

Directors' responsibilities

The duties of company directors have, until recently, been defined by case law. Under the Companies Act 2006 they have now been set out in a single statement.

Company Directors are responsible for the management of their companies. They must act in a way most likely to promote the success of the business and benefit its shareholders. They also have responsibilities to the company's employees, its trading partners, and the state. As a director, you need wide powers to help you promote the company. However, you face serious penalties if you abuse those powers, or use them irresponsibly.

This briefing covers:

- Appointing company directors.
- Directors' powers.
- Directors' responsibilities.
- Penalties for misuse of position.
- How to protect yourself.

1 Appointing directors

Every private limited company must have at least one company director. Since 1 October 2008, at least one of the directors must be an actual person (as opposed to another company).

1.1 The first directors (though there may be only one of them) are appointed by the shareholders who form the company.

- Directors are often also shareholders or employees of the company, but do not have to be.

1.2 Subsequent appointments must follow procedures set out in the Articles of Association. Usually, the board can appoint a new director (subject to any maximum number set in the Articles), or the shareholders can appoint a person who has either been recommended by the board, or who has been proposed as a director in advance.

1.3 If you are a director but have no executive position within the company, you will be classed as a **non-executive**.

- As a non-executive director, you may have nothing to do with the day-to-day running of the company. Even so, you will still carry the same responsibilities as other directors.

1.4 Even if you have never been appointed

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a director, you could be classed as a **shadow director** (if the other directors are 'accustomed to act' under your instructions) or as a 'de facto' director if you act as if you were one - for example, if you resign your directorship but continue making decisions as a director.

- As a shadow director or de facto director you carry many of the legal responsibilities, and are subject to many of the penalties, of other directors.

1.5 Some people are **debarred** from becoming directors.

- Auditors may not be appointed directors of the companies for which they act.
- People who have been disqualified (see **6.3**) may not be appointed.
- Undischarged bankrupts may not be appointed unless they have first obtained leave from court.
- Since 1 October 2008, directors must be aged at least 16 or over.

1.6 The appointment, departure or change of particulars of a director or directors must be **reported** to Companies House within 14 days, using form 288a/b/c (0870 333 3636; www.companieshouse.gov.uk/forms/introduction.shtml).

2 Exercising directors' powers

Check if there are any limits on directors' activities in your company.

2.1 You must pursue the **objectives listed** in the Memorandum of Association.

- Most companies list a wide range of objectives ('objects') to give directors the flexibility to carry out any type of business.
- Some companies list only specific objectives.
- If the directors act outside the company's objects, the company may have an action against them.
- You can only change the company's objectives by getting shareholder agreement to a new Memorandum.

2.2 You must act within the **powers granted** in the Memorandum and Articles of Association.

- The Memorandum normally sets out a list of powers which the directors may exercise in pursuing the objective(s) of the company.
- The Articles of Association define the rules governing the directors.

2.3 In exercising directors' powers, you are required to exhibit 'such a **degree of skill** as may reasonably be expected' from a person with your knowledge and experience.

- For example, a chartered accountant might be expected to know if the company was trading while insolvent.

2.4 You must also exercise a **degree of care** in your actions as a director.

- The test of an acceptable level of care is what a reasonable person would do in looking after their own affairs.
- You are generally not liable for the actions of your fellow directors, if you knew nothing about them and took no part in them, but you have a duty to make sure you are informed about the company's affairs - it is very dangerous to turn a blind eye.

3 Fiduciary responsibilities

As a director, you must act in a way which you think is most likely to promote the success of the company for the benefit of its shareholders. You need to consider a number of statutory factors, including the long-term consequence of decisions, your firm's reputation and the interests of other stakeholders, such as employees and the community.

3.1 **The company** is a separate legal entity from its directors, shareholders and employees. The best interests of the company are not always the same as the best interests of the shareholders.

- You must consider the interests of other stakeholders such as creditors and employees.
- You must consider the long-term prospects of the company and its reputation.

3.2 You must give equal consideration to **all shareholders**.

- Even if you hold most of the shares, or act as the nominee of the major shareholder, you must consider the interests of shareholders as a whole.
- In practice, it is very difficult for a minority shareholder to have a significant say in decisions made by majority shareholders.

3.3 You must not use your position to make **private profits** at the company's expense.

- If you are found to have secretly profited

“The principal responsibility of the directors is to the company's shareholders, so always ensure you communicate with them on significant matters.”
Martin Dunne,
Sayers
Butterworth LLP

from a contract, you might be forced to hand those profits over to the company.

3.4 You are legally obliged to declare any actual or potential **conflict of interest**.

- For example, if you have interests in another company with which your company is planning to do business.
- The Articles may say you should not vote on such a deal and, if you do, your vote is disregarded.

3.5 If you, or someone connected with you, such as a relative, personally plan to enter into **substantial deals** with the company, they must be approved by the shareholders.

3.6 Your **contract of employment** must be approved by the shareholders in a general meeting if your term of employment is capable of exceeding two years.

4 Duties under company law

Directors are personally responsible for ensuring that the company complies with company

Wrongful trading

You will be guilty of wrongful (or even fraudulent) trading if you allow the business to carry on, and incur debts, when you know there is no reasonable prospect of the company repaying them. If you do, you could be held personally liable for the company's debts if it subsequently becomes insolvent.

A The fact that the company is making **losses** does not in itself mean that the company is trading wrongfully.

- But if there is no reasonable prospect of it moving into profit, and there are doubts about whether its assets will cover its liabilities or whether it can pay its debts, the company is probably trading wrongfully.

B The value placed on **assets** may be critical.

- The values as stated in the balance sheet are on a going-concern basis. The value of any assets will be much lower in a forced sale. This is particularly true with intangible assets, such as goodwill.

C Allow for the expenses of winding up the company in calculating your **liabilities**.

law. These duties are usually delegated to the company secretary (if the company has one) or to a director or trusted employee. However, you must ensure that these responsibilities are carried out..

4.1 You must make sure that the **statutory returns** are filed with the Registrar of Companies on time.

- These include the annual report and accounts, the annual return and notice of changes to directors and secretaries.
- Failure to deliver can result in fines for which you may be personally liable, disqualification or criminal conviction.

4.2 All companies have to **file accounts** with Companies House.

- In most cases small and medium-sized companies can submit abbreviated accounts. Small companies with a turnover below £6.5 million, or fixed and current assets below £3.26 million, do not need to have their accounts audited and as such are not required to appoint an auditor.
- Directors are required to sign declarations that they have not hidden any material information. If they are later found to have done so, they face fines or imprisonment.

4.3 Most private companies are no longer obliged to hold an **AGM**, although they must give adequate notice of and hold a general meeting if any director or 5 per cent of members request it.

- Private companies with traded shares must still hold an AGM.
- If you do hold a general meeting, you must give appropriate notice (usually 14 days) and ensure that minutes record all decisions taken. This could protect you if you face legal action later (see **6**).

4.4 You are no longer required to circulate copies of the annual accounts for **approval** at a general meeting. However, members must be sent a copy before they are filed with the Registrar of Companies.

- A director must sign the balance sheet and approve and sign off the directors' report.

4.5 You must ensure that all the company's business stationery carries its name, registered number, country of registration and registered address. These details must also appear on your company website, emails and order forms.

► Visit the Companies House website at www.companieshouse.gov.uk.

5 Other legal duties

5.1 You must comply with **employment law** in dealings with employees.

- You (personally) can be sued for unfair dismissal, discrimination or unfair work practices, such as unequal pay.
- Act quickly to ensure the company complies with any new employment laws.

5.2 You must take reasonable care to ensure the **health and safety** of your employees.

- You can be prosecuted for dangerous practices started or continued with your consent, or illness or accident attributable to your negligence.
- If your company employs more than five people, you must have a written policy on health and safety and undertake an assessment of risk.

5.3 You must ensure that the correct amounts of **tax, VAT** and **National Insurance** are paid on time.

5.4 Watch out for **legal pitfalls** in other areas.

- These include data protection, defamation, libel and providing misleading information.

6 Potential penalties

Exercise your directors' responsibilities carefully as the penalties for failing to do so can be formidable.

6.1 Even in a limited liability company, you could be held **personally liable** for losses resulting from some acts or omissions.

- These include illegal acts and acts beyond your powers or undertaken with insufficient skill and care (see **2**).
- You could be liable to contribute for company debts incurred through wrongful or fraudulent trading.

6.2 Directors can be **jointly and severally liable** for the consequences if they act collectively in breach of their responsibilities.

- Liability could be unlimited, so you could be made bankrupt as a result of decisions of the other directors, even in a limited liability company.
- If you disagree with the decisions being made, have it noted in the minutes, including your reasons for disagreeing.

6.3 You could be **disqualified** from acting as a director for some types of conduct.

- They include continuing to trade when the company is insolvent, failure to keep proper accounting records, failure to pay tax and failure to co-operate with the official receiver.
- Disqualification lasts from two to 15 years.

6.4 Some actions could result in **criminal convictions**.

- They include failure to keep proper accounting records, fraudulent trading, health and safety shortcomings and misappropriation of company funds.

7 Avoiding danger

7.1 **Monitor** the financial situation of the company continuously, whether or not you are the financial director.

7.2 Take steps to **minimise losses** to creditors if the company is in, or seems likely to face, financial difficulties.

- Ask an insolvency practitioner to advise the board. Take detailed minutes of the meeting.

7.3 Make sure that **minutes** of directors' meetings are maintained in any event.

- They could protect you against future legal action, particularly where there have been boardroom disagreements.

7.4 Keep in mind the requirements of your **employment contract** and powers granted under the Articles.

7.5 Whenever possible, avoid giving **personal guarantees** of the company's debts

- Always negotiate to limit the extent of any guarantee (eg by limiting its duration).

7.6 Ensure the company considers directors' and officers' **liability insurance**. The company may also be able to indemnify directors.

- These will pay for legal expenses, and sometimes, damages awarded against you, if you are sued for negligence or breach of duty. But they may not protect you against actions for dishonesty, or company failure.

Expert contributors

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