contract.

Further requirements in relation to transactions with related parties including directors are contained in the Financial Reporting Standard 'Related party transactions' (FRS 8).

Substantial property transactions

42 An arrangement under which a director of a company or its holding company or a person connected with such a director acquires or disposes of a non-cash asset from or to a company is voidable at the instance of the company unless it is first approved by the company in general meeting. Non-cash assets of less than £2,000 are excluded. Subject to that, non-cash assets exceeding £100,000 or 10% of the amount of the company's net assets (whichever is the less) are included. The Companies Act 1985, sections 320 and 321 should be consulted for the details of this and other exclusions.

Arrangements of a financial nature

43 With certain exceptions, no company may make a loan to any of its directors or the directors of its holding company, or guarantee or provide

security for any loan made by any person to any such director (Companies Act 1985, section 330). The section includes 'anti-avoidance' provisions. In this paragraph and paragraphs 44 to 47 below director includes shadow director.

44 Various transactions are excepted, for example loans up to an aggregate amount of £5,000 and funds provided to meet a director's expenditure in relation to the company, within an aggregate limit of £20,000 in the case of a 'relevant company' (Companies Act 1985, sections 334, 336 to 340).

45 A 'relevant company' is, briefly, either a public company or a company within a group which includes a public company. In addition to the prohibition referred to at paragraph 43 above, a 'relevant company' may not make a loan or quasi-loan to, or enter into a credit transaction for, any such director or any person connected with any such director, or guarantee or provide security for any loan, quasi-loan or credit transaction made by any person to or for any such director or connected person (Companies Act 1985, sections 330 and 331). Again, there are 'anti-avoidance' provisions.

46 Various transactions are excepted (Companies Act 1985, sections 332 to 340). Examples of excepted transactions are:

(a) short-term quasi-loans up to an aggregate of £5,000;
(b) purely intra-group loans or quasi-loans;
(c) loans up to an aggregate of £5,000;
(d) credit transactions up to an aggregate of £10,000;
(e) the provision of funds to meet a director's expenditure in relation to the 'relevant company' up to an aggregate of £20,000;
(f) loans or quasi-loans made by a money-lending company in the ordinary course of its business and on commercial terms, but subject to an aggregate limit of £100,000 for a 'relevant company' unless the 'relevant company' is a company authorised under the Banking Act 1987.

47 Particulars of all loans, quasi-loans, credit transactions, guarantees and security of the kind described in section 330, Companies Act 1985, whether or not they are prohibited, must be declared in a company's accounts. The particulars required include the details of the transaction itself and the name of the person for whom it was made and any director with whom that person was connected (Companies Act 1985, section 232 and Schedule 6).

Directors' emoluments and compensation for loss of office

48 Company law does not establish a director's right to remuneration although section 311 of the Companies Act 1985 prohibits tax-free payments to directors. A director's right to remuneration comes from the company's articles and the director's service contract. Some large companies have established remuneration committees to act in setting directors' remuneration. The Listing Rules of the FSA now include (as an annex) best practice provisions addressing remuneration committees and also remuneration policy, service contracts and compensation. A director may be removed by the members under section 303, and possibly by the board if the articles permit. Particulars of any payment proposed to be made by way of

compensation for loss of office, or as consideration for or in connection with his retirement from office, must be disclosed to the members and approved by them (Companies Act 1985, section 312).

However, a payment of damages for breach of contract is not treated as compensation for this purpose (Companies Act 1985, section 316(3)). Schedule 6 to the Companies Act 1985 specifies the disclosure to be made in a company's accounts in respect of directors' remuneration and compensation for loss of office. In addition, UK listed companies are required by the Listing Rules to make additional disclosures (see A53 below).

Share transactions

49 There is nothing to prevent a director, his spouse or minor child entering into a transaction relating to his company's shares if:

(a) the transaction is duly disclosed by the director (Companies Act 1985, sections 324 and 328);
(b) the transaction does not amount to buying options to buy or sell listed shares in, or listed debentures of, his company or associated companies (Companies Act 1985, sections 323 and 327);
(c) the transaction does not contravene the insider dealing provisions of the Criminal Justice Act 1993; and
(d) for a company traded on the London Stock Exchange or traded on the Alternative Investment Market, the transaction does not contravene the conditions laid down in the Model Code for transactions in securities by directors, certain employees and persons connected with them published by the FSA as an Appendix to chapter 16 of its Listing Rules, or any more rigorous code adopted by the company. A code must be adopted by all such companies in a form no less exacting than that set down in the Model Code.

50 The articles of association of a company may specify a share qualification for directors. A director not already qualified is required to obtain his holding within 2 months of his appointment, or such shorter time as may be fixed by the articles (Companies Act 1985, section 291).

Disclosure

51 On appointment, a director must notify the company of any interest in its shares or debentures or those of its holding and subsidiary companies, and must also notify the company of any subsequent changes in those interests. The Companies Act 1985, section 324 and Schedule 13 should be consulted for the details to be disclosed and the time for notification.

52 The company is obliged to keep a register of the interests notified to it by its directors. The register is to be open for inspection by members and non-members and must usually be kept at the company's registered office (Companies Act 1985, Schedule 13, Part IV). In the case of a listed company, details of a director's interests must be passed to the Stock Exchange when notification is received from the director (Companies Act 1985, section 329).

Insider dealing

53 Under the Criminal Justice Act 1993, an offence is committed if an individual, who has information as an insider, deals in securities which are price-affected in relation to that information. A person who has information as an insider is also guilty of insider dealing if he:

(a) encourages another person to deal in securities which are price-affected in relation to that information, knowing or having reasonable cause to believe that the dealing would take place; or
(b) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.

Dealing is only caught if it is on a regulated market, or by a professional intermediary, or the person dealing relies upon on a professional intermediary.

54 A person has information as an insider if:

(a) it is, and he knows that it is, inside information;
(b) he has it, and knows that he has it, from an inside source.

A person has information from an inside source if:

(c) he has it through being a director, employee or shareholder of an issuer of securities, or through having access to the information by virtue of his employment, office or profession; or
(d) the direct or indirect source of the information is a person within (c).

Directors are therefore automatically regarded as insiders.

55 The Financial Services Act 1986, Part VII empowers the Secretary of State to appoint inspectors to investigate suspected insider dealing offences and provides sanctions against those who refuse to assist such inspectors.

Directors' responsibilities

Fraudulent trading

56 Directors, as persons involved in the carrying on of the company's business, will be responsible should the company trade with intent to defraud creditors if they are knowingly a party to such conduct, and may be liable to a fine, imprisonment or both (Companies Act 1985, section 458). Responsibility for fraudulent trading will arise whether or not the company is in the course of winding up (Companies Act 1985, section 458). In a winding up, however, the court may impose additional penalties on those guilty of fraudulent trading; it may order them to make such contributions to the company's assets as it thinks proper (Insolvency Act 1986, section 213), and may also make a disqualification order (Company Directors Disqualification Act 1986, section 4).

Wrongful trading

57 Where the company is in the course of winding up, the provisions of section 214 of the Insolvency Act 1986 regarding wrongful trading may also apply. An action for wrongful trading may be brought against a director (or a

former director) if at some time before the commencement of the winding up of the company that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into an insolvent liquidation. In section 214 of the Insolvency Act, director includes shadow director. Although an action cannot be commenced until a company is in insolvent liquidation, it is based on events and conclusions drawn prior to the commencement of the winding up. Directors should have regard to the implications of section 214, and ensure that the accounting records kept by the company are sufficient to enable them to draw their own conclusions about the position of the company. The penalty for wrongful trading is a personal one, and a director or former director may be directed to make such contribution to the company's assets as is felt proper by the court (Insolvency Act 1986, section 214), and is also liable to disqualification (Company Directors Disqualification Act 1986, section 10).

58 The only defence available to the director is that, from the time when he first knew or should have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, he took every step that he should have taken towards minimising potential losses to creditors. In assessing the conduct of the director, the court must assume that the facts which the director ought to know or ascertain, the conclusions he ought to reach and the steps he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person with both (a) the general knowledge, skill and experience which the director actually has, and (b) the general knowledge, skill and experience which could reasonably be expected of a person carrying out the same functions as the director carries out in relation to the company (Insolvency Act 1986, section 214). The requirement to have regard to the functions carried out by the director in relation to the company involves having regard to the particular company and its business. However, even in the case of a small company, certain minimum standards are to be assumed to be attained. (*Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.) That decision also confirms that knowledge imputed to a director is not limited to facts which he ought to know but includes facts which he ought to ascertain.

59 Where there is a real possibility of insolvent liquidation the directors may wish to consult a licensed insolvency practitioner and/or to take legal advice. Further, it should be remembered that directors are required to maintain minutes of all proceedings at meetings (Companies Act 1985, section 382). In circumstances where insolvent liquidation is a real possibility, it is particularly important that a full record is kept of all decisions taken and the reasons for them. If the directors disagree on material questions the dissentients should ensure that their views are clearly recorded too, and they may need to consider taking independent legal advice about their position.

Responsibilities of directors of holding or subsidiary companies

60 A subsidiary company's directors should not act in accordance with the instructions of the directors of the holding company unless they are satisfied that the act required to be done is prudent and in the interests of the

subsidiary: to act blindly in accordance with instructions will expose those directors to liability in respect of breach of duty as well as wrongful trading. In addition, the directors of the holding company, and indeed the holding company itself, may be deemed to be shadow directors of the subsidiary and thus may also be liable to an action for wrongful trading if the subsidiary goes into insolvent liquidation. Again, it is important that all instructions given by holding company directors are fully minuted and that legal advice is sought where appropriate.

Theft Acts

61 Under the Theft Acts 1968 and 1978, criminal liability is imposed for obtaining property or pecuniary advantage by deception and for false accounting. Where such an offence is committed by a company with the consent or connivance of a director or other officer, that person will be liable as well as the company. Also, an offence will be committed by an officer of a company who, with the intention of deceiving members or creditors of the company, publishes, or concurs in publishing, any written statement or account which he knows is or may be misleading, false or deceptive in a material particular. (Theft Act 1968, sections 15 to 19 and Theft Act 1978.)

Accounting records

Contents

62 A company is required to keep accounting records, which are sufficient to show and explain the company's transactions (Companies Act 1985, section 221).[2] More specifically they must:

(a) disclose with reasonable accuracy, at any time, the financial position of the company at that time;
(b) enable the directors to ensure that the balance sheet and profit and loss account comply with the requirements of the Companies Act as to the form and content of company accounts and otherwise;
(c) contain entries from day-to-day of all sums of money received and expended by the company and the matters to which the sums relate; and
(d) contain a record of company assets and liabilities.

In the case of a company dealing in goods, the accounting records must also:

(e) contain statements of stock held by the company at the end of each financial year;
(f) contain statements of stocktakings from which any statement prepared under (e) above is made; and
(g) except when the sale is an ordinary retail sale, contain statements of all goods sold and purchased showing the goods and the buyers and sellers in sufficient detail to enable the goods and the buyers and sellers to be identified.

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[2] The technical release 'Accounting records' (FRAG 5/92) gives further guidance on the requirement to keep accounting records.

63 A parent company which has a subsidiary undertaking in relation to which the above does not apply, must take reasonable steps to ensure that the undertaking keeps such records as are needed to enable the parent company to produce group and individual accounts in accordance with the Companies Act 1985.

64 Failure to keep accounting records in accordance with the above requirements may render every officer of the company liable to a fine, imprisonment or both (Companies Act 1985, section 221).

65 In addition to the statutory requirement to keep proper accounting records, the directors have an overriding responsibility to ensure that they have adequate information to enable them to discharge their duty to manage the company's business.

66 The duty to manage the company's business will involve ensuring that adequate control is kept over its records and transactions, for example:

(a) cash;
(b) debtors and creditors;
(c) stock and work in progress;
(d) capital expenditure; and
(e) major contracts.

67 The nature and extent of the accounting and management information needed to exercise this control will depend upon the nature and extent of the company's business.

68 To restrict the possibility of actions for wrongful trading, directors will need constantly to be aware of the company's financial position and progress, and the accounting records should be sufficient to enable them to be provided with the information required for drawing conclusions on these matters. The directors should also be satisfied that proper systems to provide them with regular and prompt information are in place.

69 Directors must also be aware of a company's prospects. It may therefore be prudent to prepare a plan against which the subsequent performance of the business can be measured. Periodic management accounts assist in enabling the actual operating results and cash position to be compared with the plan. Once again, the need for, extent and frequency of the preparation of such accounts and the level of management to which they are presented will depend upon the size, scope and nature of the business. However, the directors' report on the financial statements must contain an indication of the likely future developments in the business of the company and its subsidiary undertakings (Companies Act 1985, Schedule 7), and a plan is likely to be helpful in this context.[3]

[3] Small companies are exempt from this disclosure requirement. See A46.

Retention of records

70 Accounting records are required to be kept at the company's registered office or at such other place as the directors think fit and such records must be open at all times to inspection by the company's officers. Special provisions apply where the records are kept outside Great Britain (Companies Act 1985, section 222).

71 Subject to any directions in respect of the disposal of records in a winding up, the records must be preserved in the case of a private company, for 3 years from the date on which they were made, and in the case of a public company, for 6 years from the date on which they were made (Companies Act 1985, section 222).

72 However, directors may feel that it is wise to keep documents for longer in view of the periods which the law allows for legal actions to be brought. The main minimum limitation periods are:

(a) in the case of simple (i.e. non-specialty) contracts, 6 years from the date on which the cause of action arose (Limitation Act 1980, section 5);
(b) in the case of specialty contracts (i.e. contracts under seal), 12 years from the date on which the cause of action arose (Limitation Act 1980, section 8);
(c) in cases of personal injury, 3 years from the date the cause of action became apparent (Limitation Act 1980, section 11);
(d) in cases of negligence (excluding personal injuries), the time limit for an action for latent damage will be the later of: (Limitation Act 1980, section 14A).
    (i) six years from the date on which the cause of action accrued; and
    (ii) where the facts are not known at the date the cause of action accrued, three years from the earliest date on which the plaintiff, or any person in whom the cause of action was vested before him, had the knowledge required to bring an action and a right to bring such action;
(e) an overriding time limit for actions for negligence (excluding personal injuries) of 15 years is imposed from the date on which there occurred any act or omission:
    (i) which is alleged to constitute negligence;
    (ii) to which the damage in respect of which damages are claimed is alleged to be attributable; (Limitation Act 1980, section 14B).

73 Also to be considered are the various tax and related requirements:

(a) For corporation tax purposes, a company must keep and preserve its records for a period of six years from the end of the period for which a tax return may be required. Records for these purposes includes records of all receipts and expenses and sales and purchases together with any supporting documents which includes accounts, books, deeds, contracts, vouchers and receipts. If a company fails to keep and preserve its records, it is liable to a fine of up to £3,000. The Inland Revenue has the power to require a company to produce documents relating to its tax liability. (Finance Act 1998, Schedule 18, paragraphs 21, 23 and 27.)

(b) For VAT purposes, every taxable person must keep records, including accounts and all related documents, for 6 years (Value Added Tax Act 1994, Schedule 11, paragraph 6(3) and section 58 and paragraph 31 of the Value Added Tax Regulations 1995 (SI 1995/2518)).
(c) For PAYE purposes, employers are under a duty to retain documents and records relating to the calculation or payment of their employees' emoluments for not less than 3 years after the end of the year to which they relate (Regulation 55 of the Income Tax (Employments) Regulations 1993 (SI 1993/744)).
(d) For Tax Credits purposes, employers must keep copies of all wage sheets, deduction working sheets and other documents and records relating to the calculation and payment of Tax Credits to employees. These should be retained for at least three years after the end of the tax year to which they relate.
(e) For National Minimum Wage purposes, employers must keep records to establish that an employee is receiving at least the National Minimum Wage. These records must be kept for a minimum period of three years from the end of the pay reference period (Regulation 38 of the National Minimum Wage Regulations 1999 (SI 1999/584).
(f) For Student Loan purposes, employers must keep a record of all wages sheets, deductions working sheets and other documents and records relating to the calculation and deduction of Student Loan repayments for a period of at least three years after the end of the tax year to which they relate.

74 While original records will naturally be the best evidence of the information they contain, copies will be admissible in court, so long as the copies can be regarded as trustworthy. A judge has power to admit copies in evidence and to specify the method of authentication (Civil Evidence Act 1968, section 6). Therefore, if original company documents are to be copied or microfilmed, directors should ascertain that the procedures adopted not only ensure that all records are copied but also that they are legible, stored safely and capable of being properly authenticated. If accounting records are in a non-legible form any software, etc. necessary to retrieve the information in a usable form should also be retained.

Directors' and officers' insurance

75 Generally a company cannot indemnify a director or any other officer against a liability arising from an act of negligence, default or breach of duty or breach of trust in relation to the company. However, this statutory rule does not prevent a company from buying and maintaining insurance against such a liability for its directors and other officers (Companies Act 1985, section 310). Obviously the existence of such insurance does not exonerate members from their obligations.

Annual Accounts

76 Directors have a number of responsibilities in relation to the preparation and filing of annual accounts and returns. A statement of the directors'

responsibilities should be included in the financial statements of all companies (see A18 below).

Shares and dividends

Share issues

77 Shares cannot be allotted by directors unless they are authorised to do so either by the company in general meeting or by the articles of association. The authorisation can normally only last for 5 years from the resolution or the date of incorporation if the authorisation is in the articles of association. It may, however, be renewed by the company in general meeting. Private companies can extend the authority for a fixed period beyond five years or for an infinite period by elective resolution. If it is proposed to make a new issue of shares for cash the existing shareholders will have certain statutory rights of pre-emption, but these rights can be excluded or disapplied (Companies Act 1985, sections 80, 80A, 89 to 96).

78 Payment for shares may be in money or money's worth but a public company may not accept in payment for its shares an undertaking by a person to do work or perform services for the company or any other person (Companies Act 1985, section 99). Where a public company accepts non-cash consideration, an expert must value the consideration and report on it (Companies Act 1985, sections 103 and 108). Further, there is a total prohibition in relation to all companies on the allotment of shares at a discount (Companies Act 1985, section 100). Shares of a public company may not be allotted except as paid up to at least one quarter of the nominal value and the whole of the premium (Companies Act 1985, section 101).

Financial assistance

79 The general rule is that it is not lawful for a company or its subsidiary to give financial assistance directly or indirectly for the purpose of the acquisition of shares in the company or for the purpose of reducing or discharging a liability incurred by any person for the purpose of such an acquisition. Reducing or discharging such a liability is defined to include wholly or partly restoring the person's financial position to what it was before the acquisition took place. Thus the prohibition is on the provision of financial assistance before, at the same time as, or after the acquisition takes place. Financial assistance is widely defined and includes such things as gifts, guarantees and loans (Companies Act 1985, sections 151 and 152).

80 There are exceptions to the general prohibition on providing financial assistance. For example: distributions by way of dividend lawfully made; financial assistance for the purposes of an employees' share scheme; loans to employees other than directors for the purpose of acquiring shares in the company; and money lending where this is in the ordinary course of business of the company (Companies Act 1985, sections 153 and 154). Any company, acting in good faith, may give financial assistance if its principal purpose is not to give financial assistance for the purpose of the acquisition of its own or a holding company's shares or to reduce or discharge such a liability, or if the

giving of the financial assistance for that purpose or the reduction or discharge of such liability is only an incidental part of a larger purpose of the company (Companies Act 1985, section 153). However, note the relatively restrictive interpretation of this provision by the House of Lords in *Brady* v *Brady* [1989] 1 A.C. 755.

81 In addition, a private company may give financial assistance if it does so out of distributable profits, or if it has net assets which are not thereby reduced. If a private company wishes to take advantage of this relaxation, it must adhere to the detailed procedures, including a statutory declaration by the directors, laid down by statute, which are designed to protect the interests of shareholders and creditors (Companies Act 1985, sections 155 to 158).

Acquisition of own shares

82 Companies may acquire their own shares provided that they meet certain conditions. The conditions relate to procedure and to the funds out of which the acquisition can be made. A company may acquire its own shares either by redemption or purchase and in both cases the authority to acquire must be contained in its articles of association (Companies Act 1985, sections 159 and 162).

83 When a company is considering acquiring its own shares, it must follow a detailed timetable of action which depends, in general, on whether or not the shares are to be acquired on The Stock Exchange (Companies Act 1985, sections 163 to 166). The aim of the rules is to ensure that the interests of shareholders and creditors are protected.

84 The funds available for the acquisition must be from distributable profits or the proceeds of a fresh issue of shares made for the purposes of the acquisition. Special rules designed to protect the company's capital relate to the acquisition of shares at a premium (Companies Act 1985, sections 160 and 162).

85 A private company may acquire its own shares out of capital if it is so authorised by its articles of association (Companies Act 1985, sections 171 to 177). The provisions are designed to ensure that publicity is given to the payment and that the interests of creditors and shareholders are protected.

86 When a company acquires its own shares it is obliged to cancel them. Cancellation does not, however, affect the amount of the company's authorised share capital, only that of its issued share capital (Companies Act 1985, sections 160 and 162).

87 A company may reduce its share capital in any way by special resolution and with the confirmation of the court (Companies Act 1985, sections 135 to 139).

Capital requirements

88 In order to register as a public company, a company must satisfy various

conditions, one of which is that its authorised share capital must be at least £50,000 (Companies Act 1985, sections 117 and 118). If the nominal value of the company's allotted share capital falls below that minimum amount, the company will have to re-register as private (Companies Act 1985, sections 139 and 146).

89 If a public company's net assets fall to half or less of the amount of its called-up share capital, its directors are under a duty to convene an extraordinary general meeting of the company. The directors have 28 days, from the earliest day on which the fact is known to one of their number, in which to convene the meeting and the meeting must take place within 56 days of that day (Companies Act 1985, section 142).

90 There are no provisions as to what action should be taken by the meeting; this will be for the directors to recommend. They should, however, bear in mind the provisions of the Insolvency Act 1986 and the Companies Act 1985 with regard to fraudulent and wrongful trading (Insolvency Act 1986, sections 213 and 214, Companies Act 1985, section 458) (see paragraphs 56 to 59 above).

Dividends
91 Under normal articles of association it is for the directors to recommend to the annual general meeting the amount of dividend, if any, to be paid and this amount will be shown in the directors' report. Interim dividends may, however, be resolved to be paid by the directors (Companies (Tables A–F) Regulations 1985, Table A, regulations 102 and 103). In paying a dividend, or making any other distribution, only profits available for the purpose may be used. The profits of a company so available are defined as 'its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or re-organisation of capital duly made'. In addition, public companies must ensure that a distribution does not cause their net assets to fall below their share capital plus undistributable reserves (Companies Act 1985, sections 263 and 264).

92 Section 281 of the Companies Act 1985 preserves existing enactments or rules of law restricting the making of distributions. Thus in recommending or paying a dividend directors must take note of their common law duties (see paragraph 20 above) which would generally preclude payment of an imprudent dividend as not being in the best interests of the company. There is also a long-standing rule that dividends may not be paid out of capital which would require directors to consider whether losses incurred since the 'relevant accounts' had eroded the distributable profits.

Public issues, takeovers and mergers

Public issues
93 When a company wishes to make a public issue of shares for the first time or to make a subsequent issue, there are several methods of doing so. The

purpose of this statement is, however, to examine the duties placed upon directors with regard to the issue of prospectuses and similar documents, rather than to provide guidance on the available methods of issue. It is important that professional advice be taken as soon as an issue is envisaged and to remember that it is a criminal offence for a private company to offer shares or debentures to the public or to allot shares with a view to their subsequent sale to the public; these provisions are applicable whether or not the issue is for cash (Companies Act 1985, section 81). It should also be noted that it is an offence to issue an investment advertisement in the UK (Financial Services Act 1986, section 57) unless it is issued by or has the approval of a person authorised under Chapter III of Part I of the Financial Services Act 1986 (see paragraph 103 below). The term 'investment advertisement' is broadly defined and includes any advertisement containing information calculated directly or indirectly to lead persons to enter into an investment transaction.

94 A prospectus must comply strictly with the requirements relating to content. In the case of shares for which an official listing is sought, the requirements of the Financial Services Act 1986, Part IV apply, together with additional requirements imposed by the FSA, as embodied in the Listing Rules. In the case of all other public issues, including those on the Alternative Investment Market, the requirements of the Public Offers of Securities Regulations 1995 will apply.

95 Both the Public Offers of Securities Regulations 1995 and the Listing Rules require a prospectus to contain a declaration by the directors of the issuer that to the best of their knowledge the information contained in the prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

96 There are stringent provisions relating to civil and criminal liability for mis-statements in a prospectus (Financial Services Act 1986, section 150 and the Public Offers of Securities Regulations 1995, regulation 14). The Misrepresentation Act 1967 provides civil remedies for misrepresentation and there is a common law right to sue for negligent mis-statements where there has been a breach of a duty of care to the plaintiff. In addition, any person who makes a false or misleading statement for the purpose of inducing another person to enter into an investment transaction or refrain from doing so, commits an offence (Financial Services Act 1986, section 47).

97 When applying for listing, certain information, known as 'listing particulars', is required by the FSA, and a general duty of disclosure is imposed by the Financial Services Act 1986, section 146.

98 Once listing has been granted, the company is required to prepare a half-yearly report which sets out specific information relating to the company's activities and profit and loss during the relevant 6-month period. The half-yearly report must be either sent to shareholders or advertised within 4 months of the end of the period to which it relates (the Listing Rules, paragraphs 12.46 and 12.48 to 12.50).

99 Companies that do not require a full listing may apply to have their securities traded on the Alternative Investment Market. Offers of securities to be admitted to the Alternative Investment Market are regulated by the Public Offers of Securities Regulations 1995. Chapter 16 of the rules of the London Stock Exchange (which should not be confused with the Listing Rules) sets out the requirements for annual reports and accounts and half-yearly reports for companies traded on the Alternative Investment Market.

Takeovers and mergers

100 Statute does not deal specifically with takeovers and mergers. It does, however, deal with the relationship between a successful bidder and dissenting minority shareholders and other aspects of a successful offer (Companies Act 1985, Part XIIIA).

101 Takeovers and mergers involving public companies and some classes of private company are governed by the City Code on Takeovers and Mergers. The City Code lays down rules of conduct which form a general guide to the principles and practices which should be followed. As an adjunct to the City Code, the Takeover Panel has issued rules governing substantial acquisitions of shares. Directors are expected to observe the spirit as well as the letter of these rules.

102 Chapter 10 of the Listing Rules contains specific provisions relating to acquisitions, disposals and takeovers and mergers. Different requirements are imposed in different situations, depending on the size of the transaction and the identity of the parties involved; in particular circumstances shareholder approval is a prerequisite.

Investment business

103 The conduct of investment businesses is regulated by the Financial Services Act 1986 which makes it an offence for any person to carry on, or purport to carry on, investment business unless he is authorised under Chapter III or exempt under Chapter IV of Part I of the Act (Financial Services Act 1986, section 3). Investment business is extremely widely defined (Financial Services Act 1986, Schedule 1). Any transaction entered into by an unauthorised person is unenforceable, and investors who suffer losses may be able to obtain restitution from him (Financial Services Act 1986, sections 5 and 6).

Taxation

104 The directors are responsible for the maintenance and retention of the company's tax records (see paragraph 73 above). Normally the tasks of computing tax and making the proper returns will be delegated. The fact that a task may be delegated will not relieve a director of all responsibility. If it is delegated, a director must ensure that the person concerned is suitable for the job and the director should reasonably monitor the work. In any event, a director may, depending on all the circumstances, rely on co-directors and the officers of the company but such reliance should not be totally unquestioning (*Re City Equitable Fire Insurance Co*).

105 The principal taxes with which directors will be concerned are the company's corporation tax, its liability to VAT if it is a registered trader and its employees' income tax under PAYE. Of particular importance in relation to directors and employees earning £8,500 per annum or more is the proper completion of form P11D as regards expenses payments and benefits in kind (Income Tax (Employments) Regulations 1993, regulation 46).

Department of Trade and Industry inspections

Inspection of a company's documents
106 The Secretary of State may at any time, if he thinks there is good reason to do so, order the production of a company's documents. This power includes the right to take copies of any such documents and require an explanation of them from any past or present officer or employee of the company. Any company or person who fails to comply with a requirement to produce documents or to provide an explanation of them is liable to criminal penalties (Companies Act 1985, section 447). Where there are reasonable grounds for believing that documents not produced are on any premises, the Secretary of State may obtain a warrant for the entry and search of those premises (Companies Act 1985, section 448).

Investigation of a company's affairs
107 The Secretary of State must appoint inspectors when ordered to do so by the court and may make such an appointment in a number of situations (Companies Act 1985, sections 431 and 432). The situations of particular relevance to directors are, if it appears that:

(a) the business of the company is being or has been conducted with the intent of defrauding its own creditors, the creditors of any other person or for another fraudulent or unlawful purpose, or in a manner which is unfairly prejudicial to some part of its members;
(b) the company was formed for a fraudulent or unlawful purpose;
(c) the promoters or officers of the company have been guilty of fraud, misfeasance or other misconduct towards the company or its members; or
(d) the company's members have not been given all the information which they might reasonably expect.

108 It is the duty of all officers and agents of the company to give inspectors all assistance which they are reasonably able to give, including the production of documents of or relating to the company, and they may be examined on oath by the inspectors. An inspector may also require any person to produce documents relating to a matter relevant to the investigation. Any officer or agent of the company who fails to assist an inspector may be reported to the High Court and punished as if he had been in contempt of court (Companies Act 1985, sections 434 and 436).

Investigation into membership and share dealings
109 The Secretary of State has wide powers to investigate the ownership of a company whenever he thinks there is good reason to do so for the purpose of determining the true persons who are or have been financially interested in the

success or failure (real or apparent) of the company or able to control or materially influence its policy (Companies Act 1985, section 442).

110 If it appears to the Secretary of State that there have been breaches of the requirements concerning directors' share dealings or of the duty of directors to notify interests in shares and debentures (see paragraphs 49 and 51 above), he may investigate in order to establish whether or not such breaches have occurred (Companies Act 1985, section 446).

Insolvency and winding up

111 A director has a general duty to cooperate with the administrator, administrative receiver, liquidator or provisional liquidator of a company (Insolvency Act 1986, section 235).

Reports on directors

112 Any liquidator, administrator or administrative receiver appointed to an insolvent company has a duty to report to the Secretary of State on the conduct of all directors and particularly if he is of the opinion that the conduct of a past or present director or shadow director is such that it makes him unfit to be concerned in the management of a company. An application to the court for a disqualification order may follow (Company Directors Disqualification Act 1986, sections 6 to 9 and the Insolvent Companies (Reports on Conduct of Directors) No.2 Rules 1986). In making such an order, the court will have regard to the matters listed in Schedule 1 of the Company Directors Disqualification Act 1986.

113 If it appears that any past or present officer of the company has been guilty of any criminal offence in relation to the company, the liquidator is under a duty to report the matter, in the case of a winding up by the court, to the official receiver and, in the case of a voluntary winding up, to the Director of Public Prosecutions (Insolvency Act 1986, section 218). A director is under an obligation to provide any information required during an investigation under the above provision (Companies Act 1985, section 434 and Insolvency Act 1986, section 219).

Personal liability

114 Where a liquidator has been appointed, he will take over full control of the running of the company from the directors until it is struck off. However, directors should bear in mind that they can be held personally liable for a variety of circumstances occurring both prior to and after the commencement of winding up proceedings, including:

(a) trading with intent to defraud creditors;
(b) wrongful trading;
(c) misapplication of company money or property or other breach of duty or trust;
(d) concealing company property and falsifying its books;
(e) failing to keep proper accounting records;
(f) acting as a director or being involved in any way in the promotion,

formation or management of any company or business carried on under a prohibited name; or

(g) failing to provide a statement of affairs.

These are discussed in paragraphs 115 to 121 below.

Trading with intent to defraud creditors

115 In addition to the criminal offence created by the Companies Act 1985 section 458, in the case of a company in the course of winding up, the liquidator can apply to the court for a declaration that persons knowingly party to trading with intent to defraud creditors be liable to make a contribution to the company's assets (Insolvency Act 1986, section 213) (see paragraph 56 above).

Wrongful trading

116 Any past or present director (including a shadow director) of a company in insolvent liquidation who knew or ought to have known that there was no reasonable prospect of the company's avoiding insolvent liquidation may, in certain circumstances, be ordered by the court to contribute to the company's assets (Insolvency Act 1986, section 214) (see paragraphs 57 and 58 above).

Misapplication of company money or property or other breach of duty or trust

117 The liquidator, official receiver or any creditor or contributory may apply to the court for the examination of a director, officer or other person concerned in the management of the company, past or present, if it appears that he has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any duty in relation to the company. The court may then order a delinquent director to repay or restore company money or property or make other reparations (Insolvency Act 1986, section 212).

Concealing or disposing of company property and falsifying its books

118 When a company is in voluntary or compulsory liquidation, any past or present officer of the company (including a shadow director), commits an offence and will be liable to a fine, imprisonment or both, if he:

a. has committed fraud in anticipation of winding up or commits fraud during the winding up (Insolvency Act 1986, section 206);
b. has been involved in any transaction in fraud of creditors (Insolvency Act 1986, section 207);
c. commits misconduct in the course of winding up (Insolvency Act 1986, section 208);
d. falsifies company books (Insolvency Act 1986, section 209);
e. has made, or makes, material omissions from any statement relating to the company's affairs (Insolvency Act 1986, section 210); or
f. has made, or makes, false representations to creditors (Insolvency Act 1986, section 211).

Failing to keep proper accounting records and file accounts

119 The requirements to keep accounting records and to file accounts and

related statutory returns and the consequences of failure to meet those requirements are summarised in paragraphs 62 to 64 above and paragraphs A31 and A32 of the Appendix to this statement.

Carrying on a business under a prohibited name

120 Any person who was a director or shadow director during the period of 12 months prior to commencement of its insolvent liquidation is prohibited, for a period of 5 years from the date of that commencement, from being involved in any way with any company or business carried on with the same name as that by which the company in liquidation was known within that 12-month period, or one so similar as to suggest an association (Insolvency Act 1986, section 216). Contravention of this provision will lead to personal liability for the debts of the new company incurred during the period of involvement (Insolvency Act 1986, section 217) unless leave is granted by the Court under Chapter 22 of Part 4 of the Insolvency Rules 1986.

Failing to provide a statement of affairs

121 In a creditors' voluntary liquidation, the directors are required to prepare and verify by affidavit a statement as to the affairs of the company in a prescribed form, and to lay it before a meeting of creditors (Insolvency Act 1986, section 99). Where an administrative receiver is appointed to the company he may give notice requiring directors and others to provide him with a sworn statement of affairs within 21 days of that notice (Insolvency Act 1986, section 47). Similar provisions apply to directors of a company in compulsory liquidation (Insolvency Act 1986, section 131) or subject to an administration order (Insolvency Act 1986, section 22). Directors failing to comply with their obligations under the above sections will be liable to a fine and, for continued contravention, except of section 99, to a daily default fine.

APPENDIX

Annual Accounts

Preparing accounts
A1 A company's 'annual accounts' comprise the individual accounts (see A5 below) and any group accounts (see A19 below) (Companies Act 1985, section 262). If group accounts are prepared, special provisions apply to the profit and loss account of the parent company (see A20 below). To the annual accounts must also be attached the directors' report and the auditors' report (Companies Act 1985, sections 238, 239, 241 and 242). The preparation of the accounts is the responsibility of the directors and is governed by statute.

A2 Directors of companies, other than small or medium-sized companies (see A34 below), are required to disclose whether or not the accounts comply with applicable accounting standards and to give details of any non-compliance (Companies Act 1985, section 246 and Schedule 4, paragraph 36A). In normal cases, a departure from accounting standards will result in the issue of a qualified or adverse opinion on the view given by the financial statements. The Accounting Standards Board (ASB) is a body authorised to issue accounting standards for the purposes of section 256 of the Act. The ASB adopted as accounting standards the Statements of Standard Accounting Practice (SSAPs) extant at 1 August 1990. The SSAPs were developed by the Accounting Standards Committee, now replaced by the ASB, and issued by the accountancy bodies.

A3 The form of the annual accounts will vary according to the type of company. Most companies will be required to prepare their accounts in accordance with Schedule 4 to the Companies Act 1985 (Companies Act 1985, section 226). Paragraphs A5 to A20 below deal with the requirements which are of general application and A21 to A25 below refer to the two exceptions, banking and insurance companies.

A4 The annual accounts must be approved by the board and the balance sheet must be signed on their behalf by a director (Companies Act 1985, section 233). The wording of the section requires a director to sign, that is, a director in office at the time of signing, rather than those in office during the year to which the accounts relate.

Schedule 4 accounts
A5 The 'individual accounts' required by law are a profit and loss account and a balance sheet (Companies Act 1985, section 226). Unless a company is a 'special category' company (see A21 to A23 below), its accounts must comply with Schedule 4, which lays down rules as to the form and content of the balance sheet and profit and loss account as well as in respect of additional information which has been provided by way of notes to the accounts. These rules are subject to the overriding requirement that the balance sheet must give a true and fair view of the state of affairs of the

company at its year end and the profit and loss account must give a true and fair view of the company's profit or loss for the financial year. This may mean supplying information in addition to that specified or, in special circumstances, even departing from the requirements. However, the need to make such departures will be rare, and while it is for the directors to decide, the question should be discussed with the company's auditors. In the event of any departure, particulars of it, the reasons for it and its effect must be given in a note to the accounts (Companies Act 1985, section 226). The UITF (see A27 below) has issued Abstract 7 on true and fair override disclosures which interprets this requirement.

A6 The responsibility for preparing the annual accounts rests upon the company's directors (Companies Act 1985, section 226 and Schedule 4). As Schedule 4 is crucial to their preparation, it should be studied by each of the directors. The following text does not attempt to analyse the Schedule in detail (a number of helpful guides and model accounts are available) but highlights some of the key points.

A7 In preparing the annual accounts, statute requires that certain accounting principles must be used (Companies Act 1985, Schedule 4, paragraphs 10 to 14), namely that:

(a) the company is presumed to be carrying on business as a going concern;
(b) accounting policies are applied consistently within the same accounts as from one financial year to the next;
(c) the amount of any item is determined on a prudent basis – and in particular only realised profits at the balance sheet date may be included in the profit and loss account, and all liabilities and losses which have arisen or are likely to arise in respect of the financial year to which the accounts relate or a previous financial year shall be taken into account, including those which only become apparent between the balance sheet date and the date on which it is signed on behalf of the board of directors;
(d) the accruals concept is used; and
(e) the amount of each asset or liability to be included in any balance sheet is determined separately.

A8 If, however, the directors believe that there are special reasons for departing from any of these principles, they may do so, as long as particulars of the departure, the reasons for it and its effects are set out in the notes to the accounts (Companies Act 1985, Schedule 4, paragraph 15). It is advisable that any proposed departure should be discussed with the company's auditors.

A9 In the presentation of the balance sheet, Schedule 4 provides a choice between two formats, one 'vertical', the other 'horizontal'. The basic disclosure requirements are similar for each format.

A10 In the case of the profit and loss account, there are four formats from which to choose. Formats 1 and 3 are perhaps more suitable to a trading company: Format 1 presents the information in a vertical form, Format 3 in a horizontal manner; while Formats 2 and 4 may be more suitable for a

manufacturing company, again with the option between vertical (Format 2) and horizontal (Format 4) presentations.

A11 The balance sheet and profit and loss account formats are set out in the Schedule with the individual items being allocated letters, Roman numerals and Arabic numerals. These designations do not have to be reproduced but are important because the order of those headings distinguished by letters and Roman numerals must be adhered to while the items under the sub-headings, which have been allocated Arabic numerals, can be re-arranged or adapted in certain circumstances (Companies Act 1985, Schedule 4, paragraphs 1 and 3).

A12 Once the choice of formats has been made for the balance sheet and profit and loss account, the same formats must be used for subsequent financial years, unless, in the directors' opinion, there are special reasons for a change, in which case particulars of the change and the reasons for it must be disclosed in a note to the accounts (Companies Act 1985, Schedule 4, paragraph 2).

A13 Any item shown in the formats may be given in greater detail than required by the format adopted and must be so if it is necessary to present a true and fair view. If no amount is shown against any heading or sub-heading for the financial year in question and the preceding financial year that particular item need not be shown. Amounts in respect of items representing assets or income may not be set off against amounts in respect of items representing liabilities or expenditure or vice versa (Companies Act 1985, Schedule 4, paragraphs 3 to 5).

A14 Corresponding amounts for the financial year immediately preceding the financial year in question must be shown. Where the former are not comparable with the latter, they must be adjusted and the adjustments explained in a note to the accounts (Companies Act 1985, Schedule 4, paragraph 4).

A15 Paragraphs 8 and 35 to 58 of Schedule 4 also prescribe information which must be shown in notes to the balance sheet and to the profit and loss account.

A16 Schedule 4, Part II, Section B sets out the rules which must be followed when preparing historical cost accounts and covers matters such as the treatment of fixed and current assets. Schedule 4, Part II, Section C provides alternative accounting rules, which permit intangible and tangible fixed assets, fixed asset investments and current asset investments and stock to be shown at current cost or market value.

Directors' report

A17 The directors' report attached to the annual accounts must include the following information, where applicable (Companies Act 1985, section 234, Schedule 7):

(a) a fair review of the development of the business of the company and its subsidiaries;
(b) recommended dividend;
(c) names of directors;
(d) principal activities of the company and its subsidiaries and any significant changes therein;
(e) directors' share and debenture interests in the company or subsidiary and holding companies;
(f) directors' interests in share and debenture options granted by the company or subsidiary and holding companies and whether any such options were exercised;
(g) important post balance sheet events of the company and its subsidiaries;
(h) likely future developments in the business of the company and of its subsidiaries;
(i) research and development in the business of the company and of its subsidiaries;
(j) in cases where the number of employees exceeds 250, specified information relating to the company's policy relating to the employment of disabled persons and employee involvement;
(k) particulars of acquisition of own shares;
(l) political or charitable contributions;
(m) substantial differences between market values and balance sheet values of land;
(n) indication of the existence of branches outside the UK; and
(o) in cases where the company was a public company or a subsidiary of a public company not qualifying as small or medium-sized on the grounds of size, the company's policy on the payment of creditors and its creditors' days calculated as specified.

Statement of directors' responsibilities

A18 The Combined Code (see A52 below) requires that the directors of listed companies should explain their responsibility for preparing the accounts next to a report by the auditors about their reporting responsibilities. An example wording is given in the Statement of Auditing Standards *Auditors' Reports on Financial Statements* (SAS 600, Appendix 3) as follows:

'Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.'

Auditors' professional standards require that, if the financial statements or accompanying information (for example, the directors' report) do not include an adequate description of directors' relevant responsibilities, the auditors' report should include a description of those responsibilities.

Group accounts

A19 Where a company has subsidiary undertakings there is an obligation to prepare group accounts in the form of consolidated accounts (Companies Act 1985, section 227). Small and medium-sized groups are exempt from this requirement (see A44 below). A parent company which is not listed on an EC stock exchange, which is a subsidiary of an EC parent and which complies with certain other conditions is not required to produce group accounts (Companies Act 1985, section 228). A subsidiary undertaking may be excluded from the group accounts in certain circumstances, for example, where the information necessary for the preparation of group accounts cannot be obtained without disproportionate expense or undue delay (Companies Act 1985, section 229).

A20 Unless a group is a 'special category' group (see A21 to A25 below), its accounts must comply with Schedule 4A. They must also comply with Schedule 4 as far as practicable (Companies Act 1985, Schedule 4A, paragraph 1). These requirements are subject to the overriding requirement that the group accounts give a true and fair view of the state of affairs as at the end of the financial year, and the profit or loss for the financial year, of the undertakings included in the consolidation as a whole, so far as concerns the members of the parent company (Companies Act 1985, section 227). The parent company must draw up an individual profit and loss account and the board of directors must approve it, but it need not be published or filed provided that the notes to the company's individual balance sheet show the company's profit or loss for the financial year and that it is disclosed in the company's accounts that this exemption applies (Companies Act 1985, section 230).

Banking and insurance companies and groups

A21 A banking company must produce its individual accounts in accordance with section 255 and Schedule 9 to the Companies Act 1985. The parent of a banking group shall prepare group accounts in accordance with section 255A of and Schedule 9 to the Companies Act 1985.

A22 An insurance company must produce its individual accounts in accordance with section 255 and Schedule 9A to the Companies Act 1985. The parent of an insurance group shall prepare group accounts in accordance with section 255A of and Schedule 9A to the Companies Act 1985.

A23 A banking company is a company authorised under the Banking Act 1987; an insurance company means the same as in the Insurance Companies Act 1982 (Companies Act 1985, section 744).

A24 A group is a banking group if the parent company is a banking company; or:

(a) the parent company's principal subsidiary undertakings are wholly or mainly credit institutions; and
(b) the parent company does not itself carry on any material business apart from the acquisition, management and disposal of interests in subsidiary undertakings (Companies Act 1985, section 255A).

A25 A group is an insurance group if the parent company is an insurance company; or:

(a) the parent company's principal subsidiary undertakings are wholly or mainly insurance companies, and
(b) the parent company does not itself carry on any material business apart from the acquisition, management and disposal of interests in subsidiary undertakings (Companies Act 1985, section 255A).

Financial Reporting Standards

A26 Accounting standards are issued by the Accounting Standards Board (see A2 above) as Financial Reporting Standards.

A27 The ASB has set up an Urgent Issues Task Force (UITF) to assist in areas where an accounting standard or Companies Act provision exists, but where unsatisfactory or conflicting interpretations have developed or seem likely to develop. The UITF will seek to obtain a consensus on the issue in question. While a consensus will not have the status of an accounting standard, the Financial Reporting Review Panel may take it into account in considering whether financial statements require revision (see A59 below).

Accounting reference periods

A28 The period covered by the annual accounts (the financial year) must coincide with the company's accounting reference period or be within 7 days of that period (Companies Act 1985, section 223). The accounting reference period would normally cover 12 months and the company's accounting reference date will be the date on which, in each successive year, its accounting reference period ends.

A29 A company's first accounting reference date will normally be the last day of the month in which the anniversary of incorporation falls (Companies Act 1985, section 224).

A30 A company may alter its accounting reference period if certain conditions are met (Companies Act 1985, section 225):

(a) Adequate notice must be given. A notice to alter a previous accounting

reference period may not be given if the period allowed for laying and delivering accounts and reports in relation to that period has already expired.

(b) If the result of the change is that the accounting period is extended, it may not be extended beyond 18 months unless the company is in administration.

(c) A company may only extend its accounting reference period a second or subsequent time if it complies with the following rules:
   (i) there must be a gap of at least 5 years between the end of the earlier extended accounting period and the subsequent notice; or
   (ii) the change is to bring the company's accounting reference period into line with that of a parent or subsidiary undertaking, though reference should be made to the precise terms of section 225(4)(a); or
   (iii) the company is in administration; or
   (iv) the consent of the Secretary of State for Trade and Industry has been given.

Laying and delivering accounts

A31 The directors are responsible for laying the company's annual accounts, the directors' report and the auditors' report before the company in general meeting (Companies Act 1985, section 241). This will normally take place at the company's annual general meeting. The annual accounts, the directors' report and the auditors' report must also be delivered to the Registrar of Companies (Companies Act 1985, section 242). A disqualification order may be made against any person persistently in default in filing accounts and other statutory returns, or convicted in consequence of a failure to comply with legislation requiring the filing of accounts and other returns (Company Directors Disqualification Act 1986, sections 3 and 5).

A32 The annual accounts, directors' report and auditors' report must be laid and delivered within a specified time. If a company is private, the period is 10 months after the end of the accounting reference period, and 7 months in the case of a public company. These periods may be extended by 3 months where a company carries on business, or has interests, overseas and notifies the Registrar of Companies accordingly. Where the annual accounts are for the company's first accounting reference period after incorporation and that period exceeds 12 months, the time allowed for laying and delivering the accounts and reports is reduced by the excess over 12 months, but not to less than 3 months. (Companies Act 1985, section 244). Failure to deliver the accounts and reports within the required period renders the company liable to an automatic penalty (Companies Act 1985, section 242A). In addition every person who was a director immediately before the end of that period is liable to a fine and, for continued contravention, to a daily default fine (Companies Act 1985, section 242).

A33 At least 21 days before the general meeting at which the accounts are laid, a copy of the annual accounts and reports must be sent to the company's members and debenture holders. There are exceptions to this requirement: for

example, a company need not send copies to those members and debenture holders who are not entitled to receive notices of general meetings and of whose address the company is unaware (Companies Act 1985, section 238). Members who are not entitled to receive copies of the accounts and reports as of right may, however, require a copy from the company (Companies Act 1985, section 239).

Abbreviated accounts

A34 The standard accounts delivered to the Registrar of Companies are full accounts. Small and medium-sized companies may, however, deliver abbreviated accounts. In addition, a small company is entitled to certain exemptions from the disclosure requirements of the Companies Act 1985 in respect of the annual accounts and directors' report sent to members and certain small companies are exempt from the statutory requirement for audit (see A46 to A49 below). The exemptions applicable to small and medium-sized companies are not available to public companies, banking and insurance companies and authorised persons under the Financial Services Act 1986, regardless of their size; nor to any company which is a member of a group which includes any such company. (Companies Act 1985, sections 246 and 247A.)

A35 A company qualifies as a small company in a financial year if for that year it satisfies two or more of the following conditions:

(a) its turnover does not exceed £2,800,000;
(b) its balance sheet total does not exceed £1,400,000;
(c) the average number of its employees does not exceed 50.
(Companies Act 1985, section 247.)

A36 A company qualifies as a medium-sized company in a financial year if for that year two or more of the following conditions are satisfied:

(a) its turnover does not exceed £11,200,000;
(b) its balance sheet total does not exceed £5,600,000;
(c) the average number of its employees does not exceed 250.
(Companies Act 1985, section 247.)

A37 A company qualifies as small or medium-sized in relation to a financial year if the qualifying conditions are met:

(a) in the case of the company's first financial year, in that year; and
(b) in the case of any subsequent financial year, in that year and the preceding year.

A38 A company shall be treated as qualifying as small or medium-sized in relation to a financial year:

(a) if it so qualified in relation to the previous financial year under paragraph A.37 above or was treated as so qualifying under (b) below; or
(b) if it was treated as so qualifying in relation to the previous year by virtue of (a) above and the qualifying conditions are met in the year in question.

A39 A small company delivering abbreviated accounts delivers only an abbreviated balance sheet and notes to the accounts. A medium-sized company delivering abbreviated accounts delivers a full balance sheet, an abbreviated profit and loss account and a full director's report. The Companies Act 1985, sections 256 and 246A, and Schedule 8A should be consulted for details of the permissible modifications.

A40 Where abbreviated accounts are delivered, the balance sheet must contain a statement in a prominent position that the accounts are prepared in accordance with the special provisions of Part VII of the Act relating to small or medium-sized companies.

A41 A parent company can only qualify as a small company in relation to a financial year if the group headed by it qualifies as a small group, and can only qualify as a medium-sized company in a financial year if the group qualifies as a medium-sized group (Companies Act 1985, section 247A).

A42 A small group is one which satisfies two or more of the following conditions:

(a) its turnover does not exceed £2,800,000 net or £3,360,000 gross;
(b) its balance sheet total does not exceed £1,400,000 net or £1,680,000 gross;
(c) the average number of its employees does not exceed 50.
(Companies Act 1985, section 249.)

A43 A medium-sized group is a group that satisfies two or more of the following conditions:

(a) its turnover does not exceed £11,200,000 net or £13,440,000 gross;
(b) its balance sheet total does not exceed £5,600,000 net or £6,720,000 gross;
(c) the average number of its employees does not exceed 250.
(Companies Act 1985, section 249.)

A44 In the group figures, 'net' means with set-offs and other adjustments required by Schedule 4A (i.e. elimination of intra-group turnover, balances and profit or losses), and 'gross' means without those set offs and other adjustments. A group may satisfy the relevant requirements on the basis of either the net or the gross figure. Abbreviated group accounts do not have to be prepared as small or medium-sized groups are exempt from the requirement to prepare group accounts (Companies Act 1985, sections 248 and 249).

A45 Where abbreviated accounts may be delivered to the Registrar of Companies this does not affect the obligation to prepare and have audited a full set of accounts for the shareholders, although as noted below small companies are entitled to omit certain disclosures and, in some instances, may exempt themselves from a statutory audit.

Small companies

A46 As noted above, there are a number of exemptions in relation to the statutory disclosures required in the annual accounts of small companies.

These exemptions provide for a reduction in the disclosures required in the directors' report, a simplified balance sheet with a number of sub-headings being aggregated, and a reduced level of disclosure in the notes to the accounts. These exemptions were introduced in 1992 by the Companies Act 1985 (Accounts of Small and Medium-Sized Enterprises and Publication of Accounts in ECUs) Regulations 1992 (SI 1992/2452) and amended by both the Companies Act 1985 (Miscellaneous Accounting Amendments) Regulations (SI 1996/189) and the Companies Act 1985 (Accounts of Small and Medium-sized Companies and Minor Accounting Amendments) Regulations (SI 1997/220). These Regulations amended section 246 of and Schedule 8 to, the Act and inserted Schedule 8A to the Act. Unless the company is dormant, the accounts, directors' report and the accounts delivered to the registrar must contain a statement in a prominent position above the signatures that they are prepared in accordance with the special provisions of Part VII of the Act relating to small companies (Companies Act 1985, section 246(7) and (8)). Schedules 8 and 8A should be consulted for further details.

A47 The Companies Act 1985 (Audit Exemption) Regulations 1994 (SI 1994/1935) inserted sections 249A to 249E of the Companies Act 1985. These sections were later modified by the Companies Act 1985 (Audit Exemption) Regulations 2000 which abolish completely the statutory audit requirements for eligible companies with a turnover below £1 million[4] in respect of companies with financial years ending on or after 26 July 2000. (For financial years ending before that date, the Companies Act 1985 (Audit Exemption) Regulations 1997 had abolished completely the statutory audit requirement for eligible companies with a turnover below £350,000.) Charitable companies with gross income between £90,000 and £250,000 require a reporting accountants' report to be exempt from the statutory audit requirement and those with gross income in excess of £250,000 must be audited. A company which is exempt from the statutory audit requirement is also exempt from the obligation to appoint auditors (Companies Act 1985, section 388A).

A48 Besides the turnover criteria referred to above, there are other qualifying conditions to be met which include:

- the company must be able to qualify as a small company for the purposes of filing abbreviated accounts, although full accounts may still be filed (see A35, A37 and A38 above);
- the balance sheet total (total assets) must not be more than £1,400,000; and
- no objection to exemption is made by members holding in total more than 10% of the issued share capital or 10% of a particular class of share by depositing a written notice at the company's registered office not later than one month before the year end.

A company is not eligible for this relaxation of the audit requirement if it is:

[4] If the company is a charity, 'gross income' is substituted for 'turnover' and the upper limit is reduced from £1 million to £90,000.

- a public company;
- a banking or insurance company;
- enrolled in the list maintained by the Insurance Brokers Registration Council under s 4 of the Insurance Brokers (Registration) Act 1977;
- an authorised person or an appointed representative under the Financial Services Act 1986;
- a special register body as defined in s 117(1) of the Trade Union and Labour Relations (Consolidation) Act 1992 or an employers' association as defined in s 122 of that Act.

A parent company or a subsidiary undertaking for any part of a financial year cannot take advantage of audit exemption unless either it was a subsidiary undertaking that was dormant for any period in the financial year in which it was a subsidiary undertaking or it is a member of a group meeting the conditions set out below throughout that period:

- the group qualifies as a small group, in relation to the financial year in which the period falls and is not, and was not at any time within that year, an ineligible group within the meaning of section 248(2);
- the group's aggregate turnover is not more than £1 million net (or £1.2 million gross); and
- the group's aggregate balance sheet total for that year is not more than £1.4 million net (or £1.68 million gross). (Companies Act 1985, sections 249A and 249B.)

A49 If a company takes advantage of the audit exemptions the directors are required to make a statement on the balance sheet:

- that the company was entitled to the exemption;
- that holders of 10% or more of the issued share capital (or any class) have not deposited a notice in the allotted period requiring an audit;
- acknowledging their responsibility for maintaining proper accounting records and preparing true and fair accounts that comply with the Act.

This statement is required whether or not the company is required to obtain a statutory reporting accountants' report (i.e. whether or not it is a charitable company with gross income between £90,000 and £250,000).

A50 If applicable, a copy of the reporting accountants' report on the annual accounts will need to be filed with the abbreviated accounts (Companies Act 1985, section 249E). The Statement of Standards for Reporting Accountants *Audit Exemption Reports* issued by the Auditing Practices Board suggests that to avoid confusion, the directors may choose to add to the copy of the report that is to be delivered some explanatory words such as follows:

'The following reproduces the text of the report prepared for the purposes of section 249A(2) Companies Act 1985 in respect of the company's annual accounts, from which the abbreviated accounts (set out on pages . . . to . . .) have been prepared.'

Stock Exchange requirements

A51 Listed companies and those traded on the Alternative Investment Market are under additional obligations to the Financial Services Authority and the London Stock Exchange respectively as regards their accounts. Directors of such companies should therefore be familiar with the obligations set out in the Listing Rules and those for companies traded on the Alternative Investment Market set out in chapter 16 of the rules of the London Stock Exchange (these rules should not be confused with the Listing Rules).

The Combined Code

A52 Disclosures on corporate governance in annual reports and accounts originally prompted in 1992 by the recommendations of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee) now fall under the Combined Code ('the Code') published by the Stock Exchange in June 1998. The Code, which is appended to the Listing Rules, is derived from the final report of the Committee on Corporate Governance (the Hampel Committee) and from the Cadbury and Greenbury Reports. The Turnbull Report issued in September 1999 provides additional guidance on the Principle and Provisions relating to internal control within the Code. The Greenbury Report, issued in July 1995, built on the requirements of Cadbury in respect of directors' emoluments. The report's requirements were incorporated into the Combined Code issued in 1998. The Code specifically requires directors to report on the company's system of internal control, and that the business is a going concern. Additional guidance for directors on 'Going concern and financial reporting' and 'Internal control' (Turnbull) was issued in November 1994 and September 1999 respectively. Both documents are available from the Technical Department of the Institute. Reference should be made to the Listing Rules and the Turnbull Report for details of the relevant disclosure requirements. Transitional arrangements for disclosures on internal control apply for periods ended on or after 23 December 1999, and details are contained in a letter to all listed companies from the London Stock Exchange dated 27 September 1999. Both the Turnbull Report and the letter from the Stock Exchange can be found on the ICAEW website.

Summary financial statements

A53 A company listed on the London Stock Exchange may send copies of a summary financial statement to shareholders, debenture holders and other persons entitled to receive notice of general meetings ('entitled persons') if it has duly consulted the entitled person and provided the company's Articles or debenture trust deed or governing instrument do not require the full accounts and reports to be sent to entitled persons (Companies Act 1985, section 251). The Companies (Summary Financial Statements) Regulations 1995 (SI 1995/2092) should be referred to on the method of due consultation and the details of the form and content of the summary financial statement. An entitled person retains the right to request a copy of the full accounts and report even if he has given his consent to receive a copy of the summary financial statement.

Publication of accounts

A54 Where a company publishes any balance sheet or profit and loss account in respect of a financial year otherwise than as part of the statutory accounts, it must state that they are not statutory accounts. The statement must also say whether statutory accounts have been delivered to the Registrar of Companies, whether the auditors have reported on the statutory accounts and, if so, whether their report was qualified or contained any reservations about accounting records or obtaining necessary information. Statutory accounts comprise individual or group accounts, or abbreviated accounts. (Companies Act 1985, section 240 and Companies Act 1985, Schedule 8, paragraph 26).

Dormant companies

A55 A company is dormant during any period in which it has no significant accounting transaction, not including certain fees to the registrar as set out in section 249AA of the Companies Act 1985. A dormant company is exempt from the requirements of Part VII of the Companies Act 1985 relating to the audit of accounts and from the obligation to appoint auditors if:

(a) the company has been dormant since its formation; or
(b) the company has been dormant since the end of the previous financial year and meets all of the following criteria:
   - it qualifies as small in relation to that year (see A35, A37 and A38 above) or would do save for being a member of an ineligible group (see A41 above);
   - it is not required to prepare group accounts for that year;
   - it is not a banking or insurance company or an authorised person for the purposes of the Financial Services Act 1986;
   - no objection to exemption is made by members holding in total more than 10 per cent of the issued share capital or 10 per cent of a particular class of share by depositing a written notice at the company's registered office not later than one month before the year end.

If a dormant company takes advantage of the audit exemptions, the directors are required to make a statement on the balance sheet as set out in A49. The Companies Act 1985, sections 249AA and 388A should be consulted for further details. In addition, where the directors of a dormant company that has acted as an agent for any person during the financial year take advantage of audit exemption, they must state that fact in the notes to the accounts and in the abbreviated accounts if such accounts are produced. For year ends prior to 26 July 2000, a special resolution was required before a company that had not been dormant since its incorporation could take advantage of audit exemption. The Companies Act 1985 (Audit Exemption) (Amendment) Regulations 2000 removed this requirement by repealing section 250.

Annual return

A56 All companies are required to deliver to the Registrar of Companies an annual return signed by a director or the company secretary (Companies Act 1985, section 363). The return must be delivered within 28 days of the

'return date' and must contain the prescribed information. A company's 'return date' is the anniversary of the company's incorporation or, if the company's last return was made up to a different date, the anniversary of that date. Failure to observe these provisions will make the company liable to fines, and every director and secretary too unless he shows that he took all reasonable steps to avoid the offence.

Defective accounts

A57 Annual accounts or the directors' report are defective if they do not comply with the requirements of the Companies Act 1985. In summary, the Act provides for:

- the directors voluntarily to revise the annual accounts or directors' report (section 245);
- the Secretary of State to request directors either to revise the annual accounts or directors' report or to explain the apparent non-compliance (section 245A); and
- the Secretary of State, or another person authorised for the purpose, to apply for a court order requiring directors to revise the annual accounts or directors' report (section 245B and 245C).

A58 The Companies (Revision of Defective Accounts and Report) Regulations 1990 (SI 1990/2570 as amended by SI 1996/315) set out how the provisions of the Act are to be applied to annual accounts or directors' reports that are being voluntarily revised because the originals do not comply with statutory requirements. The Act and the Regulations should be consulted on the detailed procedures relating to the revision of the annual accounts or directors' report.

A59 The Financial Reporting Review Panel has been authorised under section 245B(1) of the Companies Act 1985 for the purposes of challenging accounts as defective in the courts. If the court finds that the accounts are defective, it may order that all or part of the costs of the application and any reasonable expenses incurred in connection with or in consequence of the preparation of revised accounts shall be borne by the directors who were party to the approval of the defective accounts. For this purpose, every director of the company at the time the accounts were approved is taken to have been a party to their approval unless he can show that he took all reasonable steps to prevent them being approved.