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# D&W | New Company Law

What's Coming Into Force in April 2008?

# New Company Law

## *What's Coming into Force in April 2008?*

### **Introduction**

We have previously reported on all of the key changes introduced by the Companies Act 2006 (the Act). The next major tranche of the Act comes into force on 6 April 2008 and the purpose of this bulletin is to remind readers of the changes coming into force on that date.

There are new measures to limit the liability of auditors, improve the transparency and quality of the audit process and provide members, creditors and regulators with better access to information in relation to audits.

The law governing annual accounts and reports is also restated and amended, with the detailed reporting requirements that apply to these documents for financial years beginning on or after 6 April 2008 set out in the Act and new associated regulations. Another new requirement in the Act means that directors must not approve the accounts unless they are satisfied that they give a 'true and fair' view of the financial position of the company.

The timeframes within which companies are required to file the accounts and reports at Companies House are reduced by one month for both private and public companies. Quoted companies (which include companies quoted on the main market of the London Stock Exchange but not on the AIM or PLUS markets) have been under an existing obligation to publish their accounts and reports within 4 months.

The Act also introduces important deregulatory measures. Companies can execute any document (including a deed) by the signature of one director in the presence of a witness who must also sign. Private companies are no longer required to have a company secretary unless they wish to.

The Government has also taken the opportunity to clarify the law in key areas.

There are new rules governing the transfer of non-cash assets within groups of companies, which remove the uncertainty faced by companies in recent years and should make it easier for many companies carrying out reorganisations after 6 April 2008. The Act restates the existing prohibition on private companies offering shares or debentures to the public but has removed the criminal sanctions for breach.

Companies have new powers to restrict and contest the disclosure of information requested by third parties relating to interests in a company's shares and the register of debenture-holders. There are also new notification obligations placed on directors that refuse to register a transfer of shares or debentures pursuant to a company's articles of association.

Finally, the Act amends the basic order of priority of payment of expenses on the winding-up of a company, the liquidator's general expenses moving up and having priority over the claims of preferential creditors and floating charge holders.

The rest of this bulletin includes more detail about the changes to company law mentioned above.

### **Auditors**

The key changes affecting auditors set out below will generally take effect for appointments in respect of financial years beginning on or after 6 April 2008.

#### *Limitation of liability*

The Act permits an auditor to limit its liability to a company for negligence, default, breach of duty and breach of trust in relation to the audit of the company's accounts by entering into a fair and reasonable 'liability limitation agreement' (LLA) with the company for a specified financial year.

A majority of the company's members must authorise the LLA each year (although it is possible to specify a higher threshold in the articles of association). The existence of the LLA must be disclosed in the annual accounts or directors' report.

The members of a company can approve the LLA either before, or after, the LLA is entered into by the company and its auditor. The members of a private company can also opt to waive the need for such approval. It is also possible for the members to withdraw their authorisation to an LLA by passing a resolution requiring a majority vote, either prior to the company actually entering into the LLA or, where the company has already entered into it, before the beginning of the financial year to which the LLA relates.

An LLA could be ineffective if the liability of the auditors is limited to such an extent that it would result in the company recovering less than an amount which would be fair and reasonable, having regard to: the kind of acts or omissions covered; the nature and purpose of the auditor's contractual obligations to the company; and the professional standards expected of the auditors. The Secretary of State has powers to insist on the inclusion of specified provisions in an LLA. The Courts also have powers to raise the limit in an LLA to such an amount as is considered fair and reasonable.

### *Criminal liability for false or misleading audit reports*

Although the Act permits an auditor to limit its civil liability to a company in a limitation liability agreement, it imposes a new criminal offence on an auditor, punishable by a fine, of knowingly or recklessly including false, deceptive or misleading information in an audit report (or omitting important statements required by the Act relating to any problems with the accounts). The offence can be committed by any qualified member of the audit team.

### *Signature of audit report by an individual*

The Act requires an audit report prepared by a firm of auditors to be signed by an

individual in his or her own name, albeit for and on behalf of the firm. The individual, referred to in the Act as the 'senior statutory auditor', will usually be the lead audit partner. The signing of the audit report by the senior statutory auditor will not, of itself, affect his or her exposure to liability in any way.

If the disclosure of the senior statutory auditor's name on an audit report might expose him or her to violence or intimidation from aggrieved third parties, the company can apply for an exemption from this new requirement if certain procedures set out in the Act are followed (including obtaining the approval of members).

### *Greater disclosure on ceasing to hold office*

The Act changes the existing rules governing the statement that an auditor is required to give upon leaving office before the end of the relevant term.

The auditor of a *quoted* company (including companies quoted on the main market of the London Stock Exchange but not those on the AIM or PLUS markets) *must* disclose the circumstances surrounding resignation or dismissal in a statement which must be sent to the company's registered office, Companies House and a designated audit authority (the Financial Reporting Council's Professional Oversight Board). The quoted company must then circulate the statement to all members and others entitled to receive the annual accounts to enable them to understand the reasons for the auditor ceasing to hold office. The timing of these obligations will vary, depending on whether or not the quoted company makes an application to the Court challenging the auditor's statement.

The auditor of an *unquoted* company (including private companies, unlisted public companies and companies trading on AIM) faces similar obligations to disclose the circumstances surrounding resignation or dismissal but, where appropriate, has the *alternative* option of depositing a statement at the company's registered office to the effect that there are no circumstances which

need to be brought to the attention of the members or creditors. If an auditor chooses to make use of that option, it must nevertheless inform the designated audit authority of the reasons for leaving. Failure to do so is an offence, punishable by fine.

### *Company to notify regulators on auditor ceasing to hold office*

The Act also imposes new obligations on a company to notify the designated audit authority if the auditor resigns or is dismissed before the end of his term. For certain companies, the notice must be accompanied by the auditor's statement of the circumstances surrounding resignation or dismissal. This will be the case for all quoted companies and those unquoted companies that choose to provide such a statement. For unquoted companies choosing not to provide a statement of the circumstances surrounding resignation or dismissal, the notice to the designated audit authority must be accompanied by a general statement from the *company* explaining the reasons for the auditor ceasing to hold office.

There are also new obligations on the designated audit authority to refer any notification given to it by a company to a relevant accounting authority (the Financial Reporting Council's Financial Reporting Review Panel), which will inevitably result in the accounts of the company coming under greater scrutiny.

### *Website publication of audit concerns by quoted companies*

Members of a quoted company have a new right to require the company to publish on its website any questions or statements of concern regarding the audit of the company's accounts, or the circumstances connected with the auditors ceasing to hold office, until such matters are raised at the next general meeting at which the annual accounts and reports are considered.

A company must publish a relevant question or statement on its website if requested by members holding 5% of the voting rights (or by one hundred members holding shares on

which there has been paid up an average sum per shareholder of at least £100). The request and accompanying statement must be received by a company at least one week before the meeting to which it relates. The company must publish the statement on its website within three days of the request and at the same time, send a copy of the statement to its auditor. The statement must remain available on the company's website until the meeting to which it relates.

## **Accounts and reports**

As previously reported, a few key provisions in the Act concerning accounts and reports were brought into force at the beginning of October 2007. Most notably, important changes were made to the content requirements of the 'business review' part of the annual directors' report, obliging companies (other than those designated by the Act as 'small' companies) to show how their directors have complied with the new duty to 'promote the success' of the company for the benefit of the members. Quoted companies are obliged to provide investors with additional forward-looking information.

The Act restates and amends the existing law governing accounts and reports, and the provisions set out below generally take effect for financial years commencing on or after 6 April 2008.

### *Content*

The Act and associated regulations (*The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* and *the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008*) set out the detailed reporting requirements that now apply to accounts and reports for financial years beginning on or after 6 April 2008.

### *Filing and circulation*

Private companies are no longer required to hold a general meeting at which the annual accounts and reports are placed before the members. However, private companies must

file the accounts and reports at Companies House within a new reduced period of 9 months from the end of the relevant accounting period (instead of the previous 10 month period). Copies of the accounts and reports must also be circulated to members and others entitled to receive them by the deadline for delivery to Companies House or, if earlier, the date that they are delivered to Companies House.

Public companies must continue to lay their accounts and reports before the members in general meeting, and the documents must now be filed at Companies House within a new reduced period of 6 months from the end of the relevant accounting period (instead of the previous 7 month period).

Companies quoted on the main market of the London Stock Exchange are under an existing obligation to publish annual accounts and reports within 4 months of their year end because of the requirements of the Disclosure and Transparency Rules of the Financial Services Authority.

### *Website publication of quoted company accounts and reports*

A quoted company must publish the preliminary announcement of annual results (if prepared) and the full annual report and accounts on its website. The preliminary results must remain available until the full accounts and reports are published, which must remain available until the following year's accounts are published.

### *Approval of accounts by directors*

The directors of any company must not approve the accounts unless they are satisfied that they give a 'true and fair' view of the assets, liabilities, profit, loss and other aspects of the financial position of the company (and in the case of group accounts, the undertakings included in the consolidation as a whole) so far as concerns the members of the company.

### **Company secretaries**

Private companies no longer need to have a

company secretary unless they choose to, or are specifically required to do so by their existing articles of association. Consequently, a private company with articles requiring the appointment of a company secretary must first amend those articles before taking advantage of the new law.

A private company choosing not to appoint a company secretary should review its internal procedures as the time-honoured duties of the secretary to maintain company registers and file documents at Companies House pass to the directors, with penalties for non-compliance. Consequently, many private companies will continue to appoint a company secretary who will enjoy the same rights and responsibilities under the Act as at present.

Public companies must continue to appoint a person with the prescribed qualifications as company secretary.

### **Execution of documents**

The Act permits companies to execute documents (including deeds) by the signature of one director in the presence of a witness who must also sign. The witness does not necessarily have to be another director or the company secretary, or even a person connected with the company. This should make life easier for many companies, particularly those wishing to dispense with the appointment of a company secretary. The new method for executing documents is in addition to the existing methods of execution (for example, by the signature of two directors or a director and a secretary, or by affixing a company's common seal to the document).

### **Distributions arising from intra-group transfers**

Companies that have carried out reorganisations in recent years by transferring non-cash assets within their groups at less than market value have faced uncertainty over the legality of such transfers. The effect of case law in this area is that a company without *any* distributable profits that transfers a non-cash asset to a

shareholder in its group at less than market value is regarded as having made an unlawful distribution. Other existing common law principles require a company transferring a non-cash asset to a shareholder within its group at 'book value' to have sufficient profits available for distribution to cover the *full difference* between the book value and the market value of the asset.

The Act includes new rules that override the common law principles and make it easier for a company to determine the value at which it can transfer a non-cash asset within its group.

The new rules have the effect of clarifying that a company which has profits available for distribution can lawfully transfer a non-cash asset to a shareholder in its group at a value calculated by reference to the asset's 'book value' rather than its market value. If the consideration received by the transferring company for the non-cash asset is equal to or exceeds the book value of the asset, the amount of the distribution arising from the transfer is treated as being zero and the distribution is considered to be lawful. Alternatively, if the asset is transferred at less than book value, the amount of the distribution is equal to the difference between the book value and the consideration received, in which case the transferring company must have sufficient distributable profits to cover the difference if the distribution is to be lawful.

### **Public offers of securities by private companies**

The existing law prohibiting a private company from offering shares, debentures or other securities to the public is largely restated in the Act. However, a private company will no longer commit a criminal offence if it offers securities to the public. Instead, the Court can compel a company in breach to re-register as a public company or even grant an order for the compulsory winding up of the company.

The Act permits a private company to offer securities to the public in limited

circumstances, for example, where the offer is made as part of arrangements under which the company re-registers as a public company before the securities are allotted, or where the company undertakes to re-register as a public company within six months under the terms of the offer.

### **Restricting access to information**

The Act gives companies new powers to restrict and contest the disclosure of information requested by anyone about interests in a company's shares and the register of debenture-holders. This reflects increasing concern amongst many companies that information requested by, and supplied to, third parties is used for improper purposes.

#### *Information about interests in a company's shares*

The Act includes new rules governing the inspection of the register of interests in a company's shares and the disclosures anyone wishing to undertake an inspection must first make to the company to be allowed to do so (including the purpose of the inspection). Anyone who is refused access to the relevant information may apply to the Court in an effort to overturn a company's refusal.

#### *Information about the register of debentures*

There are new rules governing the inspection of the register of debenture-holders which are designed to restrict the disclosure of information on the register. Anyone making a request to inspect or obtain a copy of the register of debenture holders must also provide certain information in the request, including the purpose for which the information is to be used. There is also a new right for a company to apply to the Court to release it from the obligation to allow inspection of the register, or to provide a copy of the register where the request has been made for an improper purpose.

### **Transfer of securities**

The existing law governing the certification and transfer of securities is largely restated

in the Act. However, the Act imposes a new statutory obligation on directors refusing to register a transfer of shares in a company pursuant to the company's articles of association. In such cases, the directors must give the relevant person (the transferee) notice of the refusal to register and the reasons for such refusal as soon as practicable, and at the latest, within 2 months of the transfer being lodged. In a similar vein, there is also a new requirement on a company that refuses to register a transfer of a debenture to provide the transferee with reasons for such refusal.

### **Payment of expenses on winding up**

The Act has the effect of amending the basic order of priority of payment of expenses on a winding-up of a company. The liquidator's general expenses associated with the winding-up will, after 6 April 2008, usually move up the order and have priority over the claims of preferential creditors and floating charge holders. This reverses the effect of a

contentious case law decision, which has caused uncertainty in this area in recent years.

### **Other provisions**

The Act restates the existing law governing arrangements and reconstructions. The law relating to mergers and divisions of public companies is also re-stated without change.

### **Further information**

We will, in subsequent bulletins, remind and update readers about the changes to company law set to be brought into force by the penultimate and final implementation phases of the Act on 1 October 2008 and 1 October 2009.

The full implementation timetable for the Act is available on the website of the Department for Business, Enterprise and Regulatory Reform at [www.berr.gov.uk](http://www.berr.gov.uk).

This bulletin is correct to the best of our knowledge and belief at the time of going to press. It is however written as a general guide, so it is recommended that specific professional advice is sought before any action is taken. We are required by law to protect personal data.

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If you have any questions or wish to arrange a dedicated training session on the matters addressed in this bulletin, please call the person at D&W with whom you normally liaise, or Shan Shori, Head of Corporate Know How.

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