

Chapter 4

Audit regulation

4.1 (a) *False*

CA 2006 allows the directors in a private company to appoint the first auditors (s.485(3)(a)) or where the company did not have auditors because they were exempt (s.385(3)(b)) or to fill a casual vacancy in the position of auditors. The equivalent provisions also exist for public companies and are in CA 2006 (s.489(3)(a), (b) and (c))

(b) *True*

CA 2006 s. 492(1), states that where the auditors have been appointed by the members then the members must fix the remuneration by ordinary resolution or it may be fixed in such a manner as members by ordinary resolution determine. Auditors appointed by the directors must have their remuneration fixed by the directors (CA 2006 s.492(2)). In addition, in exceptional circumstances, where auditors have been appointed by the Secretary of State then that person must fix the remuneration (CA 2006 s.492(3)).

(c) *True*

CA 2006 s.510(3) provides that where an auditor has been removed from office nothing is to be taken as 'depriving the person removed of compensation or damages payable to him in respect of the termination of his appointment as auditor, or of any appointment terminating with that as auditor'.

(d) *False*

Auditors are allowed under CA 2006 (s. 511(3)) to make written representations, of a reasonable length, to the company and request they be distributed to the members of the company. However, they are not allowed to make *any* representations. If on the application of the company or of any other person who claims to be aggrieved the court is satisfied that the right to make representations is being abused to secure needless publicity for defamatory matter, they need not be communicated to the shareholders (CA 2006 s. 511 (6)).

Similar provisions apply when the auditor is not re-appointed at the end of his term of office (CA 2006 s.514 and 515).

4.2 (a) You will have seen from your reading of CA 2006 s.386(4), that accounting records required to be kept by a company dealing in goods must include all statements of stocktakings relating to the year-end stocks/inventories figure appearing in the financial statements. If stock sheets cannot be relied upon, it can be argued the company has not kept proper accounting records. However, provided the auditors can satisfy themselves by other means that the stock/inventory figure in the accounts is reasonable, they may be able to avoid mentioning it in their report.

(b) In answering this question it is important to determine if the directors wish to remove her before her term of office expires or simply not re-appoint her as auditor for the following financial year. If they decide to remove her from office the various regulations relating to this and the rights given to auditors are contained in sections 510-513 of CA 2006. These provide that that special notice, that is at least 21 days notice for a resolution at a general meeting of the company. On receiving the notification of intended removal the auditor can make written representations to the company and ask for these to be circulated to shareholders. Where the resolution to remove the auditor is passed then the registrar must be informed within 14 days. Even though the auditor is removed they will still be entitled to attend the meeting at which his/her term of office would have been expired and in respect of matters of concern to them be heard at

that meeting.

The requirements relating to the situation where the directors decide not to re-appoint Janet as auditor are contained in sections 514 and 515 of CA 2006. These sections provide that Janet must be provided with notification that the intention is not to reappoint her as auditor. On receipt of such notification Janet can make written representation and request these be circulated to shareholders. In both cases where the representations are received too late or if the company does not for some other reason send the representations out to members, the outgoing auditor may require that they are read out at the meeting and;

- that if the court is satisfied that the rights to make representations are being abused to secure needless publicity for defamatory matter, then the representations need not be sent or read out.

Where an auditor for whatever reason ceases to be auditor of an unquoted company they are required to deposit at the company's registered office a statement of any circumstances relating them ceasing to hold office. If there are no circumstances then they are required to send a statement to the office that there are no circumstances. Where the audit is a quoted company then the auditor must deposit at the deposit a statement of the circumstances relating to them ceasing to be auditors.

The Companies Act 2006 s. 522 contains provisions relating to when an auditor on ceasing to hold office must inform the appropriate audit authority (Professional Oversight Board) that he has ceased to hold office and a statement of the reasons for ceasing to hold office.

- (c) The question of fees where an auditor is removed from office is covered by CA 2006 s. 510(3) which makes clear that any compensation or damages payable to an auditor, in this example Janet Helmsley, due to them for acting as auditor is not precluded by them having been removed. Where the auditor has simply not been re-appointed at the end of their period of appointment which appears to be the likely situation in this example they will be owed the fees that have been agreed for performing the audit.
- (d) The actions you would take assuming you were a member of a body of professional accountants are clearly stated in the rules of professional conduct. The answer below is based on the guidance provided by the ACCA in their Code of Ethics and Conduct on changes in professional appointments:
  - (i) The prospective auditor should inform the client that they have a professional duty to communicate with the previous auditor, Janet Helmsley. The prospective auditor should request that the client give Janet Helmsley written authority to discuss the client's affairs with the prospective auditor.
  - (ii) Assuming this permission is obtained you should write to Janet Helmsley 'requesting all the information which ought to be made available to enable the prospective accountant to decide whether or not to accept the appointment.' This is not just professional courtesy, but also to ensure that there is no professional reason why you, the prospective auditor, should not accept the appointment. The existing auditor should provide the information honestly and unambiguously.
  - (iii) Where the outgoing accountants/auditors has been refused permission to discuss the client's affairs with the prospective auditor they should inform the latter of this fact and the prospective auditor should refuse the appointment.

- (iv) Where permission is obtained the existing auditors should inform the prospective auditor of the nature and details of any matters that the latter should be aware. If there are not any matters that they believe should be brought to the attention of the prospective auditor they should state that fact. It is recommended that any communication should be in written form but where it is given orally then each party should keep their own written record of the conversation that took place. The prospective accountants/auditors would have to consider carefully the information received before accepting appointment. In the case cited of Janet Helmsley and Skiplam Ltd you may have doubts about the wisdom of accepting the appointment.
- (v) If no reply were received from Janet Helmsley, you must make every effort, such as by telephoning, to contact her. If this fails you should send a letter by registered post or recorded delivery, saying that if no reply is received within (say) 7 days you will assume there are no matters that should be brought to your attention. Where no reply is received the prospective auditor should obtain information on the client by other means, for example, through third parties and background investigations. You should note that if no reply is received then the prospective auditors may complain to their accounting body that the existing auditors failed to respond to their enquiry.

The case in point is an audit matter concerning inadequate accounting records. If, on the other hand, Helmsley had resigned because she had suspicions that the client was guilty of an unlawful act, but has no proof, she would have to be very careful before communicating these suspicions to you.

4.3 You should advise the two partners that converting a partnership to a limited company brings with it onerous duties as well as certain advantages. You should warn them that limitation of liability can be more apparent than real, as banks frequently require personal guarantees from directors as well as charges on company assets to secure loans and overdrafts made by them. Specific duties imposed upon companies and directors of companies include:

- (a) Proper accounting records as defined in CA 2006 s.386 and penalties if they are not kept s. 387;
- (b) Duty to prepare accounts s.394 that show a true and fair view (s. 393(1)).
- (c) Preparation of a directors' report s.415(1) with significant disclosure requirements (s.416 and 417). There are certain exemptions from the disclosure requirements for small and medium sized entities;
- (d) Duty to provide a copy of the company's annual accounts and report, or subject to satisfying certain requirements a summary financial statement (s.426), to members and holders of the company's debentures (s.423). The penalty for failing to comply with this requirements (s.425(2) or in the case of failure in respect of supplying summary financial statements (s.429(2)). In the case of a public company the directors must lay before the company in a general meeting copies of its annual report and accounts (s.437(1)) and the penalties if they are found guilty for failing to do so (s.438(4)). If the directors prepare annual accounts that do not comply with the Companies Act 2006 and where applicable relevant IAS regulation they may subject to penalties

The basic audit requirements are laid down in CA 2006 and are as follows:

- (a) S.475 requires that a company's annual accounts must be audited unless it is exempt. The auditors must state whether the financial statements give a true and fair view of what they purport to show that they comply with the provisions of

CA 2006 and have been properly in accordance with the relevant financial reporting framework (s.494((3)).

- (b) The auditors must satisfy themselves that:
- (i) adequate accounting records have been kept and by the company and proper returns adequate for their audit have been received from branches not visited by them;
  - (ii) the financial statements are in agreement with the records and returns;
  - (iii) the auditor must state in their audit report if the information given in the directors' report is consistent with the financial statements themselves s.496. If they are not so satisfied they must state that fact and describe the inconsistency in their report. See ISA 720 (revised) Section B The auditor's statutory reporting responsibility in relation to directors' reports.
  - (v) for quoted companies that the auditable part of the directors' remuneration report agrees with the accounting records and returns. Where the part of the directors remuneration report audited does not comply with the requirements of the CA 2006 the auditor in their report must as far as is possible provide the required information (CA 2006 s498(4)). More generally if the company has not complied with the information relating to directors' remuneration required by CA 2006 s.412 then they should include in their report as far as is possible the required information.
- (c) The auditors have the right of access to the company's records *at all times* (but most auditors will interpret this reasonably) s. 499(1)(a). They also require any officer or employee of the company to provide them with such information and explanations the auditors believe are necessary for them to fulfil their duties as auditor. S.499 (1)(b) and (2).

4.4 (a) *True*

See 4.3 (c) above

(b) *False?*

S.501 of CA 2006 makes it an offence for a person 'knowingly or recklessly make to an auditor of a company a statement' which is required by the auditors in course of their duties and 'is misleading, false or deceptive in a material particular'.

The second part of the statement is more problematic. The CA 2006 in s. 418 requires the directors in their directors' report to include a statement that as far as they are aware there is no relevant audit information of which the auditors are unaware. This would seem to suggest that if the directors were aware of information which they knew was pertinent to the audit then in withholding that information they would be committing an offence. The Companies Act goes on to state that the statement by the directors must also indicate that they have taken reasonable steps to make themselves aware of relevant audit information and to determine that the auditors are aware of the information. If the directors are found guilty of including a statement in their directors' report that is false then they are guilty of an offence and will be liable to a term of imprisonment. When determining the directors' guilt it will be important to examine the steps taken by the directors to ensure that to they are aware of relevant audit information and that have exercised due care and diligence. The question asked would seem to suggest that the directors were aware of facts but withheld them because they were not directly asked about the issue. If the directors were aware the facts were relevant to the audit then under this section of the Companies Act they would have committed an offence because the statement in the directors' report would be false. If the directors did not know that the facts were relevant to the audit then the determination that an offence had taken place would be more problematic.

(c) *False*

Notes to the accounts are really extensions of documents that *are* to be included in company's accounts, (see CA 2006 s.472) comprising, among other things, profit and loss account and balance sheet. They are, therefore, properly the subject of the auditor's report.

(d) *True*

The CA 2006 (s.496) provides that 'the auditor must state in his report on the company's annual accounts whether in his opinion the information given in the directors' report for the financial year for which the annual accounts are prepared is consistent with those accounts.' We will visit this topic again in Chapter 16 when we discuss auditors' reports.

(e) *False*

The rules relating to an auditor's tenure of office differs between public and private companies. For a public company the auditors' period of office runs from the general meeting at which they are appointed to the next general meeting at which the accounts for the accounting reference period are laid before shareholders. In a private company the period is determined slightly differently with the date of appointment being required within 28 days of the date by which the annual accounts and report are required to be sent out or if earlier the date on which these documents were sent out. Normally their period of office would cease at the end of the period for next appointing auditors unless re-appointed.

(f) *false*

The accounts of a public company must be laid before the company in general meeting within 6 months of the accounting reference date (CA2006 s.437(1) and (2)). The deadline of six months also applies to the date by which a public company must hold its annual general meeting (CA2006 s.336(1)). The company must also file its accounts with registrar within the six month period (CA2006 s.442(2)).

In the case of a private company they are not required to hold an annual general meeting but they are required to file their accounts with the registrar within nine months after the end of the relevant accounting reference period (CA2006 s.442(2)). They are also required to send out to members their annual accounts and report within the same nine month period after the end of the accounting reference period or if earlier the date the company actually filed its accounts (CA2006 s.423 and 424).