

Audit-related provisions

Criminal offence

Provisions protecting auditors from liability

Signature of audit reports

Resignation statements regime

Statutory auditors

Accounting records

Quoted companies: right of members to raise audit concerns at accounts meetings

Designation of the POB under Freedom of Information Act

Criminal offence (s 507)

For accounting periods commencing on or after 6 April 2008, there is a new criminal offence, punishable by an unlimited fine, for 'knowingly or recklessly' including misleading, false or deceptive matters in an audit report. The Government's view is that 'recklessness' has a very high hurdle and would only catch an auditor who is *'aware that an action or failure to act carried risks, that they personally knew that the risks were not reasonable ones to take, and that, despite knowing that, they went ahead'*. Put another way, "recklessly" is a subjective test because a risk taken must be unreasonable in the mind of the person taking it.

However, there is still the potential for unintended consequences for audit quality should the profession perceive this offence as criminalising negligence. Therefore, the DTI now need to ensure that the guidance to be issued for prosecuting authorities under the Act provides greater clarity of the criminal offence for auditors who 'knowingly or recklessly' provide an incorrect audit opinion. We think this guidance needs to make it very clear that auditors who have made honest mistakes should not be prosecuted, and have offered to work closely with the Government in developing this guidance to ensure that the unintended consequences are avoided.

The new criminal offence for auditors in relation to accounting records was originally linked to the statement as to their being proper/adequate. To address concerns that this would have been especially onerous for smaller practitioners, this new offence in the Act was changed to relate to the statement that the accounts are in agreement with the records.

Provisions protecting auditors from liability (ss 534-538)

Following extensive industry representation, from 6 April 2008 the Act allows auditors to contract annually with shareholders to limit their liability to a "fair and reasonable" amount. These provisions are widely drawn and, in order to avoid initial confusion, the FRC requesting is consulting with investor groups and the profession with a view to issuing guidance as to what is "fair and reasonable" and/or some model terms that have wide stakeholder support, to avoid initial confusion before the courts have had chance to rule in this area.

These provisions also allow the Government to mandate/preclude terms, in particular to avoid any distortion of competition (there are currently no plans for these powers to be utilized in the near future), and make it clear that no account should be taken of the ability of other parties to pay for the loss.

Signature of audit reports (ss 503-506)

Audit reports for financial years beginning on or after 6 April 2008 must be signed by the 'senior statutory auditor' in his/her own name (on behalf of the firm). Guidance is to be issued by the Financial Reporting Council on who is a 'senior statutory auditor', and they must also be named in the published accounts, with an exception where there is a risk of violence or intimidation.

Resignation statements regime (ss 510-526)

The new provisions will come into force as from 6 April 2008. For unquoted companies, the requirements for a statement of circumstances are essentially unchanged, but quoted company auditors will now *always* need to make a statement of circumstances surrounding their ceasing to be auditors.

From 6 April 2008, there is also a new regime to notify the audit authorities. Auditors of listed companies and public interest entities must notify the audit authorities whenever they cease to hold office. Auditors of other companies only need to notify if the auditor ceases to hold office before the end of their term. The notice to the audit authorities must be accompanied by the statement of circumstances or – where there is no such statement – a statement of 'reasons' for ceasing to hold office.

Companies should note that as from 6 April 2008 they, as well as the auditors, have notification duties when they change auditors, i.e. there is a double notification regime.

Statutory auditors (Part 42)

To achieve more consistency of regulation of auditors, from 6 April 2008 the existing regulatory regime for 'company auditors' is extended to cover auditors of building societies, banks and insurance undertakings (including those that are industrial and provident societies or friendly societies), all of which will register as 'statutory auditors'.

There are also minor changes to the eligibility/independence regime in respect of auditors appointed for financial years beginning on or after 6 April 2008 (ss 1212-1215), and so audit firms may need to carry out new checks to ensure they are in compliance.

Accounting records (s 498 (1) and (2))

Auditors' responsibilities on accounting records will be brought into line with those of the directors (ss 386-389); auditors will report on whether the accounting records are "adequate" (previously "proper"). (A company's duty to keep accounting records has been re-worded to be a requirement to keep 'adequate accounting records', although the definition of 'adequate accounting records' restates the existing requirements for companies, which are "*records that are sufficient (a) to show and explain the company's transactions, (b) to disclose with reasonable accuracy, at any time, the financial position of the company at that time, and (c) to enable the directors to ensure that any accounts required to be prepared comply with the requirements of this Act (and, where applicable, of Article 4 of the IAS Regulation)*".)

The APB is expected to issue revised guidance on this revised requirement on auditors.

Quoted companies: right of members to raise audit concerns at accounts meetings (ss 527-531)

Members of quoted companies (or at least a substantive body of them/their shareholdings) are given a new right to raise questions about the annual audit that they intend to raise at the accounts general meeting in relation to financial years beginning on or after 6 April 2008, and the company must publish them on their website. Companies will need to ensure they include an invitation to members to put questions about the audit in their papers for the annual accounts meeting for such financial years. They will also need to have a mechanism in place to inform the auditors if any questions are received. This is intended to improve audit quality by instituting a more direct dialogue between investors and auditors although it is unclear what else, if anything, companies and their auditors are obliged to do in relation to such questions.

Designation of the POB under Freedom of Information Act (s 1228(3))

A late amendment to the legislation in the House of Lords will mean that the Professional Oversight Board (POB) will be designated under the Freedom of Information Act. This designation has implications for POB's oversight of and reporting on RSBs and RQB, and also for AIU reporting on firms (see below), and we understand that POB is taking legal advice on the implications for its operating procedures and the reporting regime.

Once designated, the Freedom of Information Act will require POB to adopt a publication scheme, through which it will make the information it holds that is not exempted or otherwise precluded from publication available for anyone to access.

On 7 November 2007, the government announced that most of the provisions of the Companies Act 2006 due to be commenced on 1 October 2008 will now be commenced on 1 October 2009. The delay in implementation results from the need to ensure that the necessary changes to the Companies House systems and processes are in place. BERR are seeking views from stakeholders on whether some provisions due to be commenced on 1 October 2008 (and which do not necessitate changes to Companies House systems) could still be commenced on 1 October 2008. These include the general duties of directors in respect of conflicts of interest and the repeal of the restrictions under the Companies Act 1985 on financial assistance for the acquisition of shares in private companies.

POB published details of proposed new reporting arrangements for the AIU, to be implement during the 2007/08 inspection cycle, in June 2007 (['Reporting on Audit Quality Monitoring – Implementing a New Approach'](#) PDF 138kb/20 pages).

POB will also need to establish a system to deal with requests for disclosure of information not published within such a publication scheme. Such system should take account of various Freedom of Information Act exemptions that are likely to apply to the information it holds, for example, the exemptions relating to commercially sensitive information, audit or information that relates to monitoring compliance with the law.

These exemptions can be overridden if the public interest in disclosure outweighs the reasons for keeping them confidential, and POB will be responsible for making a decision on this in the first instance on a case by case basis. If POB refuse disclosure, the applicant can appeal to the Information Commissioner who has the power to overturn POB's decision on the overriding public interest.

Whether there is an overriding public interest in disclosure will always be dependent on the facts of each individual request. However, both POB and the Information Commissioner should have regard to the Government statements made in Parliament, which set out the reasons why this information should not be discloseable, for example: *“publication of the AIU's reports on individual audits or auditors would be detrimental to the inspection programme—which is, after all, designed to improve firms' practices and internal processes through constructive dialogue, rather than an adversarial approach—and therefore not in the public interest”* and *“There are a number of exceptions under the Freedom of Information Act that would probably apply with respect to much of the information contained in AIU reports”*.