



Special Release No.5

The Companies Act 2006

February 2008

Auditors

Introduction

The Companies Act 2006 ('2006 Act'), the culmination of eight years of consultation, was finally passed in November 2006. The 2006 Act repeals and restates almost all of our existing company law and is being implemented in stages, with the remaining main implementation dates being 6 April 2008, 1 October 2008, and 1 October 2009. One of the key areas coming into force this April relates to auditors. This release highlights some of the relevant changes.

Auditor Liability Limitation Agreements

What are these?

These are agreements that will enable auditors to limit their liability to a company for negligence, default, or breach of duty or trust in relation to the audit of the accounts.

Who can enter into them?

Both private and public companies will be able to enter into these agreements. Note, however, that an agreement will not be effective if it limits the auditor's liability to less than an amount that is fair and reasonable in all the circumstances of the case having regard to a number of factors. In determining what is fair and reasonable, no account is to be taken of matters arising after the loss or damage has been incurred or of the chances of recovery from other third parties responsible for the loss or damage.

What steps do you need to take?

The agreement must be authorised correctly by the members of the company. For a *private company* this is by ordinary resolution (which can be a written resolution) either waiving the need for

authorisation at all, or approving the principal terms of the agreement before it is entered into or approving the whole agreement after it has been entered into. For a *public company* this is by ordinary resolution (which must be in general meeting) approving the principal terms of the agreement before it is entered into or approving the whole agreement after it has been entered into. The company's articles of association may prescribe a higher threshold than an ordinary resolution. Companies that are *listed* will also need to consider the Listing Rule requirements for circulars to shareholders. A company may, by ordinary resolution, withdraw its authorisation for a liability limitation agreement despite anything to the contrary in the agreement itself. The agreement can only apply in respect of acts or omissions occurring in the course of the audit of accounts of one financial year and must specify the financial year to which it applies.

Companies will be required to inform shareholders of any liability limitation agreement they have made with their auditor. Information to be disclosed includes the principal terms of the agreement and the date of the resolution approving the agreement or waiving the need for approval. The method will most usually be by means of a note to the annual accounts.

Is There Any Guidance Available?

The Financial Reporting Council has established an independent working group to produce guidance on the use of liability limitation agreements, including a suggested form of agreement and a process for the implementation of such an agreement. The guidance is currently in draft, and can be found at:

<http://www.frc.org.uk/documents/pagemanager/frc/Auditor%20Liability%20Limitation%20Agreement%20draft%20guidance.pdf>.

Other Changes

New criminal offence in relation to an inaccurate auditor's report

A person will commit an offence if he knowingly or recklessly causes an auditor's report to include any matter that is misleading, false or deceptive in a material particular or if he omits a statement required by the relevant section of the 2006 Act (statements relating to problems with the accounts). (N.B: this is separate from the new liability of directors for false or misleading statements in reports that came into force in January last year). The offence can be committed by an individual auditor (or his employee or agent) or, where the auditor is a firm, a director, member, employee or agent of the audit firm. Guidance will be issued to help avoid adverse consequences when an auditor's behaviour might give rise to both disciplinary action by professional supervisory bodies and to prosecution for the new offence. This will indicate that prosecution should only be used in the most serious cases and there should be specific evidence of recklessness before a prosecution is brought. The new offence applies to audit reports in respect of financial years beginning on or after 6 April 2008.

New right for shareholders of quoted companies to raise questions about the work of auditors

Shareholders of quoted companies can require the company to publish on its website a statement setting out any matter relating to the audit of the company's accounts or the circumstances connected with the auditor ceasing to hold office that they propose to bring up at the next shareholders' meeting. The company is required to publish the statement if it receives requests from shareholders who hold either 5% of the voting rights or are at least 100 in number and hold shares on which there has been paid up an average sum per shareholder of at least £100. A company does not have to publish the statement, if on the application by the company or other aggrieved person, the court is satisfied that the rights conferred are being abused. Where a company is required to publish a statement on its website, it must forward the statement to the auditor not later than the time it puts it on the website.

Changes That Are Already In Force

Don't forget that some changes with respect to the appointment of auditors for private companies are already in force for financial years beginning on or after 1 October 2007. An auditor's term of office will typically run from the end of the 28 day period following circulation of accounts until the end of the corresponding period the following year. This applies even if the auditor is appointed at a meeting where the company's accounts are laid. An auditor is now deemed to be re-appointed unless the company decides otherwise. Finally, members with at least 5% of the voting rights can give notice to the company to prevent an auditor being automatically reappointed. The articles can provide for the requisite percentage of voting rights to be less than 5% but not more.

Contacts

This bulletin reflects the law and practice as at February 2008. It is general in nature, and does not purport in any way to be comprehensive or a substitute for specialist legal advice in individual circumstances.

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