cover story

the Companies Act

Much of the new Companies Act comes into effect in October 2007. However, this is not the case in relation to those sections of the Act which deal with accounting and reporting matters.

Despite the fact that the great bulk of these provisions are substantially unchanged, their implementation has for the most part been deferred until 2008 – until then the pre-existing rules and references in the Companies Act 1985 will continue to have force.

FINANCIAL REPORTING

the framework of accounting

There are no significant changes to the statutory rules on the framework of company accounting and reporting, since the basic rules of the Companies Act 1985 have in the main been consolidated intact. It remains the responsibility of the company's directors to keep accounting records and to prepare, approve and publish the financial statements and a directors' report.

Accounts must still give a true and fair view and parent companies should still ensure, wherever possible, that all group companies follow the same accounting framework (UK GAAP or IAS). The basic provisions now set out in the Companies Act 2006 will therefore be very familiar to all accountants.

The Act does contain a wholly new term in the form of the 'small companies regime', but in substance all this does is to act as a coherent umbrella term with which to pull together the various accounting and audit exemptions that have for many years been available to small companies (and which are continued under the new Act).

John Davies reviews the impact of the Companies Act 2006 on accounting and reporting practice, with particular regard to those provisions which introduce changes of importance to practitioners.

Under section 426, any company – not just public or quoted companies – may in future circulate to members a summary financial statement instead of its 'full' annual accounts. Where it prepares a summary financial statement, it will need to comply with rules on form and content to be set out in regulations made under the Act.

Individual members will still, however, be entitled to insist that they receive the full accounts rather than a summary. This is, therefore, not an option which is likely to have any appeal for companies other than those with very large numbers of shareholders and a consequent large postage bill.

Public companies are also presented with a new term to describe the meeting at which they lay their accounts before their members in general meeting – the 'accounts meeting'. This is to distinguish that meeting from the annual general meeting.

However, there is nothing to stop the accounts meeting and the AGM being one and the same. The accounts meeting concept does not apply to private companies since they are not obliged under the Act to hold an AGM or lay accounts before their members.

One change which will affect all companies is the reduction in filing periods. Under section 442, the deadline for the publication of private company accounts comes down from 10 months to nine and that for public company accounts comes down from seven months to six.

FINANCIAL REPORTING

form and content of annual accounts

Accountants will consider it ironic that one consequence of the drive to consolidate the fragmented state of UK company law, and in the process create the biggest single statute in UK history, has been that the rules on form and content of company accounts have been taken out of primary legislation and will be issued, in future, as regulations under the Act.

The virtue of doing things this way is that it will make it easier for the Government to make periodic changes to the rules on form and content – including those changes mandated by changes in EU legislation – without causing too much disruption. It will also allow the Government the freedom to restructure some of the schedules of the Companies Act 1985.

For example, it seems likely that in future there will be one stand-alone schedule for small company accounting and

reporting, bringing together in one place the disclosure rules on the financial statements, abbreviated accounts and the directors' report that are currently spread out over schedules 4.4A, 5, 6 and 7. This will be in line with the core aim of making the new Act simpler for small private companies to follow.

AUDITING

As with the framework and disclosure issues referred to above, the core statutory rules regarding the rights and responsibilities of the auditor are consolidated into the new Act. But there are nevertheless some important changes as set out below.

appointment of auditors

The Act contains some new material on means of appointment which is necessary in light of the fact that private companies under the Act no longer need to hold annual general meetings.

In future, private companies (other than those which decide not to appoint auditors on the ground that they will be exempt as small companies) will appoint their auditors under the procedures set out in section 485. This will normally be done by the company's members, by written resolution. Companies will have to make the appointment within 28 days of the end of the period allowed for circulating the previous year's accounts (effectively nine months from the year end): this is referred to as 'the period for appointing auditors'.

Auditors will hold office in accordance with the terms of their appointment but will be deemed to be re-appointed at the end of the next period for appointing auditors unless:

- the members have resolved that they should not be re-appointed
- the company's articles require actual re-appointment
- the directors resolve not to appoint an auditor for the next financial year
- members comprising at least 5% of the company's voting rights resolve to object to the deemed re-appointment
- they were appointed by the directors (under their residual power to appoint first auditors or to fill a casual vacancy).

(NB. these rules take effect from Oct. 2007.)

resignation of auditors

Currently, when an auditor resigns from an engagement, they are required to send to the company a statement as to whether there are any circumstances connected with their resignation that they feel should be brought to the attention of members (or a statement that there are no such circumstances). This requirement is continued under section 519 of the Act.

However, there are additional provisions as to what happens when a statement of circumstances is filed by an auditor. Unless the company applies to the court for exemption within 14 days, it must send a copy of any section 519 statement it receives to all its members and to any other persons entitled to receive copies of the accounts.

Unless the auditor receives from the company, within 21 days of the deposit of their statement, notice that it has made the aforementioned application to the court, they must send an additional copy of their statement to the Registrar of Companies – this must be done within a further seven days.

In addition to the above, there is a new requirement for notification of departing auditors to be given to what is referred to as 'the appropriate audit authority' – the identity of this body will depend on whether the audit was a 'major audit' – a listed company or some other category of company officially deemed to be a major audit – or a non-major audit. This additional notice is to be given at the same time as the deposit of the statement under section 519 is made.

Where an auditor ceases for any reason to hold office in relation to a major audit they will be required to notify the FRC, enclosing a copy of the statement they deposited with the company (which either set out the circumstances connected with their decision to resign which they felt needed to be brought to the attention of members, or stated that there were no such circumstances). Where the statement stated that there were no circumstances needing to be brought to members' attention, the auditor must additionally submit a statement of their reasons for ceasing to hold office.

The requirements relating to departing auditors in non-major audits are somewhat different. The requirement to notify the appropriate authority only applies where the auditor ceases to hold office before the end of their term of office, meaning that failure to seek or obtain re-appointment will not give rise to any duty to notify.

But where an auditor does step down during their scheduled term of office, they will be required to notify their RSB. For this purpose they will provide the same information as referred to above in the case of major audits, viz a copy of the statement they filed with the company under section 519 and, where they had filed a statement of 'no circumstances', a statement of their reasons for resignation.

The company too is required by section 523 to inform the appropriate audit authority wherever the auditor ceases to hold office mid-term. Accordingly, the authority should receive notification from both sides.

signing of the audit report

The Act implements the reform mandated by the revised EU Statutory Audit Directive so as to require all audit firms to identify a 'senior statutory auditor'. An audit report

'The scope of the Act's limitation of auditor liability is very wide – it covers the auditor's liability for any negligence, default, breach of duty or breach of trust of which the auditor is guilty in relation to the auditing of the company's accounts during the financial year to which it relates'

must be signed by the senior statutory auditor in their own name, for and behalf of the audit firm. Guidance is to be issued before this provision takes effect in April 2008 as to the criteria to be met by a person who aspires to fill this position in a firm. Every copy of the audit report that is published must contain the name of this person.

liability limitation agreements

This was one of the most radical but most contentious elements of the Act during its passage through Parliament. Chapter 6 of Part 16 of the Act provides, for the first time in UK company law, for a statutory basis of limitation of auditor liability. The scope for this limitation is very wide – it covers the auditor's liability for any negligence, default, breach of duty or breach of trust of which the auditor is guilty in relation to the auditing of the company's accounts during the financial year to which it relates. Any such agreement will be known as a 'liability limitation agreement' (LLA).

An LLA will not apply automatically to an audit engagement – limitation of liability will have effect on the basis of a valid agreement entered into voluntarily between the auditor and client company, and where an LLA has not been entered into the auditor will continue to be liable on a joint and several basis. The following are the key features of a valid LLA.

First, the LLA must be approved by the company's members. They may give their approval in one of the following three ways:

- the members can simply pass a resolution waiving their right to approve any LLA. If the members do this, the directors can proceed to negotiate and finalise the agreement directly with the auditor. This is likely to prove the most popular route in the case of owner-managed companies. But it is not available to public companies
- the company can pass a resolution approving the principal terms of a draft agreement. Again, a resolution on these terms will entitle the directors and auditor to proceed to finalise the terms of the agreement, as long as that final agreement incorporates the 'principal terms' that the shareholders have agreed to. The FRC is currently engaged in a project to identify what the 'principal terms' should be
- the company can pass a resolution after it enters into the agreement approving the LLA. The wording of this particular clause implies that the directors have authority to negotiate and actually enter into an LLA with the auditor but it will only be authorised as far as the law is concerned if the company subsequently agrees to ratify the agreement – if the members choose not to do so it will not be properly 'authorised'.

Second, the way that the parties choose to limit the auditor's liability is really up to them. While much press coverage of the LLA has suggested that the new Act brings in 'proportionate liability' for auditors this is not in fact the case. The parties can limit the auditor's liability on a proportionate basis, by means of a fixed cap, by means of a multiplier of the audit fee or by any other means provided that it meets a test of fairness and reasonableness.

Under section 537 of the Act, any LLA can only limit the auditor's liability to such amount as is fair and reasonable in all the circumstances of the case, having regard to (in particular) the auditor's statutory responsibilities with regard to the audit of the accounts, the nature and purpose of the auditor's contractual obligations to the company, and the professional standards expected of the auditor. Therefore an LLA cannot exempt an auditor from liability completely or to an extent which does not correspond to the scale of the auditor's responsibilities, and where an agreement fails the fair and reasonableness test, the courts will overrule it and substitute an appropriate figure. The Act allows the Secretary of State to make regulations which specifies particular provisions that should be incorporated in LLAs.

Third, an LLA is only valid with respect to a specified financial year, and if either or both parties wish to renew an agreement the new one will have to be approved via one of the three methods outlined above.

Fourth, every company that enters into an LLA with its auditor must disclose that fact in its annual accounts for the financial year to which the LLA relates.

With the exception of the rules on the appointment of auditors in private companies, all the changes discussed in this article are scheduled to come into effect in April 2008. ■

John Davies – Head of Business Law, ACCA

Commencement dates
You can view a list of key commencement dates during 2007 at **http://uk.accaglobal.com/uk/members/technical/companiesact_2006/**

Companies Act booklet
ACCA UK has produced a client-focused booklet called The Companies Act 2006 – its implications for company directors. The first copy of each booklet is free, and additional copies are sold in packs of ten for £5. To order copies please call 0141 582 2000 or e-mail members@accaglobal.com. The booklet can also be downloaded from *ACCA UK*'s website at **http:uk.accaglobal.com**.