These notes refer to the Companies (Audit, Investigations and Community Enterprise) Act 2004 (c.27) which received Royal Assent on 28 October 2004

COMPANIES (AUDIT, INVESTIGATIONS AND COMMUNITY ENTERPRISE) ACT 2004

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 1: Auditors, Accounts, Directors' Liabilities and Investigations
Chapter 1: Auditors

Summary and Background

13. The provisions in this Chapter amend the statutory framework for the regulation of auditors, as provided for in the Companies Act 1989. Under this framework, a company auditor must be a member of a recognised supervisory body and hold a recognised professional qualification. A professional accountancy body may act as a recognised supervisory body and/or offer a recognised professional qualification where it has been so recognised by the Secretary of State. The Secretary of State also has the power to recognise appropriate overseas qualifications as equivalent to a UK recognised professional qualification.

14. Five bodies are currently recognised by the Secretary of State as recognised supervisory bodies: the Institute of Chartered Accountants in England and Wales (ICAEW); the Institute of Chartered Accountants of Scotland (ICAS); the Association of Chartered Certified Accountants (ACCA); the Institute of Chartered Accountants in Ireland (ICAI); and the Association of Authorised Public Accountants.

15. Five bodies are currently recognised by the Secretary of State as offering recognised professional qualifications: the ICAEW; ICAS; ACCA; ICAI; and the Association of International Accountants.

16. The recognised supervisory bodies have day to day responsibility for ensuring the appropriate supervision of auditors and audit firms. The detailed requirements which they must observe in carrying out this supervision role are set out in Part 2 of Schedule 11 to the Companies Act 1989.

17. The provisions in this Chapter amend that Schedule by placing new requirements on the recognised supervisory bodies. The new requirements are designed principally to ensure the independence of the regulation of major public interest audit work, and to permit delegation of the Secretary of State's powers under Part 2 of the Companies Act 1989 (principally the power to recognise accountancy bodies as recognised supervisory bodies for auditors) to a wider category of persons than before.

18. Also relevant to the structure and funding of audit regulation are provisions in Chapter 2 which replace the Secretary of State's grant-making power in section 256(3) of the Companies Act 1985 with a new power which enables the Secretary of State to make grants in respect of a wider range of activities relating to financial reporting and administration. Previously, section 256(3) has enabled the Secretary of State to make grants for the issuing or enforcement of accounting standards or for overseeing or directing such activity. This power has been used to fund in part the activities of the FRC

(Financial Reporting Council) and its two associated Boards, the ASB (Accounting Standards Board) and the FRRP (Financial Reporting Review Panel). The extension to the power will enable grants to be made for the new activities that the FRC is taking on.

19. In accordance with the recommendations contained in the Government's report on its review of the regulatory regime of the accountancy profession, published in January 2003, the FRC has taken on the functions of the Accountancy Foundation Ltd (which was set up to provide non-statutory independent regulation of the accountancy profession in the UK). The new FRC includes five Boards formed by subsidiary companies of the FRC. These Boards have three main areas of responsibility:

- the setting of accounting and audit standards (through the ASB and the Auditing Practices Board (APB));
- their enforcement or monitoring (through the FRRP, the Accountancy Investigation and Discipline Board (AIDB), and the new audit inspection unit reporting to the Professional Oversight Board for Accountancy (POBA)); and
- the oversight of the major professional accountancy bodies (through the POBA).

20. Other provisions in Chapter 2 will enable the Secretary of State to impose a levy on bodies or persons towards the costs of a designated body (which the Government envisages will be the FRC). Currently, the FRC's costs are met by voluntary contributions divided equally between listed companies (collected alongside their listing fees), the accountancy profession and the Government. The levy is expected to be applied to those who currently contribute, should it prove necessary in order to ensure security of funding for the body concerned.

21. In addition, further provisions exempt a body receiving a grant under *section 16* (expected to be the FRC), its subsidiary bodies (currently the ASB, FRRP, APB, AIDB, POBA) and their individual members, officers and staff from liability in damages for things done or not done for the purposes of, or in connection with, the activities listed in*section 16*. That list essentially covers all the regulatory activities of the FRC and its subsidiaries.

Recognised supervisory bodies

Sections 1 and 2 - Additional requirements for recognition of supervisory bodies; arrangements to which additional requirements for recognition relate

22. *Section 1* amends Part 2 of Schedule 11 to the Companies Act 1989, which sets out the requirements that accountancy bodies must meet in order to be recognised as supervisory bodies for auditors. Specifically, the section places new requirements on the recognised supervisory bodies by making it a condition of recognition that they participate in independent arrangements for:

- the setting of auditing standards relating to professional integrity and independence (*subsection (2)*) and the setting of technical standards (*subsection (3)*);
- the monitoring of audits of listed companies and other companies whose financial condition is of particular importance (*subsection (4)*); and
- the investigation and taking of disciplinary action in relation to public interest cases (*subsection (5)*).

23. *Section 2* inserts a *new Part 3* into Schedule 11 to the Companies Act 1989. The new Part sets out the criteria which must be met by the independent standard setting, monitoring and disciplinary arrangements. The section seeks to ensure the independence of these arrangements by providing (in *new paragraph 21 of Schedule 11*) that the recognised supervisory bodies cannot be involved in the selection and appointment of those who carry out the standard setting (*new paragraphs 17* and*18*), monitoring (*new paragraph*

19) and disciplinary functions (*new paragraph 20*), nor can they be involved in the carrying out of those functions. *New paragraph 20* also provides for transparency in the disciplinary arrangements by requiring that independent disciplinary hearings must be held in public, unless that would not be in the interests of justice.

24. The practical effect of these sections is to make the recognised supervisory bodies subject to a more independent regulatory regime in respect of the setting, monitoring and enforcement of auditing standards.

Delegation of Secretary of State's functions in relation to auditors

Sections 3 to 5 - Delegation of functions by Secretary of State to new or existing body; circumstances in which Secretary of State may delegate functions to existing body; supplementary provisions about delegation orders

25. Section 46 of the Companies Act 1989 empowers the Secretary of State to establish a body corporate to exercise her powers relating to company auditors and the recognition of bodies which supervise auditors and/or provide a professional qualification; and Schedule 13 sets out a number of supplementary provisions relating to the delegation of those functions. But section 46 does not allow the Secretary of State to delegate her functions to anyone other than a body corporate actually established by the delegation order. The policy of the Government is that the functions should be delegated to the POBA, which has been set up within the FRC structure. To achieve this policy aim, these sections enable the powers to be delegated to a body other than one created by the delegation order.

26. *Section 3* amends section 46 of the Companies Act 1989 to allow the Secretary of State to delegate her functions not only to a body created by delegation order under section 46 but also to an existing body - which can be either a body corporate or an unincorporated association - provided certain requirements are satisfied.

27. *Section 4* inserts a *new section 46A* into the Companies Act 1989. The new section sets out the circumstances in which the Secretary of State may delegate functions to an existing body. *New subsection (2)* provides that the body to whom the functions are to be delegated must be willing and able to exercise the functions and must meet certain other conditions set out in *new subsection (3)*. *New subsection (5)* deals with the case of a body that has (non-statutory) functions relating to arrangements in which recognised supervisory bodies may participate in order to meet the new criteria for recognition introduced by *sections 1* and *2*. Under this subsection, such a body may also exercise the delegated functions of the Secretary of State. The aim of this provision is to ensure that the POBA (which is expected to be the body to be designated by the first delegation order, provided it fulfils the requirements for designation) is not precluded from exercising any delegated function (for example, recognition of a supervisory body) on the basis of its involvement with the monitoring, investigation or disciplinary arrangements set out in *section 2*.

28. *Section 5* amends Schedule 13 to the Companies Act 1989 to reflect the extension of the delegation power in amended section 46. Essentially, this section specifies which provisions in Schedule 13 apply to a body created by the delegation order and which apply to an existing body. *Subsection (5)* provides that where the body is an unincorporated association (as the POBA will be), any proceedings brought in connection with the exercise of the delegated functions by the body may be brought in the name of the body corporate whose constitution provides for the establishment of the association - this would be the POBA Ltd.

Auditors' qualifications

Section 6 – Approval of overseas qualifications for auditors

29. This amendment of section 33 of the Companies Act 1989 is designed to improve the operation of the Secretary of State's power to approve overseas qualifications. It is intended that this power, together with other functions under Part 2 of the Companies Act 1989, will be delegated to an independent regulator under section 46 of that Act as amended by *section 3*.

30. Section 33 of the Companies Act 1989 allows the Secretary of State to recognise overseas qualifications as equivalent in the UK. Before its amendment by *section* 6, it was only possible to recognise either all or none of the people who held a particular overseas qualification (for example, all those who held a particular accounting diploma). However, there are circumstances where it would in fact be appropriate to recognise some but not all of those people. For example, where an overseas qualification originally fell below the criteria for approval in section 33 but was subsequently changed so that it met those criteria, the Secretary of State may wish to recognise the qualification, provided that it was gained after the date when the change was made. Similarly, where different combinations of learning modules and examinations offer alternative routes to the same qualification, the Secretary of State may wish to recognise the qualification, provided that the audit-related modules and examinations have been undertaken.

31. The unamended section 33 did not allow the Secretary of State to do either of these things and she therefore had to refuse recognition to the qualification as a whole. *Section 6* amends section 33 to remedy this, by providing that persons who hold a specified professional qualification *and meet other specific requirements* may be regarded as holding an approved overseas qualification.

Services provided by auditors

Section 7 - Disclosure of services provided by auditors and related remuneration

32. *Section 7* replaces sections 390A(3) and 390B of the Companies Act 1985 with a *new section 390B* and makes a number of related amendments to the Act. The purpose of this section is to enable the Secretary of State, by regulations, to require companies to publish more information about the types of services they and their associates have purchased from their auditors and their associates. Section 390B in its previous form gave the Secretary of State power to require companies to disclose the total value of their non-audit services (that is to say, services not related to the audit which an auditor provides to the company it is auditing). Under previous section 390A(3) companies were required to disclose the amount of remuneration paid for audit services. The effect of this section is to widen the Secretary of State's regulation-making power, so that regulations can also require disclosure differentiating between audit and non-audit services and between different types of non-audit service, with a breakdown of the costs of each. Examples of non-audit services include tax advice, valuations, actuarial work, litigation support , IT and legal advice.

33. The aim is to address concerns about possible conflicts of interest between the audit firm in its role as auditor and in its role as provider of other services to the company. More detailed disclosure requirements should allow stakeholders and others to identify particular features of the company/auditor relationship that may raise concerns over the auditor's independence.

34. *Subsection (1)* replaces existing section 390B of the Companies Act 1985.

35. *Subsection (1)* of *new section 390B* enables the Secretary of State to make regulations requiring disclosure by companies of (a) the nature of the services provided to a company by its auditors and their associates, and (b) the amount of remuneration to

be paid for those services. The effect of *new subsection (1)* is also to replace existing section 390A(3) which, under *subsection (2)(a)* of *section 7*, ceases to have effect.

36. *Subsection (2)* of *new section 390B* enables regulations under *new subsection (1)* to be flexible in how they classify the services provided by auditors and their associates for which disclosure is required. The effect, for example, is that the regulations could differentiate between a particular service which was considered so important that it should be disclosed separately (no matter how relatively small the amount paid for it) and other services considered less important from the perspective of ensuring auditor independence and which would thus not require separate identification at all, or not below a certain amount. The subsection also enables the audit or non-audit fees to be broken down so that, for example, it will be possible to require separate disclosure of amounts paid in respect of tax advice by each company in a group or an aggregate figure for tax advice for the group as a whole.

37. *Subsection (3)* of *new section 390B* provides further powers to require disclosure of auditors' remuneration to include "expenses", benefits in kind, and services provided to associates of the company; and to define what is meant by "associate" of an auditor or a company.

38. *Subsection (3)(d)* enables disclosure to be required in the case of services provided to "associates" of a company. This enables the broadening of the definition of an "associated undertaking" of a company contained in Regulation 2 of the Companies Act 1985 (Disclosure of Remuneration for Non-Audit Work) Regulations 1991 (SI 1991/2128). will mean that services provided, for example, to pension funds (which are not "undertakings") may be included in the regulations, as part of any disclosure.

39. *Subsection (4)* of *new section 390B* is concerned with the location of the required disclosures. Previously, the disclosure of audit services required by section 390A(3) had to be made in the notes to the company's individual or group accounts; and disclosures of non-audit services required by regulations under previous section 390B could be required to be made in the auditors' report or in the notes to the company's individual or group accounts. *Subsection (4)* is drafted flexibly to allow the regulations to require the disclosure to be made in the notes to the company's individual or group accounts; in the directors' report; or in the auditors' report.

40. Under *subsection (5)* of *new section 390B*, if directors are required by the regulations to make the disclosures in the notes to the accounts or the directors' report, the regulations may also require the auditors to supply the directors with any information necessary to enable them to make the disclosure. This re-enacts the latter part of the previous section 390B(3). In addition, *new subsections (5)(b)* and *(6)* enable the regulations to apply, as appropriate, the criminal penalties in sections 233(5) (approval of defective annual accounts) and 234(5) (preparation of defective directors' report) of the Companies Act 1985. They also enable the existing administrative arrangements under sections 245 to 245C of the Act on the voluntary revision, or compulsory revision through application to the court, of accounts and reports to be applied. Non-compliance by an auditor with the requirement to supply the directors with the information they need will be dealt with by disciplinary action by the relevant supervisory body.

41. *Subsection (7)* of *new section 390B* re-enacts previous section 390B(4). It enables the regulations to differentiate, for example, between larger and smaller companies. It is not currently intended to apply the detailed disclosure requirements for non-audit services to companies qualifying as small or medium-sized (SMEs) under the 1985 Act. SMEs will, however, have to continue to disclose the audit fee itself where relevant. In January 2004 the Government increased the qualifying conditions for SMEs for company law purposes. To qualify as an SME, a company must satisfy two or more of the following requirements: turnover of not more than £22.8 million; balance sheet total of not more than £11.4 million; and no more than 250 employees.

42. *Subsection (2)(a) and (3)* of *section 7* repeal the provisions in section 390A and in Schedule 4A of the Companies Act 1985 relating to disclosure of remuneration for audit services, so that all the requirements relating to disclosures about services provided by auditors are located in one place under the *new section 390B. Subsection (2)(b)* updates the reference to "payments in cash" in section 390A(5), by changing it to "payments of money".

Chapter 2: Accounts and Reports

Auditing of accounts

43. The purpose of*sections 8* and *9* is to strengthen the rights of company auditors, by entitling them to require information and explanations from a wider group of people than previously; and by requiring the directors' report to contain a statement that the directors are not aware of relevant information which has not been disclosed to the company's auditors.

Section 8 - Auditors' rights to information

44. Under previous legislation (section 389A of the Companies Act 1985) a company's auditors were entitled to require from the company's officers such information and explanations as they thought necessary for the performance of their duties as auditors. It was a criminal offence for an officer of the company to provide misleading, false or deceptive information or explanations. However, it was not an offence for them to fail to provide any information or explanation that the auditors required of them.

45. This section is intended to help auditors to carry out their duties by strengthening their right to require information or explanations, with the aim of increasing the reliability of, and confidence in, company accounts.

46. It does this in two ways:

- it entitles the auditor to require information and explanations from a wider group of people. Specifically, it reflects a recommendation in the Company Law Review that those required to provide information and explanations to auditors should include employees (*Modern Company Law for a Competitive Economy*, Final Report July 2001, URN 01/942, paragraph 8.119 first bullet);
- it makes it a criminal offence to fail to provide information or explanations required by the auditor.

47. *Section 8* substitutes *new sections 389A* and *389B* for the previous section 389A in the Companies Act 1985.

48. In *new section 389A*, *subsections (1)* and *(2)*:

- re-enact the auditor's right to access relevant material; and
- add to the category of people from whom the auditor may require information. Auditors previously had the right to require "officers" of the company (which includes directors, managers and company secretaries) to provide information and explanations necessary for their work. However, others, in particular employees who are not "managers", may hold relevant information. Those to whom the requirement to provide information applies are set out in *subsection (2)*.

49. *Subsections (3)-(5)* in *new section 389A* re-enact previous provisions dealing with information and explanations concerning non-GB subsidiaries, extended to include employees and certain others. It is neither desirable nor effective to place a direct responsibility on a non-GB subsidiary and those associated with it to give information and explanations to a UK auditor. The responsibility is therefore placed on the parent

company to do what is reasonable to obtain the required information and explanations from the subsidiaries.

50. *New section 389B* sets out criminal offences relating to the provision of information to auditors. *Subsection (1)* re-enacts the previous offence in section 389A(2) of the Companies Act 1985 of providing false or misleading information or explanations to an auditor. The subsection also applies this offence to the new categories of people from whom the auditor may require information under *new section 389A*.

51. There has previously been no criminal sanction where an officer of the company is required to give information but fails to do so altogether. *Subsection (2)* of *new section 389B* therefore introduces a new criminal offence for such a failure by an officer of the company or by the other persons from whom the auditor is entitled to require information or explanations.

52. *Subsection (3)* of *new section 389B* provides a person with a defence if he can prove that it was not reasonably practicable to provide the information or explanations required. *Subsection (4)* makes it an offence for a parent company to fail to take all steps reasonably open to it to obtain the information or explanations which the auditor has required it to obtain from its non-GB subsidiary and those associated with it; and the offence applies also to any officer of the company who knowingly and wilfully authorises or permits the failure.

Section 9 - Statement in directors' report as to disclosure of information to auditors

53. *Section 9* complements the auditors' rights to information provided by *section 8*. It requires the directors' report to contain a statement that so far as each director is aware, there is no relevant audit information of which the auditors are unaware; and that the director has taken all the steps he should have taken as a director to make himself aware of such information and to establish that the auditors are aware of it.

54. The aim of *section 9* is to ensure that each director will have to think hard about whether there is any information that he knows about or could ascertain which is needed by the auditors in connection with preparing their report. This derives from a recommendation in the Company Law Review (*Modern Company Law for a Competitive Economy*, Final Report July 2001, URN 01/942, paragraph 8.119 second bullet) that directors should be required to volunteer information to the auditors in certain circumstances.

55. *Subsection (2)* establishes the basic requirement for the new statement in the directors' report. It applies to all companies whose accounts have been subject to a statutory audit for that financial year. Under the law as amended by the Companies Act 1985 (Accounts of Small and Medium-Sized Enterprises and Audit Exemption) (Amendment) Regulations 2004 (SI 2004/16), most small companies with a turnover of £5.6 million or less and a balance sheet total of £2.8 million or less are exempt from the requirement to have their accounts audited.

56. *Subsection (3)* inserts a new section 234ZA into the Companies Act 1985. This sets out the content of the statement. The statement must confirm that each individual director is not aware of any relevant audit information of which the auditors are unaware (*new section 234ZA(2)(a)*); and that each individual director has taken steps to ascertain relevant audit information and establish whether the auditors are aware of it (*new section 234ZA(2)(b)*). Taken with *new sections 234ZA(4)* and *(5)*, *new section 234ZA(2)(b)* provides that the steps which the statement confirms have been taken by each director to make himself aware of relevant audit information and to ascertain the auditors' awareness of it are those required by the directors' existing common law duty to exercise due care, skill and diligence. *New section 234ZA(3)* defines "relevant audit information."

57. *New section 234ZA(6)* sets out the offence and sanctions that apply if a false statement is made. (If the statement is not made at all, the existing offence in section 234(5) of the

1985 Act - failure to comply with the provisions of Part 7 of the Act as to the contents of the directors' report - will apply.) The offence applies to each individual director who knew that the statement was false, or was reckless as to whether it was false, and who did not take reasonable steps to prevent the report from being approved. A person found guilty on indictment will be liable to imprisonment for up to two years and/or an unlimited fine, and on summary conviction to up to twelve months' imprisonment and/ or a fine up to the statutory maximum (£5,000).

Defective accounts

Summary and background

58. *Sections 10-12* with *sections 14 and 15* deal with the enforcement of accounting requirements. They strengthen the role of the person authorised under section 245C of the Companies Act 1985 to apply to the court to order a company to revise its accounts. The person currently authorised is the FRRP. The statutory role of the Secretary of State or the authorised person has previously been restricted to examining companies' annual accounts and applying to the courts to order their revision as necessary. *Sections 10-12* and *14* and *15* enhance this regime in a number of ways: by (a) providing for a prescribed body (which will be the FRRP) to be appointed to monitor aspects of accounts or reports required under Listing Rules, such as interim financial statements; (b) providing for the authorised person and the prescribed body (the FRRP in both cases) to have a power to obtain information in order to carry out their functions; (c) opening an information gateway from the Inland Revenue to the FRRP.

59. In future the "Review Panel" (a body formed under the constitution of the FRRP) will be authorised under section 245C and also appointed under*section 14* to monitor aspects of accounts or reports required under Listing Rules. It is not envisaged that any other person or body is likely to be authorised or appointed. For that reason these notes refer to the FRRP or the Review Panel of the FRRP throughout, although the legislation itself does not name the FRRP.

60. Strengthening the role of the FRRP was a key recommendation of the Coordinating Group on Audit and Accounting Issues, one of the reviews set up by the Government in response to the financial reporting scandals in the US at companies such as Enron. The Group reported to the Government in January 2003. The changes to the role of the FRRP also need to be seen in the context of overall changes to the Financial Reporting Council Ltd and its associated companies, of which the FRRP is one.

Section 10 - Persons authorised to apply to court in connection with defective accounts

61. *Section 10* makes certain changes to section 245C of the Companies Act 1985 in relation to an order authorising a person to apply to the court to correct defective accounts. The person currently authorised under section 245C is the Financial Reporting Review Panel Ltd. It is expected that the person who will be authorised under *section 10* will be the Review Panel of the FRRP. Unlike the FRRP Ltd, the Review Panel is not an incorporated body but is formed under the constitution of the FRRP. *Section 10* provides that where the authorised person is an unincorporated association (as the Review Panel will be), any proceedings brought in connection with the exercise of its functions may be brought in the name of the body corporate whose constitution provides for its establishment . This means, for example, that the Review Panel may bring proceedings in the name of the FRRP Ltd. *Section 10* also makes alterations to the authorisation power under section 245C to allow the Secretary of State, if she considers it appropriate, to prescribe how the authorised person will exercise its functions.

Section 11 - Disclosure of tax information by Inland Revenue to facilitate application for declaration that accounts are defective

62. This section provides for the passage of information from the Inland Revenue (IR) to a person authorised under section 245C of the Companies Act 1985 and makes equivalent provision in Northern Ireland. That person is currently the FRRP. It adds new sections and Articles after section 245C of the Companies Act 1985 and Article 253C of the Companies (Northern Ireland) Order 1986. The new provisions permit the disclosure of information by the IR to a person authorised, under section 245C of the Companies Act 1985 and Article 253C of the 1986 Order, to apply to the court for a declaration that a company's accounts do not comply with the legislation in question. They also provide restrictions on use and further disclosure of the information.

63. *Subsection (1): 245D - Disclosure of information held by Inland Revenue to persons authorised to apply to court.* This subsection adds a *new section 245D* after section 245C of the Companies Act 1985, permitting the Inland Revenue to pass information to the authorised person if the disclosure is made for a permitted purpose. *Subsection (3)* of *new section 245D* defines what counts as a permitted purpose: to enable the authorised person to discover whether there are grounds for an application to the court, or to determine whether or not to make such an application. *Subsection (2)(b)* of *new section 245D* provides that personal data may not be disclosed in contravention of the Data Protection Act 1998. Under *subsection (4)* the Inland Revenue Commissioners may delegate the power to authorise disclosure to an officer of the Board of Inland Revenue.

64. *Subsection (1): 245E - Restrictions on use and further disclosure of information disclosed under section 245D. Subsection (1)* also adds a *new section 245E* to the Companies Act 1985, which places restrictions on the uses to which disclosed information may be put; and on further disclosure by the authorised person. Under *subsection (1)* of *new section 245E*, the uses to which the information may be put are to enable the authorised person to discover whether there are grounds for an application to the court, to determine whether or not to make such an application, and in proceedings on any such application.

65. *Subsection (2)* of *new section 245E* prevents information being disclosed by the authorised person to anyone else, except to the person to whom the information relates, or in connection with court proceedings. *Subsection (3)* of *new section 245E* makes it a criminal offence to breach the restrictions on use or further disclosure set out in *subsections (1)* and *(2)*, and should be read in conjunction with the amendments in *paragraph 10(3)* of *Schedule 2*, to Schedule 24 of the Companies Act 1985. A person guilty of use or further disclosure in contravention of the restrictions is liable on summary conviction to imprisonment for a term not exceeding twelve months or a fine not exceeding £5,000, or both; or, on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

66. *Subsection (4)* of *new section 245E* provides a person with a defence if he can prove that he did not know or had no reason to suspect that the information in question had been disclosed under this legislation; or that he took reasonable steps to prevent wrongful use or disclosure.

67. *Subsection (5)* of *new section 245E* applies to offences under *new section 245E*, sections 723, 733(2) and (3) and section 734 of the Companies Act 1985. Section 732 concerns restrictions on the institution of proceedings for offences. Section 733(2) and (3) concern the liability of individuals for corporate defaults. Section 734 makes provision for criminal proceedings against unincorporated bodies.

68. *Subsection (2) 253D - Disclosure of information held by Inland Revenue to persons authorised to apply to court;* and *253E - Restrictions on use and further disclosure of information disclosed under Article 253D. Subsection (2)* inserts, after Article 253C of the Companies (Northern Ireland) Order 1986, two *new Articles 253D and 253E* whose

purpose and effect, in respect of their application in Northern Ireland, are equivalent to that of *new sections 245D* and *245E* discussed above, in respect of Great Britain.

Section 12 - *Power of person authorised to require documents, information and explanations; and Schedule 1* - *New Schedule 7B to the Companies Act 1985*

69. The FRRP (as the person authorised under section 245C of the Companies Act 1985) previously had no power to require a company to provide it with the information it needed to carry out its functions. Hitherto, it relied on the voluntary co-operation of the company in question to provide explanations and documents which were not publicly available.

70. The view of the Government and the FRRP was that with the FRRP moving to a more proactive approach, in which the FRRP would be considering more cases, such co-operation could not be relied on in every instance. Moreover, the Committee of European Securities Regulators has set out a number of key enforcement principles, including that any competent enforcement authority should have adequate powers. *Section 12* therefore provides the FRRP with a statutory power to obtain relevant material.

71. *Subsection (1)* inserts a *new section 245F* into the Companies Act 1985. *Subsections (1)* to *(3)* of this new section provide the FRRP with a statutory power to require a company and its officers, employees and auditors to provide documents and information. The effect of *subsection (1)* is that the FRRP may use its power to obtain information, explanations and documents only when it considers that there is a question as to whether the accounts or reports comply with the relevant requirements relating to that report or those accounts. It will not be able to exercise the powers as part of a random sampling or sector-wide review of accounts where there is no reason to believe there is any particular problem with the accounts of the company in question.

72. The person against whom the power is used must produce any document that the FRRP may reasonably require in relation to such accounts or reports or provide any relevant information that the FRRP may reasonably require. *Subsection (8)* ensures that a "document" can refer to information stored on computer as well as hard copies.

73. Where a person refuses to provide information or documents to the FRRP, the FRRP may apply to the court for an order. The court may make an order requiring disclosure. Failure to comply with such an order would be contempt of court.

74. *Restrictions on further disclosure of information obtained under section 245F*.

A *new section 245G* is also inserted into the Companies Act 1985, ensuring that information obtained by the FRRP under the new powers will be subject to restrictions on onward disclosure. Information may not be disclosed by the FRRP without the consent of the individual or business in question, except for the purposes of carrying out its functions, or unless it is disclosed to specified persons or for specified purposes set out in a *new Schedule 7B* of the Act which is inserted by *Schedule 1*.

75. *New Schedule 7B* sets out the disclosures of information obtained by the authorised person under *new section 245F* which are permitted under *new section 245G*. It lists the specified persons to whom disclosures are permitted and the specified descriptions of disclosures which are permitted. It also sets out the circumstances in which a disclosure to an overseas regulatory authority is permitted. Under *subsection (4) of new section 245G*, the Secretary of State has the power to amend the Schedule. Under *subsection (5)* the Schedule can only be amended to specify persons exercising functions of a public nature or to specify descriptions of disclosure, where the purpose for which the disclosure is permitted is likely to assist in the exercise of a function of a public nature.

76. *Subsection (7)* of *new section 245G* makes it an offence to disclose information in contravention of the new section. A person guilty of such an offence is liable on

conviction on indictment to two years' imprisonment or a fine or both; and on summary conviction to twelve months' imprisonment or a fine. *Subsection (8)* provides a person with a defence if he can prove that he did not know or had no reason to suspect that the information in question had been disclosed under this legislation; or that he took reasonable steps to prevent wrongful use or disclosure.

Directors' reports

Section 13 - Power to specify bodies who may issue reporting standards

77. *Section 13* amends section 257 of the Companies Act 1985 which confers power on the Secretary of State to amend the accounting and audit provisions in Part 7 of the Act. It is primarily intended as a paving device to allow a specified body to issue a standard in relation to a new report, the operating and financial review, which it is proposed to require of directors in due course by regulations under section 257.

78. *New subsection (4A)(a)* inserted by *section 13* into section 257 gives the Secretary of State the power to specify a body to issue standards relating to reports which the directors are required to prepare under Part 7 of the Companies Act 1985. Directors are currently required to prepare a directors' report and, for the directors of a quoted company, the directors' remuneration report. This provision allows standards to be drawn up for these reports, and reports such as the operating and financial review, which are not covered by the "accounting standards" issued by bodies prescribed under section 256 of the Companies Act 1985. Such reporting standards would not have the "true and fair" authority of accounting standards. In order to confer statutory authority, *new subsection (4A)(b)* confers power on the Secretary of State to provide in regulations that compliance with the reporting standards will be presumed, unless the contrary is proved in civil or criminal proceedings for breach of the Act's requirements, to be compliance with the Act's requirements in respect of the report to which it relates.

79. Regulations under section 257 introducing the new requirement for an operating and financial review will be subject to affirmative resolution. *New subsection (4B)* inserted into section 257 stipulates that the order to be made by the Secretary of State specifying the body or bodies authorised to issue the new reporting standards will be subject to negative resolution.

Supervision of accounts and reports

Section 14 – Supervision of periodic accounts and reports of issuers of listed securities

80. *Section 14* provides the Secretary of State with the power to appoint a body (intended to be the Review Panel of the FRRP) to monitor compliance by issuers of listed securities, or certain classes of these issuers, with accounting requirements of the Listing Rules.

81. These rules are made and enforced by the Financial Services Authority (FSA). Under section 74(1) of the Financial Services and Markets Act 2000 (FiSMA), the FSA is required to maintain an official list. Under sections 74(4) and 96 of that Act, the FSA may make Listing Rules governing the admission of securities to the official list and specifying the requirements on companies and other entities which list securities.

82. The section will allow the Government to create a role for the Review Panel in checking the financial information contained in some of the documents which are required to be produced periodically under Listing Rules: namely, the half yearly (interim) report and the annual report. Currently, the FRRP checks the annual reports of Companies Act companies only (it performs a similar function under Northern Ireland companies legislation). The section thus allows the Secretary of State to extend the scope of the FRRP's activities in two directions:

- she may appoint the Review Panel to look at interim reports and any other periodic reports required by Listing Rules, in addition to annual reports;
- she may appoint the Review Panel to look at annual and interim reports of entities which are on the official list but are not Companies Act companies; this covers entities whose securities are listed in the UK but which are not UK companies, such as some UK building societies, as well as overseas companies and other entities. By virtue of *subsection (5)*, the body may be appointed in respect of certain classes of issuer only, and in respect of certain types of reports and accounts. For example, the power could be used to extend the Review Panel's remit to cover the accounts of overseas companies which have a primary listing in the UK, and the accounts of UK issuers which are not companies but which issue equities or domestic debt.

83. The section also allows the FSA to refer individual cases which may not fall within the Review Panel's remit (for example issuers of specialist debt) to the Review Panel for it to review. The FSA would conduct their own assessments and refer cases to the Review Panel only where they identified a risk in respect of the reports and accounts.

84. The section is drafted to allow maximum flexibility in these regards: negotiations in Europe (for example in the Committee of European Securities Regulators, and on the Transparency Directive) and internationally (on international accounting standards) may have an impact on the precise remit which will be set out in the order.

85. The Review Panel's function under this section will be to check that the accounting information contained in the accounts and reports complies with the accounting requirements of the Listing Rules, and to inform the FSA of any conclusions it reaches. The FSA will then decide what further action should be taken, and has a range of sanctions available to it under FiSMA 2000.

86. This will be in addition to the FRRP's existing activities in respect of annual accounts under section 245C of the Companies Act 1985, where the enforcement route is through an application to the court for an order requiring revised accounts.

Section 15 - Application of provisions inserted by sections 11 and 12 to bodies appointed under section 14

87. *Section 15* applies the provisions relating to the disclosure of information by the Inland Revenue in *section 11* to the body appointed under *section 14*. It also applies the provisions concerning the power to obtain documents and information and the restrictions on use of the information so obtained in *section 12* to the body appointed under*section 14*. The effect is that the Review Panel will have the same power, and the same access to IR information, in respect of its activity under*section 14* (checking interim reports and reporting to the FSA) as it will when exercising its remit under section 245C of the Companies Act 1985 (checking annual reports of Companies Act companies).

Bodies concerned with accounting standards etc

Section 16 - Grants to bodies concerned with accounting standards etc

88. Section 256(3) of the Companies Act 1985 allowed the Secretary of State to make grants to bodies concerned with the making and enforcing of accounting standards. The Secretary of State has paid grants under this section in respect of the work of the FRC and its companion bodies, the ASB and the FRRP.

89. Following the FRC's assumption of the functions of the Accountancy Foundation, its annual running costs will be broadly shared by Government, business and the professional accountancy bodies (with the exception of the costs of disciplinary cases, which will continue to fall to the professional accountancy bodies; and the costs of an independent audit inspection unit which will be borne by audit firms).

90. *Section 16* replaces section 256(3) of the Companies Act 1985 to allow the Government to contribute to the funding of any of the activities of a body which carries out the activities specified in *subsection (2)*. It is expected that the FRC will be the body to whom a grant will be made. *Subsection (4)* makes clear that a grant can be paid to a body in respect of activities carried out by its subsidiary, or any body established under the constitution of its subsidiary (such as a Board or a Panel).

Section 17 - Levy to pay expenses of bodies concerned with accounting standards etc

91. *Section 17* gives the Secretary of State the power to make regulations imposing a levy for meeting the costs of any body to whom the Secretary of State has paid or is proposing to pay a grant under *section 16*. The aim of the power is to ensure that the body to whom a grant is made under *section 16* – expected to be the FRC - will have security of funding; and it is anticipated that a levy would only be imposed if the currently voluntary funding arrangement was no longer viable.

92. In determining the appropriate rate of the levy, the Secretary of State must take account of the level of the Government grant paid, or expected to be paid, under *section 16*(*subsection (5)*). An amount payable by a person as a result of the levy will constitute a debt owed by that person to the FRC and be recoverable by the FRC as a debt (*subsection (6)*).

93. It is anticipated that should a levy be necessary, it would be imposed on:

- listed companies; and
- the members of the Consultative Committee of Accountancy Bodies (ICAEW, ICAS, ACCA, ICAI, the Chartered Institute of Management Accountants, and the Chartered Institute of Public Finance and Accountancy).

These bodies already contribute to the funding of the FRC under the voluntary funding arrangement.

94. The first regulations made in respect of the levy power - and any further regulations which change the persons or bodies by whom the levy is payable - will be subject to the affirmative resolution procedure of both Houses of Parliament (*subsections (10)* and *(11)*). Any other subsequent regulations will be subject to the negative resolution procedure (*subsection (12)*).

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Section 18 – Exemption from liability

95. *Section 18* exempts a body receiving a grant under *section 16*, its subsidiary bodies and their members, officers and staff from liability in damages for things done or not done for the purposes of, or in connection with, the activities listed in *section 16* (which is in effect a list of the FRC's regulatory functions). It supersedes two previous exemptions: that enjoyed by a body authorised to apply to the courts in respect of defective accounts (the FRRP) under s245C(6) of the Companies Act 1985; and that available to a body to which the Secretary of State delegates her functions under Part 2 of the Companies Act 1989 (expected to be the Professional Oversight Board for Accountancy of the FRC) under s48(3) of that Act. These two exemptions are therefore repealed.

96. *Subsection (1)* provides that an exemption from liability in damages applies when a grant has been paid to a body under *section 16*, and that it applies to acts or omissions occurring during the period of 12 months following the payment.

97. *Subsection (3)* provides for a body funded under *section 16*, its subsidiaries and their members, officers and staff to be exempt from liability in damages for things that they do or omit to do during the 12 month period since the grant was paid, for the purposes of,

or in connection with, any of the activities listed in *section 16(2)*. The exemption would not apply to any non-regulatory activities conducted by the regulator (for example, providing vocational training on a commercial basis or compiling a database of Non-Executive Directors).

98. *Subsection (4)* sets out the circumstances when the exemption will not apply – that is to say, where the act or omission was in bad faith or where it was unlawful under section 6(1) of the Human Rights Act 1998.

Chapter 3: Directors' liabilities

99. *Sections 19* and*20* relax the prohibition on provision made by companies protecting directors and other company officers from liability. They form part of the Government's response to its consultation on director and auditor liability of December 2003.

Background

The nature of directors' potential liabilities

100. Directors' general duties are owed to the company rather than to individual shareholders. It therefore falls to the company to take action for breach of duty (including the duty of care, skill and diligence): in practice this usually means the board of directors (in some cases a new board of directors) or the administrator or liquidator.

101. Directors may also have liabilities to third parties e.g. in respect of a class action by a group of shareholders in the US, or criminal or regulatory penalties.

102. The prohibition on companies exempting their officers from, or indemnifying them against, liability in respect of any negligence, default, breach of duty or breach of trust in relation to the company dates back to the 1920s. It arose because individual company articles were beginning to relieve directors from the consequences of breach of their duties. This meant the shareholders were unable to obtain redress, especially as the courts then took a very relaxed approach to the directors' duty of care. Parliament therefore changed the law in 1928 so that these exemption clauses ceased to have any effect. The Companies Act 1989 relaxed the prohibition by providing that companies could purchase liability insurance for directors and pay their legal costs if they were successful in defence of legal proceedings.

The Department's consultation on directors' liability

103. The Department of Trade and Industry published a consultative document in December 2003 in response to business concerns that suitably qualified individuals may be deterred from accepting positions as company directors. The consultation exercise built on the work of the independent Company Law Review and of the subsequent review of the role and effectiveness of non-executive directors undertaken by Sir Derek Higgs.

104. The consultation identified two particular concerns:

- exposure to liabilities arising from legal action against directors by third parties. The sharp rise in the number of class actions by groups of shareholders in the US has made this a particular concern for directors of British companies with a US listing;
- the cost of lengthy Court proceedings. Companies are currently permitted to indemnify a director against the cost of defending legal proceedings, but only when judgment has been given in the director's favour or he has been acquitted.

105. The consultation provided strong evidence that these issues are affecting the recruitment and behaviour of directors. *Sections 1* 9 and *20* have therefore been included in the Act to address these concerns.

Summary

106. The new sections inserted by *sections 19* and *20* replace the existing provisions on directors' liability (but not auditors' liability) in section 310 of the Companies Act 1985. Because of this, they begin by setting out the basic prohibition on companies exempting directors from, and indemnifying them against, liability to the company, but they also introduce two important relaxations of the prohibition:

- they permit, but do not require, companies to indemnify directors in respect of proceedings brought by third parties and applications for relief from liability (covering both legal costs and the financial costs of any adverse judgment except criminal penalties, penalties imposed by regulatory bodies such as the Financial Services Authority and the legal costs of unsuccessful criminal defences or applications for relief);
- they permit, but do not require, companies to pay directors' costs of defence proceedings as they are incurred, even if the action is brought by the company itself or is a derivative action. The director would still be liable to pay damages and to repay his defence costs to the company if his defence were unsuccessful.

Section 19 - Relaxation of prohibition on provisions protecting directors etc. from liability

107. *Section 19* does two things:

- it inserts into the Companies Act 1985 *three new sections - 309A, 309B* and *309C* - which replace the previous provisions on directors' liability (but not auditors' liability) in section 310 of that Act;
- it disapplies section 310 from directors and other officers.

108. *New section 309A* begins by restating the core prohibition on companies exempting directors from, or indemnifying them against, liability. Many of the key elements are retained from the previous form of section 310 of the 1985 Act. In particular:

- a company is prohibited from exempting a director from, or indemnifying him against, any liability "in connection with any negligence, default, breach of duty or breach of trust by him in relation to the company";
- a company is permitted to purchase and maintain insurance against any such liability.

109. There are however some important changes from the previous form of section 310 of the Companies Act 1985. *New section 309A*:

- does not extend to liabilities of officers other than directors. It therefore permits companies to indemnify officers such as the company secretary;
- does not retain the words "by virtue of any rule of law", which are usually taken to refer to a rule of non-statutory law. As a result, the new provisions on directors' liability are not limited to non-statutory liabilities;
- prohibits indemnification of a director by an associated company as well as by his own company. "Associated company" is defined under new section *309A(6)* as, in effect, a company in the same group. The prohibition on indemnification by an "associated company" is intended to prevent parent companies and subsidiaries from assuming liabilities in circumstances where the company itself would not be permitted to assume such liabilities. The intention is that the order commencing *section 19* will provide that contracts which were permitted under former section 310 but are prohibited under *new sections 309A* and *309B* will remain effective only if they were made before Royal Assent on 28 October 2004;

- permits indemnification by the company in respect of proceedings brought by third parties (such as class actions in the US) and applications for relief from liability. *New section 309A(4)* explains that the prohibition on indemnification does not apply to a "qualifying third party indemnity provision" ("QTPIP"). This is explained further in *new section 309B.*

110. *New section 309B* explains that a QTPIP must satisfy three conditions:

Condition A is that the provision does not indemnify the director against a liability to the company or to any associated company;

Condition B is that the provision does not indemnify the director against payment of a criminal fine or a regulatory penalty (such as a fine imposed by the Financial Services Authority);

Condition C is that the provision does not indemnify the director against any liability incurred:

(a) in defending any criminal proceedings in which he is convicted;

(b) in defending any civil proceedings brought by the company, or an associated company, in which judgment is given against him;

(c) in an unsuccessful application for relief from liability under the provisions for relief in the Companies Act.

111. *New section 309B(5)*, *309B(6)* and *309B(7)* explain when legal proceedings will be considered to have concluded in respect of Condition C.

112. *New section 309C* requires the company to make two forms of disclosure about indemnification by the company or an associated company:

- if a QTPIP is in force for the benefit of one or more directors or was in force during the previous year, this must be disclosed by the company in the directors' report (and where the director is of one company but the QTPIP is provided by an associated company, in the directors' reports of both companies). Companies which choose not to indemnify directors will not have to make any disclosure;

- it applies section 318 of the Companies Act 1985 (under which directors' service contracts must be open to inspection by shareholders) so QTPIPs must be available for inspection by shareholders. This will permit shareholders to look at an indemnity provision in detail.

113. *Section 19* also amends section 310 of the Companies Act 1985 by removing the references to directors and officers of the company. Section 310 now applies only to auditors, with *new sections 309A, 309B* and *309C* setting out the prohibition and related provisions in respect of directors. Other officers, such as the company secretary, are no longer covered.

Section 20 - Funding of director's expenditure on defending proceedings

114. Sections 330-344 of the Companies Act 1985 place restrictions on a company's power to make loans or quasi-loans to directors, or to enter into certain types of credit transaction with a director. The prohibition prevents a company from indemnifying a director on an 'as incurred' basis even against his legal expenses.

115. *Section 20* therefore inserts a *new section - section 337A* - into these sections of the 1985 Act. *New section 337A* provides that a company is not prohibited from funding a director's expenditure in defending any civil or criminal proceedings provided that the director:

- repays any loan; or

- discharges any other liability to the company

if he is convicted in any criminal proceedings or judgment is given against him in any civil proceedings, or he is unsuccessful in an application for relief from liability under the provisions for relief in the Companies Act. Under *new section 309B*, however, a company may permit a director not to repay a loan if all the circumstances for a QTPIP (see paragraph 110 above) are satisfied (particularly in a case in which judgement is given against him in proceedings brought by a third party).

Chapter 4: Investigations

Summary and Background

116. The Act makes a number of targeted amendments intended to strengthen the company investigations regime as part of the package designed to help ensure confidence in the UK corporate framework.

Powers to investigate

117. The Secretary of State has a range of powers under companies legislation to investigate the affairs of a company and related matters. The vast majority of company investigations are carried out under section 447 of the Companies Act 1985. Members of DTI's Companies Investigations Branch (CIB) or other competent individuals can be authorised to require the production of documents and can require explanations of any document from the person who produces it or from any past or present officer or employee of the company. These are confidential fact-finding inquiries, but there is a disclosure regime which allows, for example, information to be passed to other regulators. Investigations under section 447 are carried out where, for example, there are grounds for suspicion of fraud, misfeasance, misconduct, conduct unfairly prejudicial to shareholders or of failure to supply shareholders with information they may reasonably expect.

Changes made by the Act

118. The Act amends existing legislation in order to strengthen the current regime, without changing the basis for inspections or making any change of substance to the grounds for an investigation. Changes have been made to:

- give section 447 investigators a general power to require relevant information and strengthen their powers to require relevant documents (*section 21*);
- provide statutory immunity from liability for breach of confidence where people provide information to CIB voluntarily in certain circumstances (*section 22*);
- give inspectors and investigators a power to require entry to premises used for company business and a right to remain there for the purposes of the investigation (*section 23*);
- provide a more effective sanction for non-compliance with section 447 requirements and provide a sanction for non-compliance with the power to require entry to premises (*section 24*).

119. The details of these changes and the circumstances in which the changes will apply are set out below.

Section 21 - Power to require documents and information

120. This section replaces section 447 of the Companies Act 1985. That section contained the powers used to carry out the majority of company investigations. In almost all cases, investigations under section 447 are carried out by DTI investigators authorised for that purpose by the Secretary of State. An investigator's powers previously comprised:

- a power to require a company to produce documents specified by the investigator;
- where any other person appeared to be in possession of documents which the investigator could require the company to produce, a power to require that person to produce those documents;
- a power to copy or take extracts from documents produced;
- a power to require an explanation of documents produced from the person who produced them or from any past or present officer or employee of the company; and
- where a person did not produce specified documents as required, a power to require information from that person about their whereabouts.

121. These powers were limited in ways which were capable of slowing down investigations and undermining investigators' ability to uncover the facts, particularly in cases where companies were prepared to do no more than comply strictly with their legal obligations, narrowly interpreted. First, there was no general power to require answers to questions unrelated to documents produced. Second, while it was clear that persons other than the company under investigation could be required to produce company documents in their possession and other documents held to the order of the company, the question of what other kinds of documents they could be required to produce was open to argument. The primary purpose of *new section 447* is to remove these limitations.

122. The previous section 447 also conferred document-gathering powers on the Secretary of State. The Secretary of State had powers to direct a company to produce documents, to require other persons to produce documents (where she could require the company to produce them), to copy or take extracts from documents produced, to require explanations of documents produced from certain persons and to ask about the whereabouts of documents which were not produced. These powers suffered from the same limitations as those affecting investigators, but the main purpose of *new section 447* in this regard is only to give the Secretary of State a new, general power to require answers to questions from companies.

123. Previous section 447 stated that the Secretary of State could exercise her powers (including her power to authorise the exercise of powers by an investigator) if she thought that there was "good reason" to do so. This restriction prevented the Secretary of State from acting on trivial, irrelevant or irrational grounds. As such, it added nothing to the restrictions which apply as a matter of general administrative law to the exercise of the Secretary of State's powers. As explained below, the "good reason" restriction has not been included in *new section 447*

124. Section 452(2) prevented the powers in previous section 447 from being used to compel the production of documents which would be protected from disclosure in civil court proceedings on the grounds of legal professional privilege. Section 452(3) also provided a measure of protection for documents held by banks which relate to the affairs of their customers.

125. *Section 21* replaces previous section 447(2) to (7) and (9). (Section 447(1) had already been repealed.)

126. *New section 447(2)* gives the Secretary of State the power to direct a company to produce documents or to provide information. Because of *new section 447(1)*, the power can only be exercised for reasons relating to the company in question. The Secretary of State can either specify or describe the documents she wants. The Secretary of State's power to require documents under *new section 447(2)(a)* is narrower than her previous power to require documents under section 447 because it enables her to obtain documents only from the company concerned. But her general power to require information from a company under *new section 447(2)(b)* is new.

127. *New section 447(3)* enables the Secretary of State to authorise a person to exercise certain investigatory powers (as previous section 447(3) did). Because of *new section 447(1)*, the decision to authorise must relate to a company. Authorisation is, in effect, a decision to start an investigation of that company. For the first time a person authorised under *section 447* is referred to as an "investigator", although this is not a change of substance. Investigators can still be appointed from the DTI's ranks or from outside. An investigator has the power to require the company under investigation, or any other person, to produce documents or provide information. The investigator can either specify or describe the documents he or she wants. These powers are wider than those previously available to investigators under section 447. The general power to require information from anyone is new. It subsumes the existing powers to ask where documents are which have not been produced and to require explanations of documents which have been produced. It also enables, for example, an investigator to require a person to explain his conduct, or give his opinion about something. The power to require the production of documents by persons other than the company is expressed in such a way as to make it clear that third parties can be required to produce any relevant document, not just documents in their possession which belong to the company under investigation or are held to the order of that company.

128. The changes made to the powers of the Secretary of State and investigators do not lessen the protection which exists in relation to legal professional privilege and banking confidentiality. Section 452 of the Companies Act 1985 is amended by *paragraph 21* of *Schedule 2* so that, among other things, the protection which it provides is applied to the new powers to require information.

129. References to "good reason" are omitted from *new section 447*, but this is not a change of substance to the grounds for use of the powers. The references have been omitted because (as explained above) they add nothing to the restrictions which apply as a matter of general administrative law. The Secretary of State will not be able to act under *new section 447* on trivial, irrelevant or irrational grounds, just as she could not act on such grounds under previous section 447.

130. *New section 447(5)* provides that a requirement to produce documents or provide information must be complied with at such time and place as the Secretary of State or investigator specifies. Among other things, this enables investigators to require specified documents to be handed over immediately.

131. *New section 447(6)* provides that a lien on a document is not affected by the production of that document in compliance with a requirement imposed by the Secretary of State or an investigator. In this context a lien is, generally speaking, a legal right to keep possession of a document belonging to someone else until a claim is satisfied – for example, a claim for payment of professional fees. This subsection does not entitle a person to refuse to hand over a document to the Secretary of State or an investigator, but preserves the rights of (for example) the professional in question over those documents.

132. *New section 447(8)* and *(9)* re-enact previous section 447(9). These subsections provide that the expression "document" in *new section 447* includes information recorded in any form (for example, on paper or electronically). They also provide that, where information is recorded otherwise than in legible form (for example, electronically), the Secretary of State or an investigator can require a copy of it to be produced in legible form (for example in "hard copy") or in a form from which it can readily be produced in visible and legible form (for example, on a floppy disk).

133. *New section 447* does not re-enact previous section 447(6) and (7). So the offence of failing to comply with a requirement imposed under section 447 is repealed. To replace it, a new sanction is provided by *section 24*, which inserts *new section 453C* (failure to comply with certain requirements) into the Companies Act 1985.

134. Previous section 447(8), (8A) and (8B) is re-enacted with modifications by *new section 447A*, inserted by *paragraph 17* of *Schedule 2*.

Section 22 - Protection in relation to certain disclosures

135. Statutory powers are not generally used by the DTI for enquiries carried out when vetting complaints about companies. The vetting process is non-statutory and its purpose is to establish whether a formal investigation (usually under section 447) is appropriate. The process therefore precedes the appointment of investigators with formal powers. A requirement to produce documents or provide information imposed by an investigator using such formal powers overrides any duty of confidence which might in other circumstances prevent the person in question from handing over the document or revealing the information. In the vetting situation, however, there are no statutory provisions guaranteeing immunity from legal liability to a person who, in breach of a contractual or other duty of confidence, provides information in response to an informal DTI enquiry.

136. This is not necessarily to say that a person would not have a defence to a breach of confidence claim in such circumstances. However, the aim of this section is to remove the potential deterrent of having to argue such a defence so that individuals and businesses feel able to volunteer information in response to an informal DTI enquiry. This should give the DTI wider access to the sort of information which can help decisions to be made about whether or not to start formal investigations.

137. The section inserts a *new section 448A* into the Companies Act 1985.

138. *New section 448A(1)* provides immunity from legal liability for breach of confidence to any person who makes a "relevant disclosure".

139. *New section 448A(2)* defines "relevant disclosure" for this purpose. A relevant disclosure is one which satisfies all of the five specified conditions in *subsection (2)*. These are:

- that it is a disclosure which is not made in compliance with a requirement imposed under Part 14 of the Companies Act 1985. This makes it clear that the new statutory immunity relates to information which is volunteered, rather than information which is provided in response to the exercise of an investigation power under that Part;
- that the disclosure is of a kind which could be required by the exercise of a power under Part 14 of the 1985 Act – in other words that it is relevant to a matter which could be investigated under that Part and is not covered by the provisions of section 452 (as amended) relating to legal professional privilege;
- that the person making the disclosure does so in good faith and believes, on reasonable grounds, that the information he or she is disclosing is capable of helping the Secretary of State for the purposes of the exercise of her functions under Part 14. The "good faith" requirement will make sure that, for example, disclosures motivated by a desire to cause harm to a business competitor will not be protected;
- that the information disclosed is not more than is reasonably necessary for the purpose of assisting the Secretary of State in the exercise of her functions under Part 14. This will ensure that only disclosures which are proportionate will be protected;
- that it is not a disclosure of a kind described in *subsection (3)* or *(4)*. The effect of this last condition is that there is no statutory immunity from liability for breach of confidence where:

(i) the disclosure is in breach of a statutory duty of confidence (for example, under the Data Protection Act 1998) (*subsection (3)*);

((ii) the disclosure is made by a bank and involves revealing information about the affairs of a customer (*subsection (4)*);

((iii) the disclosure is made by a lawyer and involves revealing information about a client (*subsection (4)*).

140. Thus, for example, *new section 448A* will not make it easier for the DTI, when vetting complaints, to obtain information about companies' private banking transactions from their banks, because banks will still be exposed to the risk of having to defend breach of confidence claims if they reveal such information in those circumstances.

141. The effect of *new section 448A(5)* is that reference to statutory duties of confidence includes duties contained in secondary legislation, in Acts of the Scottish Parliament and legislation made under such Acts and in legislation passed or made after *new section 448A* comes into force.

Section 23 - *Power to enter and remain on premises*

142. It is often very useful for inspectors or investigators to be able to gain access to company premises or to other premises where records of the company are held or its business is carried on. The premises in question may be trading premises of the company, the address returned to the registrar of companies as the registered office of the company or the home address of one or more of the directors of the company.

143. To be able to gain access to, and spend time on, company premises during the course of an investigation carries great practical benefits. In particular, it enables inspectors or investigators to exercise more effectively their powers to require the production of documents and information under sections 434 and 447 of the Companies Act 1985. More generally, it also offers inspectors and investigators the opportunity to see the company's operations in practice. Inspectors have relied for this purpose on their power to require, and the directors' duty to give, reasonable assistance in connection with an investigation, which are provided for by section 434. But investigators authorised under section 447 had no similar power and could only enter and remain on premises (other than in a search warrant situation) by agreement with the company. They might be asked to leave the premises at any time and would be trespassing if they did not do so.

144. *Section 23* therefore inserts *new sections 453A* and *453B* into the Companies Act 1985. These new sections provide powers for inspectors and investigators to require access to and to remain on premises which they believe are used for the purposes of the business of the company they are investigating.

145. *New section 453A(1)(a)* provides that the new powers cannot be used in a particular investigation unless the Secretary of State specifically authorises their use.

146. *New section 453A(1)(b)* provides that the new powers are exercisable by an inspector or investigator if he or she thinks that it will materially assist his or her investigation of a company. "Inspector" and "investigator" are defined in *new section 453A(7)* and *(8)*. The effect of the definitions is that the powers are available to inspectors appointed under Part 14 of the Act (except for inspectors appointed only under section 446) and to investigators authorised under section 447.

147. *New section 453A(2)* sets out the new powers. An inspector or investigator can require entry to "relevant premises" and, having gained entry, can remain there for as long as he or she thinks necessary for the purpose of furthering his or her investigation. "Relevant premises" are defined in *new section 453A(3)*. They are premises which the inspector or investigator believes are used for the purposes of the business of the company under investigation (including premises which are used for other purposes too). If only a part of a building is used for the company's business, the new powers will only be exercisable in relation to that part, since it will only be that part which constitutes the "relevant premises". Entering that part of the building may involve passing through other parts which are not used for the company's business. *New section 453A* will permit this. "Relevant premises" also include any part of a private house which the

inspector or investigator believes is used for the purposes of the company's business, even if that part is also used for other purposes. The inspector or investigator will be able to move around "relevant premises" to which he or she has gained access and will not be confined only to a limited area (for example, one room).

148. The inspector or investigator can exercise his or her powers to enter and remain only at reasonable times. A visit to business premises outside the company's trading hours would not ordinarily be regarded as taking place at a reasonable time. Other factors would also determine whether the powers are being exercised at a reasonable time. For example, it might be unreasonable to require access to premises when a major product launch is taking place on those premises attended by all staff and potential customers of the company.

149. *New section 453A(4)* enables the inspector or investigator to bring other people with him or her when entering premises. For example, an inspector or investigator may need to be accompanied by one or more support staff to help with the copying of paper records, copying (with consent of the company) of computer records, taking notes of interviews or any other matters which may assist with the investigation.

150. When inspectors or investigators seek to enter relevant premises, they must produce evidence of their identity and their appointment or authorisation; and any person accompanying them must produce evidence of his or her identity (*new section 453B(2)* and *(3)*).

151. As soon as practicable after they enter premises, inspectors or investigators will be required to hand over to an "appropriate recipient" a written notice describing briefly their powers and the rights and obligations of the company, occupier and any persons present on the premises. "Appropriate recipient" is defined in*subsections (8)* and *(9)*. Regulations will set out the contents of this notice (*new section 453B(4)*). If there is nobody from the company present on the premises during the visit, the statement must be sent to the company as soon as reasonably practicable afterwards together with notification of the fact and time of the visit (*new section 453B(5)*).

152. Intentional obstruction of an inspector or investigator will be an offence (*new section 453A(5)*). The penalty for committing the offence is provided for by a new entry in Schedule 24 to the Companies Act 1985 added by *Schedule 2*, *Part 3*, *paragraph 26(4)*. On conviction on indictment, the penalty is a fine with no maximum limit. On summary conviction, the penalty is a fine not exceeding the statutory maximum of £5,000. This new offence relates only to intentional obstruction. The main sanction for failing to admit an inspector or investigator to premises when required is provided for by *new section 453C* added by *section 24*.

153. *New section 453B(6)* and *(7)* provide that as soon as reasonably practicable after a visit to premises by inspectors or investigators exercising their new powers, a written record of the visit containing information prescribed in regulations must be prepared. A copy of this record must be given to the company and (if different) an occupier of the premises on request.

Section 24 - Failure to comply with certain requirements

154. This section inserts a *new section 453C* into the Companies Act 1985. It provides the sanction for failing to comply with a requirement imposed by the Secretary of State or an investigator under *new section 447* or a requirement imposed by an inspector or an investigator under *new section 453A*.

155. *New section 453C* allows the Secretary of State, an inspector or an investigator (depending on who imposed the requirement in question) to take the matter to the civil court, certifying to the court that there has been non-compliance with a requirement. This procedure is therefore known as "certification".

156. Under *new section 453C(1)*, certification proceedings can be brought:

- for any non-compliance with a requirement to produce documents or information under *new section 447*; or
- for any non-compliance with a requirement to allow an inspector or investigator to enter premises under *new section 453A*.

157. After hearing any witnesses and any statement offered in defence, the court decides whether there was non-compliance with a lawful requirement and, if there was, whether the person on whom the requirement was imposed had any reasonable excuse for failing to comply with it. If the court decides that the person had no reasonable excuse, it can deal with him or her as though the non-compliance were a contempt of court. This means that the court can, for example, punish non-compliance with imprisonment and/ or a fine. But in appropriate cases, the certification procedure enables the court to give the alleged "offender" a precise indication of what he or she needs to do in order to comply and so escape punishment.

Section 25 – Minor and consequential amendments; and Schedule 2 - Minor and consequential amendments relating to Part 1

158. This section gives effect to *Schedule 2*, makes transitional arrangements for the application of penalties shown in that Schedule and makes specific provision in relation to Scotland.

Schedule 2, Part 1 - Amendments relating to auditors

159. *Paragraphs 1-3* make consequential amendments to the Companies Act 1989 to reflect the fact that:

- *section 2* inserts a *new Part 3* to Schedule 11 of the 1989 Act; and
- *section 3* provides that the Secretary of State can delegate her functions to a body designated under section 46 of the 1989 Act rather than a body established under that section.

160. *Paragraph 4* makes a minor amendment to the Companies (Northern Ireland) Order 1990 to bring the competition scrutiny regime in Northern Ireland (under which the Secretary of State must seek competition advice from the Office of Fair Trading when recognising professional audit supervisory and qualifying bodies) in line with the law in the rest of the UK.

Schedule 2, Part 2 - Amendments relating to accounts and reports

161. *Paragraph 6* amends section 249E(2) of the Companies Act 1985 which contains provisions applying with respect to certain exemptions from audit to reflect the alterations made by *section 8*.

162. *Paragraphs 7* to *9* apply the provisions concerning offences by bodies corporate and criminal proceedings against unincorporated bodies to the offences relating to disclosure of information in *sections 11* and *12*.

163. *Paragraph 10* amends the Schedule to the Companies Act 1985 setting out the punishments for offences under that Act.

164. *Paragraphs 11* to *15* make amendments to the Northern Ireland legislation resulting from the provisions of *section 11* amending legislation in Northern Ireland.

Schedule 2, Part 3 - Amendments relating to investigations

165. *Part 3* makes certain amendments to the Companies Acts 1985 and 1989 in respect of company investigations.

166. *Paragraph 17* inserts *new section 447A* into the Companies Act 1985. It re-enacts previous section 447(8), (8A) and (8B) with minor drafting changes. *New section 447A(1)* indicates that statements made to the Secretary of State or an investigator in compliance with a requirement to provide information under section 447 can be used in evidence in legal proceedings against the maker of the statement. But the general effect of *new section 447A(2)* is to prevent such compulsorily required statements being used against their maker in most types of criminal proceedings (which *new section 447A(2)* refers to as criminal proceedings in which the maker of the statement is charged with a "relevant offence"). Such statements can, however, be used against their maker in proceedings for the three offences listed in *new section 447A(3)*, which are not "relevant offences". These three offences exist to deter and punish the making of false statements. They comprise the offence under section 451 of the 1985 Act of providing false information to the Secretary of State or an investigator; and the offences of making false statements otherwise than on oath under section 5 of the Perjury Act 1911 and its Scottish equivalent. It would not be possible to prosecute such offences if the false statement itself could not be used in evidence against its maker.

167. As far as the broad range of criminal proceedings is concerned (proceedings for "relevant offences"), *new section 447A(2)* provides exceptions to the general rule that statements made under compulsion cannot be used in evidence against their maker. So, for example, a statement can be used in this way if the defence itself seeks to rely on evidence relating to the statement.

168. *Paragraph 18* replaces section 449 of the Companies Act 1985. Much of the information, including documents, obtained during the course of an investigation under section 447 of the Act is confidential. Previous section 449 recognised this by restricting its further disclosure. It was an offence under that section for any person to disclose information relating to a company which had been obtained under section 447 unless the company consented to the disclosure. However, there were circumstances where such information needed to be disclosed, for example to allow a criminal investigation to take place or to enable a regulatory or professional body to take action where some wrongdoing or irregularity had been exposed. Previous section 449(1) listed a number of purposes for which information could be disclosed and previous section 449(3) listed a number of bodies to whom it could be disclosed. Such provisions are known as "gateways". Previous section 449(1B) and (1C) also enabled gateways to be opened by order, and as a result there was a series of orders containing further gateways.

169. The restrictions and gateways in previous section 449 also applied to documents seized under a search warrant in a section 447 investigation.

170. In addition, by virtue of previous section 451A, the gateways in section 449 applied to information obtained by inspectors appointed under Part 14 of the Companies Act 1985, so that the Secretary of State could disclose, or require or authorise an inspector to disclose, such information to a person or for a purpose permitted under previous section 449. They also applied, in a similar way, to information obtained by the Secretary of State in an investigation of share ownership under section 444.

171. In substituting section 449, *paragraph 18* has three main purposes:

- to consolidate the many amendments which have been made to section 449 since its enactment and to put the various gateways currently provided for by order on the face of the legislation;
- to provide for a small number of new gateways, in particular a gateway for the Regulator of Community Interest Companies and a gateway for a body appointed under *section 14 of the present Act*; and

- to apply the restrictions on disclosure and gateways to information obtained by the Secretary of State under *new section 448A* and to information obtained during a visit to premises by investigators under *new section 453A*.

172. *New section 449(1)* applies the disclosure restrictions and gateways to information obtained by the Secretary of State or an investigator exercising powers under *new section 447*, information volunteered to the Secretary of State under *new section 448A* and information obtained by investigators during a visit to premises under *new section 453A* (for example, things the investigators have learned by seeing how the company operates). It also applies the disclosure restrictions and gateways to information obtained by any person accompanying an investigator during a visit to premises under *new section 453A*. However, because of *new section 449(9)*, the disclosure restrictions do not apply to information which already is, or has been, made available to the public.

173. *New section 449(2)* prohibits the disclosure of any of this information other than to a person specified in *new Schedule 15C* to the Companies Act 1985 or in any circumstances described in *new Schedule 15D* to the Act. In other words, these new Schedules provide for the gateways. The new Schedules are inserted by *paragraph 25* of *Schedule 2*.

174. Disclosure is no longer permitted solely because the company to which the information relates has consented.

175. New section 449(6) provides that to disclose information other than through a gateway is (as previously) an offence. The Act makes no change to the penalty except that it raises the maximum term of imprisonment on summary conviction in England and Wales from 6 months to 12 months (see *section 25* and *Schedule 2*, *Part 3*, *paragraph 26(2)*).

176. *New section 449(3)*, *(4)* and *(5)* contains a qualified power to amend the two new Schedules by statutory instrument allowing the Secretary of State to open new gateways and make changes to existing gateways.

177. The restrictions and gateways in *new section 449* and *new Schedules 15C* and *15D* also apply (by virtue of section 448(8)) to documents seized under a search warrant in a section 447 investigation.

178. *Paragraph 19* substitutes section 451 of the Companies Act 1985, with modifications to take account of the changes made by *new section 447*. The offence of knowingly or recklessly providing materially false information in response to a requirement imposed by the Secretary of State or an investigator under section 447 is re-enacted under *new section 451(1)*. But because *new section 447* gives the Secretary of State and investigators a new, general power to require answers to questions, the offence under *new section 451(1)* applies to any materially false information (other than information contained in a pre-existing document produced to the Secretary of State or an investigator) rather than just to materially false explanations of documents or materially false statements about the whereabouts of documents. The Act makes no change to the penalty for the offence in section 451 except that it raises the maximum term of imprisonment on summary conviction in England and Wales from 6 months to 12 months (see *section 25* and *Schedule 2*, *Part 3*, *paragraph 26(3)*).

179. *Paragraph 20* makes changes to section 451A so that the rules in section 451A(2) to (4) which currently apply to disclosure of information and documents obtained by inspectors, or by the Secretary of State under section 444, also apply to information obtained by inspectors during a visit to premises under *new section 453A* or by any person accompanying them.

180. *Paragraph 21* replaces section 452(1), (2) and (3) of the Companies Act 1985 to take account of the changes made by *new section 447* and to deal expressly with

confidentiality of communications in Scotland (the counterpart of legal professional privilege in England and Wales).

181. The substance of previous section 452(1) is re-enacted by *new section 452(1)* and *(5)*, with modifications to provide expressly for confidentiality of communications in Scotland.

182. Previous section 452(2) provided (among other things) that documents which would be protected from disclosure in civil court proceedings on the grounds of legal professional privilege did not have to be produced to the Secretary of State or an investigator under section 447. It is re-enacted by *new section 452(2)* with modifications so that it also applies to non-documentary information which would be protected in this way and refers expressly to confidentiality of communications in Scotland. *New section 452(5)* provides, however, that a lawyer can nonetheless be compelled to disclose the name and address of his or her client.

183. Previous section 452(3) provided a measure of protection for documents held by banks which relate to the affairs of their customers. It is re-enacted by *new sections 452(3)* and *(4)* with drafting changes. It is also modified so as to extend the protection to non-documentary information relating to the affairs of a bank's customer.

184. *Paragraph 25* inserts two new Schedules into the Companies Act 1985 for the purposes of *new section 449* (which provides for restrictions on disclosure and gateways). The new Schedules operate in different ways. As far as *Schedule 15C* is concerned, disclosure is permitted to any of the persons or bodies listed or, by virtue of *new section 449(8)*, to an officer or employee of such a person or body. But this Schedule does not itself allow onward disclosure by the person concerned. Information disclosed to such a person or body remains protected by the restrictions in section 449. *Schedule 15D* on the other hand permits a disclosure which is made in any of the circumstances it describes. So where a particular description does not refer to disclosure by or to a particular person, disclosure is permitted by or to anyone (so long as it is made in the circumstances described). The majority of the gateways in *new Schedule 15D* allow disclosure where it is made for the purpose of enabling or assisting a specified person to exercise a specified function.

185. *Paragraph 45* of *new Schedule 15D* contains a gateway to allow disclosures to be made for the purpose of enabling or assisting a body appointed under*section 14 of the present Act* (intended to be the Review Panel of the Financial Reporting Review Panel Ltd) to exercise the functions in *section 14(2)*.

186. The Act provides for two gateways, in respect of investigation material, for the Regulator of Community Interest Companies (see the note on *section 27* below). *Paragraph 40* of *new Schedule 15D* contains a gateway to allow disclosures to be made for the purpose of enabling or assisting the Regulator to exercise his functions under the Act. In addition, *paragraph 29* of *Schedule 2* to the Act amends the Companies Act 1989 so that information obtained while assisting an overseas regulatory authority under section 82 of that Act can be disclosed for the same purpose.

187. *Paragraph 27* amends section 124A of the Insolvency Act 1986 so that the Secretary of State cannot base a decision to apply to the court for a company to be wound up in the public interest on the information obtained under *new section 448A*. The Secretary of State will, however, be able to make such a decision on the basis of information obtained under *new section 453A* (and will also be able to make such a decision on the basis of information obtained under *new section 447*).

188. *Paragraph 28* amends section 8 of the Company Directors Disqualification Act 1986 so that the Secretary of State can base a decision to apply to the court for the disqualification of a director on information obtained under *new section 453A*.