

directors' duty of disclosure to auditors



Auditors will benefit from changes to the Companies Act which mean directors have a greater duty of disclosure, writes Mike Griffiths.

■ The Companies (Audit, Investigations and Community Enterprise) Act 2004 obtained Royal Assent on 29 October 2004. All of its substantive provisions are due to be brought into effect by secondary legislation. Sections 21-24 of C(AICE)A 2004, which cover the new investigatory powers, comes into force on 6 April 2005.

Amongst other things, it will increase considerably the duty of directors to disclose to auditors information of which the latter should be aware of if they are to fulfil their audit function properly and fully.

auditors' right to information

Section 389A of the Companies Act 1985 says auditors are entitled to require from a company's officers such information and explanations as they thought necessary for the performance of their duties as auditors.

However, the provision is worded in such a way as to require the auditors to have to request that information. Section 389A(1) states that: "The auditors of a company have a right of access at all times to the company's books, accounts and vouchers, and are entitled to require from the company's officers such information and explanations

as they think necessary for the performance of their duties as auditors".

Knowingly or recklessly providing misleading, false or deceptive information or explanations is a criminal offence, but there is no criminality attached to a plain failure to supply information or explanations. This is perceived by the Government as a weakness in the existing legislation.

Doubtless following in the wake of the Sarbanes-Oxley legislation in the United States, two major changes are being made to English law. First, the range of persons from whom information and explanations can

be obtained is widened and the failure to supply such information and explanations is further criminalised. Second, directors fall under a positive duty to state in a company's directors' report that all necessary information has been furnished to its auditors.

The first step in this development will be for the existing s.389A to be repealed and new s.389A inserted into the Companies Act 1985.

auditors' right of access

Under the new provision auditors will 'have a right of access at all times to the company's books, accounts and vouchers (in whatever form they are held) and may require an increased number of the persons (considered below), to provide them with such information or explanations as they think necessary for the performance of their duties as auditor'. Auditors will be able to require information and explanations from:

- any officer or employee of the company
- any person holding, or accountable for, any of the company's books, accounts or vouchers. (This could include a solicitor who is in possession, even temporarily, of a company's books, perhaps where they hold the register of members with a view to registering a change in the membership of the company)
- any subsidiary undertaking of the company which is incorporated in Great Britain
- any officer, employee or auditor of any such subsidiary, or any person holding or accountable for, any books, accounts

- or vouchers of any such subsidiary
- any person who falls within any of the above categories at a time to which the information or explanations required by the auditor relates or relate.

The criminality attached to the supply of false or misleading information or explanations to an auditor will be extended to any of the above persons from whom such information and explanations can be sought under these provisions.

The offence will also be extended so that explanations and information required by an auditor must be given 'without delay'. Thus a person who honestly and accurately answers an auditor's enquiries may nevertheless find themselves being prosecuted if the auditor takes the view that the response has been slow.

Moreover, whereas there would seem to be a defence for a director who can prove that it was not reasonably practicable for them to provide the required information or explanations, this does not seem to apply where the director simply fails to provide the information 'without delay'.

While the present criminal offence of knowingly or recklessly failing to supply information or explanations required by an auditor will continue, the criminality will be extended to any person who knowingly or recklessly supplies to an auditor information which is 'misleading, false or deceptive in a material particular'. Thus the offence will be extended to cover the telling of a half-truth by way of omission of significant facts.

The meaning of 'any person' is not defined or redefined for this provision. Therefore it must be assumed that it will have the same meaning as described above in relation to the supply of information and explanations to auditors.

There will be a defence for the person of whom the information or explanations is required – if they can prove that it has not been reasonably practicable for them to provide the information or explanations required.

The Government does not think it appropriate that there should be a direct responsibility imposed upon non-GB subsidiaries and their associates to give information and explanations to a UK auditor. Therefore the responsibility for giving information and explanations will be imposed upon the parent company to ensure that the necessary detail is provided to the auditor.

conclusion

There is no doubt that these changes will considerably strengthen the hand of the auditor. There is an increased number of persons to whom they can go for information and explanations, and the obligation of directors to make disclosure is also increased.

However, the changes must be seen in context. The provisions are not as draconian as they appear at first sight, since most small companies with a turnover of £5.6m or less, and a balance sheet total of £2.8m or less, are eligible to claim exemption from the need for an audit. ■

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