

COMPANIES ACT 2006

EXPLANATORY NOTES

COMMENTARY

Part 16: Audit

Chapter 4: Removal, Resignation, Etc of Auditors

774. This Chapter restates the law on the ways in which auditors can cease to hold office. The current provisions are in section 388 and sections 391 to 394A of the 1985 Act. There are some changes to the existing law resulting from the changes elsewhere in the Act relating to written resolutions of private companies. There are also changes in the requirements when auditors leave office: increasing the range of cases in which there is a requirement for a statement explaining why they are leaving, and for copies of any statement to be sent to shareholders and to appropriate regulators.

Section 510: Resolution removing auditor from office

775. This section restates the rule that the shareholders in a company always have the right to dismiss its auditor by ordinary resolution. As at present, to remove the auditor before the end of his term of office, even a private company will need to hold a general meeting to pass such a resolution.
776. *Subsection (2)* requires special notice of the resolution (see note on section 511). *Subsection (3)* provides that shareholders' right provided by this section does not prevent the auditor being entitled to being compensated for termination of his appointment. *Subsection (4)* specifies that the resolution described here is the only way in which an auditor can be removed before the end of his term of office.

Section 511: Special notice required for resolution removing auditor from office

777. This section restates the requirement that a resolution to dismiss an auditor needs special notice (i.e. 28 days before the general meeting, as provided in section 312). The company must send a copy to the auditor it is proposed to dismiss, and he has the right to make a statement of his case. The company then has to circulate his statement to the shareholders (or if time does not allow, the statement can be read out at the meeting).
778. *Subsection (6)* provides protection if the auditor it is proposed to dismiss is using the provision to have a statement circulated to secure needless publicity for defamatory material. It enables the company, or anyone else who is aggrieved by the statement, to apply to the court, and the court can then determine whether the auditor is using the provision in that way, in which case the company is not obliged to circulate the statement. The court can order the auditor to pay some or all of the costs of the proceedings.

Section 512: Notice to registrar of resolution removing auditor from office

779. This section restates the obligation on a company that has decided to dismiss its auditor to inform the registrar within 14 days.

Section 513: Rights of auditor who has been removed from office

780. This section restates the right of a dismissed auditor to attend certain meetings, namely, any meeting at which his term of office would have expired (i.e. a public company's accounts meeting) and any meeting at which it is proposed to replace him.

Section 514: Failure to re-appoint auditor: special procedure required for written resolution

781. This section sets out the procedure for changing auditor from one financial year to the next by written resolution (a procedure only available to private companies). This may be done (i) during the term of office of the outgoing auditor, or (ii) afterwards, if no replacement has been appointed. But case (ii) will arise only if there is no automatic deemed reappointment for one of the five reasons in section 487(2).
782. *Subsection (3)* provides that the company must send a copy of the proposed resolution both to the outgoing auditor and to his proposed replacement; and *subsection (4)* provides that the former then has 14 days to make a statement setting out his views. *Subsection (5)* then provides that the company must send, to its shareholders, the resolution together with any statement from the outgoing auditor. *Subsection (6)* specifies how the general rules on written resolutions are to apply in this case.
783. *Subsection (7)* provides protection if the outgoing auditor is using the provision to have a statement circulated to secure needless publicity for defamatory material. It enables the company, or anyone else who is aggrieved by the statement, to apply to the court, and the court can then determine whether the auditor is using the provision in that way, in which case the company is not obliged to circulate the auditor's representations. The court can order the auditor to pay some or all of the costs of the proceedings.
784. *Subsection (8)* provides that failure to comply with the rules in this section will make the resolution ineffective.

Section 515: Failure to re-appoint auditor: special notice required for resolution at general meeting

785. This section sets out the procedure for changing auditor between one financial year and the next at a general meeting. This may be done by resolution at the meeting, but special notice is required if no deadline for appointing auditors has passed since the outgoing auditor left, or if the deadline has passed when an auditor should have been appointed without one being appointed. So, for example, if a public company intends not to re-appoint an auditor at its accounts meeting, it would need to give special notice of the meeting to be able to appoint replacement auditors.
786. *Subsection (3)* provides that immediately it receives a proposed resolution for changing auditor, the company should send a copy of it both to the outgoing auditor and to his proposed replacement; and *subsection (4)* provides that the former may then send the company a written statement setting out his views. *Subsections (5) and (6)* provide that the company must send its shareholders any statement from the outgoing auditor, and that if it is received too late for this it should be read out at the meeting.
787. *Subsection (7)* provides protection if the outgoing auditor is using the provision to have a statement circulated to secure needless publicity for defamatory material. It enables the company, or anyone else who is aggrieved by the statement, to apply to the court, and the court can then determine whether the auditor is using the provision in that way, in which case the company is not obliged to circulate the auditor's representations, nor need they be read out at the meeting. The court can order the auditor to pay some or all of the costs of the proceedings.

Section 516: Resignation of auditor

788. This section restates the right of an auditor to resign by written notice to the company. His resignation is effective from the date it is delivered to the company's registered office, or from a later date specified in it. To be effective it must be accompanied by the statement required by section 519.

Section 517: Notice to registrar of resignation of auditor

789. This section restates the obligation on a company whose auditor resigns to inform the registrar. Default in complying is an offence.

Section 518: Rights of resigning auditor

790. This section restates the right of an auditor who resigns to require the directors to convene a general meeting of the company so that it can consider his explanation of the circumstances that led to his decision to resign. The auditor can ask the company to send out a written explanation either in advance of that meeting if he has requested one, or before the next appropriate general meeting. The directors have 21 days to send out a notice convening a meeting once a resigning auditor has asked for it, and it must then be held within 28 days of the notice.
791. *Subsection (9)* provides protection if the resigning auditor is using the provision to have a statement circulated to secure needless publicity for defamatory material. It enables the company, or anyone else who is aggrieved by the statement, to apply to the court, and the court can then determine whether the auditor is using the provision in that way, in which case the company is not obliged to circulate the statement. The court can order the auditor to pay some or all of the costs of the proceedings.

Section 519: Statement by auditor to be deposited with company

792. This section requires a departing auditor to make a statement when he stops being the auditor of a company and to deposit it with the company. For quoted companies, this statement should explain the circumstances surrounding his departure. For other public companies and all private companies, it should explain the circumstances unless the auditor thinks that there is no need for them to be brought to the attention of the shareholders or creditors. In that case, the statement should state that there are no such circumstances.
793. This changes the position under section 394 of the 1985 Act, where auditors were only required to make a statement if they considered there were relevant circumstances: auditors leaving quoted companies will now always be required to make a statement of the circumstances; and auditors leaving other companies must make a statement unless they think that there are no relevant circumstances.
794. *Subsection (4)* sets out the deadline for depositing such a statement with the company, namely:
- if the auditor is resigning, the statement should accompany the resignation letter;
 - if the auditor is deciding not to seek re-appointment, the statement should be deposited at least 14 days before the end of the time allowed for appointing the next auditor; or
 - in any other case, no more than 14 days after the date on which he stops being the auditor.

Section 520: Company's duties in relation to statement

795. Unless the departing auditor's statement says that there are no circumstances to be brought to the attention of shareholders and creditors, this section obliges the company

to circulate the statement to everyone to whom it needs to send the annual accounts. The company must do this within 14 days of receiving it.

796. If the company does not want to circulate the statement, it can apply to the court, and if the court decides that the departing auditor is trying to secure needless publicity for defamatory material, then the company need not circulate the statement, but instead must send an account of the court decision to those to whom it would have sent the statement. In the event of a successful application, the court can order the auditor to pay some or all of the costs. In the event of an unsuccessful application, the company must circulate the statement within 14 days of the end of the court proceedings.

Section 521: Copy of statement to be sent to registrar

797. This section provides that the departing auditor must send a copy of his statement to the registrar, unless within 21 days of depositing it he hears that the company has applied to the court. If he does not hear of an application to the court within that time, he must send the statement to the registrar within the next seven days; and if an application is made and the company lets him know that it was unsuccessful, he must send the statement to the registrar within seven days of being told.

Section 522: Duty of auditor to notify appropriate audit authority

798. This section introduces a new obligation on departing auditors to send copies of their leaving statements to an appropriate audit authority as defined in section 525. It contains different rules depending on whether the company the auditor is leaving is classified as a “major audit” as defined in section 525.
799. In relation to major audits, the departing auditor should always send a copy of his statement to the appropriate audit authority. He should do this at the same time as he deposits his statement with the company under section 519. In relation to other audits, the departing auditor is required to send his statement to the appropriate audit authority only if he is leaving before the end of his term of office, meaning only if he has resigned or has been dismissed; and he must do so at the time required by the authority.
800. *Subsection (3)* provides that where the auditor’s statement to the company said that there were no circumstances that needed to be brought to the attention of shareholders or creditors, that statement must have attached to it a statement of the auditor’s reasons for leaving when sending it to the audit authority.
801. *Subsections (5) to (8)* set out the offence of failure to comply with these requirements, and the maximum penalties.

Section 523: Duty of company to notify appropriate audit authority

802. This section introduces a new duty on a company to notify the appropriate audit authority whenever an auditor leaves office before the end of his term, that is when he has resigned or is dismissed. The company has the choice of sending in the statement of circumstances made by the auditor under section 519, or of sending in its own statement of the reasons. *Subsection (3)* sets the deadline for notification as 14 days after the auditor has deposited his statement with the company. *Subsections (4) to (6)* set out the offence of failure to comply with this requirement, and the maximum penalties.

Section 524: Information to be given to accounting authorities

803. This section sets out the duty of the audit authorities to give the accounting authorities information about auditors’ departure, and the power, if they think it right to do so, to pass on the statements which they receive from departing auditors under the section 522 or from companies under section 523. The accounting authorities are the Secretary of State and anyone the Secretary of State has authorised under Part 15 to apply to the

court in respect of the revision of defective accounts. At present this is the Financial Reporting Review Panel, part of the Financial Reporting Council organisation.

804. *Subsection (3)* deals with the situation where the same body is both an audit authority and an accounting authority. If an accounting authority receives a statement that the court has determined need not be circulated to members, then *subsection (4)* provides that it must treat the statement as confidential, in the same way that authorities have to treat information obtained under compulsory powers under Part 15.

Section 525: Meaning of “appropriate audit authority” and “major audit”

805. This section defines two terms used in connection with the duty to inform the audit authority when an auditor leaves office, namely *appropriate audit authority* and *major audit*. The former means the Secretary of State, or the body to whom he has delegated functions in relation to the supervision of statutory auditors under Part 42, currently the Professional Oversight Board, part of the Financial Reporting Council organisation.
806. A major audit is defined as meaning the audit of a listed company, or of any other company where there is a major public interest. Whether there is a major public interest is to be determined by reference to guidance issued by any of the audit authorities. In practice, this will generally be guidance issued by the Financial Reporting Council.

Section 526: Effect of casual vacancies

807. This section applies when one out of two or more joint auditors ceases to be an auditor of the company. It enables the remaining auditors to continue in office. It restates section 388(2) of the 1985 Act.