



TECHNICAL RELEASE

TECH07/13BL

EXEMPTION FROM AUDIT BY PARENT GUARANTEE

ABOUT ICAEW

ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

This guidance has been prepared by the Company Law Subcommittee of the ICAEW Business Law Committee, which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies. The guidance reflects consultation with the Audit and Assurance Faculty, which is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole.

© ICAEW 2013

All rights reserved.

If you want to reproduce or redistribute any of the material in this publication, you should first get ICAEW's permission in writing.

Laws and regulations referred to in this ICAEW Technical Release are stated as at [insert date]. Every effort has been made to make sure the information it contains is accurate at the time of creation. ICAEW cannot guarantee the completeness or accuracy of the information in this ICAEW Technical Release and shall not be responsible for errors or inaccuracies. Under no circumstances shall ICAEW be liable for any reliance by you on any information in this ICAEW Technical Release.

ISBN 978-0-85760-927-4

CONTENTS

PAGE

INTRODUCTION	4
GUIDANCE	4
Q1 When does the new exemption become available?	4
Q2 When do the formalities for obtaining the exemption need to be completed?	4
Q3 Are any companies ineligible to use the exemption?	4
Q4 What are the conditions for exemption?	5
Q5 What are the formalities for members agreeing on use of the exemption?	5
Q6 What are the requirements in relation to the parent?	6
Q7 What are the requirements for filing the written notice of agreement?.....	6
Q8 What does a subsidiary using the audit exemption need to disclose in its own accounts?	7
Q9 How is the guarantee given?	7
Q10 What are the requirements for the statement referred to in s479C?.....	7
Q11 What is the effect of the guarantee?.....	7
Q12 What is the scope of 'outstanding liabilities' covered by the guarantee?.....	8
Q13 Will the guarantee be enforceable against an overseas parent undertaking?.....	8
Q14 What is the effect of a change of ownership of the company after a guarantee has been given?	8
Q15 Does the guarantee fall away if the company later decides to have an audit for the year in question?	9
Q16 Are there any special considerations for charities?.....	9
Q17 Do the accounts of the subsidiary still have to be prepared and filed at Companies House? ...	9
Q18 For a company with a premium listing in the UK, could entering into a guarantee require shareholder approval as a class 1 transaction?.....	9

INTRODUCTION

This Technical Release provides guidance on the exemption from audit under s479A-479C of the Companies Act 2006 (the Act) for companies. Equivalent provisions are in place for LLPs.

The guidance is concerned with the requirements for obtaining the exemption and its effect. The guidance provides no advice or recommendations as to the use of the exemption. Directors of parent undertakings should weigh up the benefits of using the exemption compared with the costs of giving that guarantee, in particular the risk that the guarantee may be called upon. They may wish to take their own legal advice based on the specific facts and circumstances. Some subsidiaries will require audits for contractual or regulatory reasons.

Counsel has confirmed that the guidance is consistent with English law at 1 June 2013. Counsel accepts no responsibility (other than to the Institute) in relation to this guidance.

GUIDANCE

Q1 When does the new exemption become available?

- 1.1. The amendments to the Act which introduce the exemption are made by The Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012 (SI 2012/2301). They apply to accounts for financial years ending on or after 1 October 2012.
- 1.2. A company with an accounting reference period ending on 30 September 2012 can use the seven day flexibility in s390(3) so that its financial year ends on or after 1 October 2012. A company with an accounting reference period ending up to six months earlier may be able to extend its accounting reference period in accordance with s392 to qualify for the exemption.

Q2 When do the formalities for obtaining the exemption need to be completed?

- 2.1 The formalities for obtaining the exemption do not need to be completed before the subsidiary's year end and need only be completed before the subsidiary's accounts are filed. However, the consolidated accounts of the parent providing the guarantee must refer to the guarantee being given and the name of the subsidiary and this may impose an earlier effective deadline. In practice, a decision would have to be made early enough to be taken into account when planning whether to carry out a statutory audit or only the work needed to support the audit of the parent's consolidated accounts.

Q3 Are any companies ineligible to use the exemption?

- 3.1 In accordance with s479B, a company is not entitled to the exemption conferred by s479A if it was at any time within the financial year in question:
 - a quoted company as defined in s385(2) of the Act;
 - a company that is an authorised insurance company as defined in s1165(2) of the Act;
 - a banking company as defined in s1164(2) of the Act;
 - an e-money issuer as defined in s474(1) of the Act
 - a MiFID investment firm as defined in s474(1) of the Act;
 - a UCITS management company as defined in s474(1); or
 - a company that carries on insurance market activity as defined in s1165(7) of the Act; or is
 - a special register body as defined in section 117(1) of the Trade Union and Labour Relations (Consolidation) Act 1992; or
 - an employers' association as defined in section 122 of that Act or Article 4 of the Industrial Relations (Northern Ireland) Order 1992.

- 3.2 There is no limit on the size of a company for the purposes of the exemption. A subsidiary within a small group or a dormant subsidiary may qualify for exemption from audit under other provisions without the need for a parent guarantee.
- 3.3 The restrictions listed above refer to the status of the subsidiary company seeking to use the exemption. There is no concept of an 'ineligible group' (ie the fact that the company's parent undertaking or fellow subsidiary is a quoted company or an authorised insurance company does not affect the company's own eligibility for the exemption).
- 3.4 A quoted company principally means one with equity share capital listed on the main market of the London Stock Exchange, officially listed in an EEA state or traded on the New York Stock Exchange or NASDAQ. It does not include a company traded on AIM although such a company would in practice require an audit to comply with AIM rule 19.

Q4 What are the conditions for exemption?

- 4.1 Under s479A, a company is exempt from the requirements of the Act relating to audit of its individual accounts (but not any group accounts) for a financial year if:
- it is itself a subsidiary undertaking;
 - its parent undertaking is established under the law of an EEA state (see 6.1 below);
 - all of the members of the company agree to the exemption in respect of the financial year in question (see 5.1 to 5.6 below);
 - the parent undertaking gives a guarantee under section 479C in respect of that year (see 9.1 to 10.2 below);
 - the company is included in the consolidated accounts drawn up for that year or to an earlier date in that year by the parent undertaking in accordance with the provisions of the Seventh EU Company Law Directive or EU-adopted IFRSs (see 6.2 and 6.3 below);
 - the parent undertaking discloses in the notes to the consolidated accounts that the company is exempt from the requirements of the Act relating to the audit of individual accounts by virtue of s479A (see 6.4 and 6.5 below); and
 - the directors of the company deliver to the registrar on or before the date that they file the accounts for that year:
 - a written notice of the agreement by members of the company in accordance with s479A(2)(a) (see 7.1 below);
 - the statement (of guarantee) referred to in s479C (see 10.1 and 10.2 below);
 - a copy of the consolidated accounts of the parent which has provided the guarantee;
 - a copy of the auditor's report on those accounts; and
 - a copy of the consolidated annual report (ie directors' report) drawn up by the parent undertaking.

Q5 What are the formalities for members agreeing on use of the exemption?

- 5.1 The members of the subsidiary must consent unanimously. Members will include the immediate parent undertaking which may not be the company that is providing the guarantee.
- 5.2 Separate consent will need to be given for each year the exemption is used. This is because, first, the Act is clear that consent must be specific to the financial year in question. Furthermore, it would not be advisable for members to consent in relation to future financial years. This is because the exemption is from an obligation (to have an audit) arising each financial year and so to give consent in advance of a financial year, on a prospective basis, might give rise to a claim of invalidity.

- 5.3 There is no reason why a single document cannot evidence consent by a parent in relation to multiple subsidiaries. However, separate copies of the document should be filed at Companies House for each subsidiary claiming the exemption.
- 5.4 The requirement for consent of all of the members of the company– being the legal holders of its shares (ie, those who have agreed to become a member and have been entered into the register of members, s112 Companies Act 2006) – and so this includes holders of preference shares or non-voting shares. It will also include any shares that are presented as liabilities for financial reporting purposes. What matters is the legal status of the shares and of their holders as members.
- 5.5 There is no prescribed form in which consent must be given but the company will need evidence that consent was obtained. A written resolution signed by all the members would be satisfactory but is not the only way in which consent may be evidenced.
- 5.6 There is no facility in the Act for a member to withdraw consent for a particular financial year once it has been given. However, the exemption is subject to the requirements of s476, which allows members holding 10 per cent of any class of shares to require an audit by giving notice to the company at least one month before the end of the financial year in question. This could be used by one or more members in effect to ‘withdraw their consent’.

Q6 What are the requirements in relation to the parent?

- 6.1 The parent undertaking providing the guarantee must be established under the law of an EEA state. The EEA comprises all Member States of the EU plus Norway, Iceland and Liechtenstein. The Channel Islands and the Isle of Man are not part of the EEA. The guarantee does not have to be provided by the ultimate parent undertaking and could be provided by an intermediate parent undertaking although that parent undertaking would have to prepare consolidated accounts.
- 6.2 The consolidated accounts must be drawn up under EU-adopted IFRSs or in accordance with the provisions of the EU Seventh Company Law Directive. The national GAAP of any Member State would be acceptable for this purpose.
- 6.3 If the parent’s accounts are not in English (or Welsh for a non-traded Welsh company) a certified translation must be filed (see regulations issued under s1105(2)(d)).
- 6.4 The notes to the consolidated accounts of the parent undertaking must disclose that the company (ie the subsidiary) is exempt from the requirements of the Act relating to the audit of individual accounts. It is therefore necessary to state the name of each subsidiary for which a guarantee has been given even if the list would be very long. For a UK incorporated parent company, the concession granted by s410 where compliance with s409 would result in information of excessive length (which permits most disclosures about subsidiary undertakings to be restricted to ‘principal subsidiaries’ and for full details to be attached to the annual return) does not apply for the purposes of s479A.
- 6.5 Companies House guidance booklet GP2 states that the parent’s consolidated accounts should show the subsidiary companies’ names and registered numbers in a prominent place. This could be done by adding a column for the registered number to the listing of subsidiary companies.

Q7 What are the requirements for filing the written notice of agreement?

- 7.1 There is no prescribed form for the written notice of agreement by the members of the company (see 5.1 to 5.6 above). Companies House guidance booklet GP2 states that the notice of agreement by members must show the subsidiary company’s name and registered number in a prominent place.

Q8 What does a subsidiary using the audit exemption need to disclose in its own accounts?

8.1 The exemption has effect subject to s475(2) and (3) (requirements as to statements contained in balance sheet).

8.2 Companies House guidance booklet GP2 includes example wording for the subsidiary taking the exemption to include in its balance sheet which is as follows:

For the year ending(dd/mm/yyyy) the company was entitled to exemption from audit under section 479A of the Companies Act 2006 relating to subsidiary companies.

Directors' responsibilities:

- the members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476;
- the directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts.

Q9 How is the guarantee given?

9.1 The guarantee is effected by delivering the s479C statement to Companies House. The guarantee is created by the operation of s479C rather than by contract. No contract is required between the parent giving the guarantee and the parties who benefit from the guarantee.

Q10 What are the requirements for the statement referred to in s479C?

10.1 A guarantee is given by a parent undertaking under s479C when the directors of the subsidiary company deliver to the registrar a statement by the parent undertaking that it guarantees the subsidiary company under s479C. The statement must be authenticated by the parent and must specify:

- the name of the parent undertaking
- if the parent undertaking is incorporated in the United Kingdom, its registered number (if any);
- if the parent undertaking is incorporated outside the United Kingdom and registered in the country in which it is incorporated, the identity of the register on which it is registered and the number with which it is so registered;
- the name and registered number of the subsidiary company in respect of which the guarantee is being given;
- the date of the statement; and
- the financial year to which the guarantee relates.

10.2 The requirement for a statement referred to in s479C will be met by filing a correctly completed Form AA06 with the registrar. Form AA06 indicates that it must be authenticated by being signed on behalf of the parent undertaking rather than merely indicating the name of the parent undertaking.

Q11 What is the effect of the guarantee?

11.1 A guarantee given under s479C has the effect that:

- the parent undertaking guarantees all outstanding liabilities to which the subsidiary company is subject at the end of the financial year to which the guarantee relates, until they are satisfied in full; and
- the guarantee is enforceable against the parent undertaking by any person to whom the subsidiary is liable in respect of those liabilities.

11.2 Where the guaranteed liability is an amount outstanding on an account that may be partially repaid and redrawn several times after the year end ('churned'), such as a bank facility, there is case law¹ that the balance would be considered discharged when:

- in the absence both of specific direction for appropriation by the debtor and of any contrary intention,
- monies repaid on the account are presumed to discharge the earliest debits on the account (ie first in, first out).

Q12 What is the scope of 'outstanding liabilities' covered by the guarantee?

12.1 The question of scope is one of law and not accounting. Having sought legal advice, the position at law is uncertain. Whilst the obvious source of meaning for 'liabilities' is insolvency law, which brings in all types of pecuniary obligation, including contingent and prospective liabilities (eg, respectively, a litigation and future rentals on a lease), it is uncertain whether and, if so, to what extent a court would restrict the set of guaranteed liabilities as a result of the reference to '*outstanding* liabilities'. Ultimately these uncertainties would be resolved if one or more cases come before the courts. In the meantime, it would be prudent for companies that are contemplating the giving of such a guarantee to establish the population of the relevant subsidiaries' liabilities, including contingent and prospective liabilities since it is possible that they may be exposed to some or all of them.

Q13 Will the guarantee be enforceable against an overseas parent undertaking?

13.1 In a consultation on the proposed audit exemption in October 2011, BIS stated the following at paragraph 68:

The Government is satisfied that guarantees will be enforceable. Where an elective parent is formed under the laws of another EU Member State, under the provisions of the European Convention on Jurisdiction and Enforcement of Judgements in Civil and Commercial Matters, an English or Scottish court has jurisdiction to hear a claim by a creditor of a British elective subsidiary against a parent incorporated elsewhere in the EU which has given a guarantee. If a creditor obtains a judgement in his favour in an English or Scottish court under the terms of the guarantee, then under the Convention, a court elsewhere in the EU should recognise that judgment.

Q14 What is the effect of a change of ownership of the company after a guarantee has been given?

14.1 The guarantee remains in force until the liabilities in question are settled in full. There is no provision to revoke the guarantee or novate it to another party. If a parent undertaking disposes of a subsidiary for which a guarantee has been given, it will remain liable under that guarantee until all the liabilities have been settled. It could seek an indemnity from the purchaser of the subsidiary but would remain liable to the creditors of the former subsidiary.

14.2 If the new parent also entered into a guarantee under s479C for a subsequent financial year and liabilities outstanding at a previous balance sheet date remained outstanding, it is possible that the same liabilities may have been guaranteed by more than one parent. A creditor might claim against either guarantor. The guarantor against which the claim is made is given no rights by the Act against the other guarantor but is likely to have an equitable right of contribution from other guarantors of the same outstanding liabilities.

¹ Clayton's case [Devaynes v Noble (1816) 1 Mer 572]

Q15 Does the guarantee fall away if the company later decides to have an audit for the year in question?

- 15.1 No. Once the guarantee has been given by delivering the s479C statement to Companies House, there is no provision in the Act for the parent's liability to cease except on the full satisfaction of the subsidiary's liabilities that had been covered by the guarantee given previously. Therefore, reverting to an audit would not bring an end to those liabilities.

Q16 Are there any special considerations for charities?

- 16.1 Yes, the Charities Commission has issued guidance².
- 16.2 Charitable companies are required by the Charities Act to have an audit if they have income over £500,000. Those with income over £250,000 are also required to have an audit if their assets are greater than £3.26m. Those not required to have an audit are required to have an independent examination of their accounts if their income is over £25,000. These requirements apply irrespective of any guarantee.
- 16.3 The Charity Commission guidance referred to above states that if a subsidiary is a charity, a guarantee under s479C can be given by a parent charity if it is in the parent charity's interest to do so but draws attention to the above requirements.
- 16.4 That guidance also states that a guarantee should not be given by a charity for a non-charitable subsidiary because it risks charitable funds being used for a non-charitable purpose if the guarantee were to be called upon. This would give rise to a breach of trust and so a guarantee for a non-charitable trading subsidiary should not be given.

Q17 Do the accounts of the subsidiary still have to be prepared and filed at Companies House?

- 17.1 In general, yes. However, dormant subsidiary companies fulfilling the conditions for exemption from audit by parent guarantee are also exempt from the requirement to prepare and/or file accounts at Companies House.
- 17.2 Most dormant companies were already exempt from audit under s480. However, for financial years ending on or after 1 October 2012, they can claim exemption from the requirements to prepare and file statutory accounts. The requirements to qualify for these exemptions are essentially the same as those set out in this guidance relating to audit exemption.
- 17.3 The exemption from preparing accounts for a dormant subsidiary is in s394A-C and the exemption from filing accounts for a dormant subsidiary is in s448A-C. Form AA06 should indicate which of the exemptions is being claimed.

Q18 For a company with a premium listing in the UK, could entering into a guarantee require shareholder approval as a class 1 transaction?

- 18.1 LR 10.2.4 requires certain indemnities and similar arrangements to be treated as class 1 transactions and therefore to require shareholder approval. However, this does not apply to an agreement or arrangement with a wholly-owned subsidiary undertaking of the listed company. It therefore appears that provided the subsidiary in question is wholly-owned, entering into a guarantee under s479A would not be a class 1 transaction. This is consistent with the draft guidance in TN/310.1³, which was published for consultation by the UK Listing Authority (UKLA) in February 2013. The UKLA is considering the responses to that consultation.

² http://www.charity-commission.gov.uk/faqs/sending_annual_returns/id247.aspx

³ http://www.fsa.gov.uk/pubs/ukla/ukla_indemnities_guarantees_arrangements.pdf

18.2 Where the arrangements involve a subsidiary that is not wholly owned, it appears that the arrangements may be a class 1 transaction because the guarantee is unlimited. This is the position taken in the UKLA draft guidance in TN/310.1, but the UKLA is considering the responses to that consultation and has yet to reach a finalised position on this matter. Given the requirements in Listing Rule 10.2.4⁴ apply only when the arrangements are 'exceptional', pending clarification from the UKLA as to their finalised position in this regard, companies considering entering into guarantees in respect of non-wholly owned subsidiaries should obtain their own legal advice or consult their broker and/or the UKLA.