

DIRECTORS RESPONSIBILITIES

DO YOU KNOW WHAT IS INVOLVED?

Often individuals accept appointment as a company director without completely understanding the duties the role involves. Such ignorance can be costly, because the penalties on a director for failing to meet their responsibilities can be severe.

This briefing is designed to be a general guide to the potential pitfalls you face as a company director and how to avoid them. By its very nature, this briefing cannot be comprehensive, but it does highlight the main areas of risk and where advice is necessary.

WHAT'S NEW?

The Companies Act 2006 is still being brought into force. The latest group of changes include:

Trading disclosures – Revised rules on when a company's name must be displayed and what information must be disclosed on request.

Conflicts of interest – New rules on a director's duty to avoid conflicts of interest and on third party benefits.

Even if you were familiar with your duties prior to the changes, it is important to make sure you know the current position.

ARE YOU A DIRECTOR?

There is no precise definition of a director in company law. Broadly, a director is anyone occupying the position of a director by whatever name called. The precise name does not matter — for example, it could be Chairman, Managing, Chief Executive, Non-executive or Associate.

You may even be regarded as a shadow director if you do not formally have the word director in your title, but you act as a director and in some way control the business.

Being an employee of the company does not prevent you from also being a director. A director/employee should have the security of a written contract of service, which a director alone may not possess.

All directors, however named, have duties and responsibilities. In some instances, it may be wise to reject an appointment as a director; for example where the financial status of the company is precarious.

STATUTORY DUTIES OF DIRECTORS

The Companies Act 2006 has codified the old common law duties of directors. There have not been major changes to the substance of the duties, but most are subtly different. It is important to understand your duties under the current law.

The most important duties of directors are:

- ***Act within powers:*** A director must act in accordance with the company's constitution. A director must not do anything that he is not authorised to do or must only use powers for the purpose that they are conferred. In many cases it is obvious what a director can or can't do. Care needs to be taken, however, where decisions fall on the boundary of a director's powers, or need to be taken in a particular way.
- ***Promote the success of the company:*** Directors must act in the way most likely to promote the company and its members as a whole. Directors need to be careful when making decisions that benefit some, but not all members.
- ***Exercise independent judgment and reasonable care, skill and diligence:*** Directors must be independent and competent. The level of skill expected depends on how a director holds himself out. It is important that directors do not suggest that they have experience or expertise that they do not actually possess.
- ***Conflicts of interest:*** Directors must avoid conflicts of interest between themselves and the company. Such conflicts can be authorised by the shareholders and, in certain circumstances, by directors who do not have a conflict of interest. Directors must also declare any interest they have in a transaction or arrangement with the company – even if there is no conflict of interest.
- ***Third party benefits:*** Directors must not accept benefits from third parties that are presented because of their director status or for doing anything as a director.
- ***Financial arrangements with a director:*** As a general rule, a company should not provide loans or any other financial assistance to a director or 'connected person'. This does not prevent a director being an employee of the company.

ACCOUNTING RESPONSIBILITIES

Directors are responsible for ensuring that the company's accounts are accurate and filed correctly. Directors must ensure that the company:

- ***Keeps accounting records*** which give an up to date picture of the company's financial position.

- ***Produces and files accounts within set time limits.*** The accounts, which include a directors' report, must satisfy the Companies Act legal requirements in form and content.

FINANCIAL RESPONSIBILITIES

The Companies Act imposes a range of financial responsibilities on directors, including:

- Company borrowings.
- Share issues and registration.
- Redemption and purchase of the company's own shares.
- Financial assistance for the purchase of the company's own shares.
- Dividend policy and identification of distributable profits.

CORPORATE GOVERNANCE

There have been a series of reports and recommendations regarding the conduct of directors over recent years. These have resulted in a significant increase in directors' obligations with regard to corporate governance and financial disclosures.

We keep abreast of these changing requirements and can advise you on the current views of best practice from bodies such as the Institute of Chartered Secretaries and the Financial Reporting Council.

UNLIMITED LIABILITY

Unlike shareholders, whose liability is limited, a director's personal liability is potentially unlimited. Liability could arise if directors:

- ***Exceed their authority*** as laid down in the company's Memorandum and Articles of Association.
- ***Act recklessly or fraudulently*** (which can also lead to criminal prosecution).

Directors may be personally liable for exceeding their authority if they:

- Sign cheques that do not carry the company's correct name – even if only one letter is missing.
- Enter into contracts and sign cheques, letters or other documents without stating that they are acting on the company's behalf.

CRIMINAL LIABILITY

In the most serious cases, directors can face criminal prosecution.

Examples include:

- ***Allowing the company to breach*** Health and Safety legislation, the Environmental Protection Act 1990 and other similar legislation.
- ***Failure to comply*** with the Financial Services and Markets Act 2000.
- ***Breaches of Companies Act legislation***, such as failure to provide annual accounts or annual returns.

RESPONSIBILITY UNDER INSOLVENCY LEGISLATION

The Insolvency Act 1986 provides that directors may become personally liable for an insolvent company's debts when:

- Wrongful trading has occurred, i.e. a director has allowed the company to continue trading when they knew, or *ought to have known*, that there was no reasonable prospect of avoiding insolvent liquidation. What directors should have known and done depends on the knowledge, skill and experience they have or might be expected to have.

Wrongful trading is a serious hazard for the inexperienced, well-intentioned director, particularly if they are poorly informed about the company's financial health or unaware of the warning signs.

- There has been misfeasance (wrong doing) and/or a breach of common law or statutory duties.
- The company was unable to pay its debts as they fell due.
- The directors did not take every step possible to minimise creditors' losses.
- Fraudulent trading has taken place, i.e. trading with the intent of defrauding creditors.

These rules catch not only rogue traders but also people who try to trade their way out of hopeless financial situations.

PROTECTIVE ACTION

Informed and experienced directors take proper and reasonable steps to protect themselves from personal liability. These include:

- *Accurately defining* their functions and responsibilities.
- *Ensuring they are informed fully* of the company's current and anticipated trading position.
- *Seeking professional advice* immediately if doubts arise about the company's future viability.
- *Documenting all decisions* affecting the company's activities.
- *Arranging appropriate insurance cover.* Directors can insure against many of the risks by taking out a directors' and officers' liability policy. Care should be taken to match the policy to the needs of the company and its directors.

DISQUALIFICATION

Directors can be disqualified for up to 15 years for:

- Persistent default in filing returns, accounts or other company documents (these can also carry fines).
- Fraudulent trading or fraud against the company discovered during a winding up.
- Conviction of an indictable offence connected with running a company.
- Breaches of competition law, e.g. involvement in a price-fixing cartel.

- Actions which are deemed to make the individual unfit to be involved in the management of a company.

Failure to observe a disqualification order can lead to personal liability for the new company's debts, a fine and a two year prison sentence.

A person who has been a director of a company in the 12 months leading up to it falling into insolvent liquidation cannot set up in business under the name of the company or its trading name or a similar one for five years from the date of liquidation.

HOW WE CAN HELP

Directors should be aware of a large volume of other legislation not mentioned in this briefing. For example, the laws on taxation, data protection and employment policies all impact upon the responsibilities of a director. The sheer volume of legislation affecting directors is daunting, but nevertheless continues to grow apace.

As experienced accountants, we can guide you in your duties as a director, with the aim of ensuring that you and your company enjoy a successful future. We can help you with many areas of your business including:

- Advice on the structure of your board of directors.
- Production and analysis of financial information, whether historic, current or projected.
- Practical assistance and advice if your company is in financial difficulty.
- Liaison with your or your company's lawyers when drafting legal documents.

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