

*These notes refer to the Companies Act 2006 (c.46)
which received Royal Assent on 8 November 2006*

COMPANIES ACT 2006

EXPLANATORY NOTES

COMMENTARY

Schedule 5: Communications by a company

Part 42: Statutory Auditors

1544. The provisions of this Part concern the regulation of auditors. The effects of this Part are:
- To replace Part 2 of the 1989 Act and equivalent Northern Ireland provisions, by restating those provisions with some modifications.
 - To extend the category of auditors that are subject to regulation and to make provision for the registration and regulation of auditors (whether based in the UK or not) who audit companies which are incorporated outside the EU but listed in the UK;
 - To provide that the Comptroller and Auditor General and the regional Auditors General are eligible to be appointed to perform statutory audits and provide a mechanism for the regulation and supervision of their functions as statutory auditor.
1545. Many of the provisions in this Part implement obligations contained in the Updated Eighth Company Law Directive on Audit (2006/43/EC) that was published on 9 June 2006. The provisions relating to Auditors General implement recommendations contained in Lord Sharman's report, "Holding to Account, The Review of Audit and Accountability for Central Government", published in 2001.

Chapter 1: Introductory

Sections 1209 to 1211: Introductory

1546. Part 2 of the 1989 Act regulates only the auditors of companies. Section 1210(1) defines the meaning of statutory auditor more broadly. Persons within *subsection (1)(a) to (g)* are 'statutory auditors'. This list includes those persons who audit companies (as required under Part 16 of the Act) and those who audit building societies, insurers and banks. In addition, the Secretary of State has a power to add auditors of other persons to this list. Section 1211 cross-refers the eligibility for appointment as a statutory auditor to the requirements contained in Chapter 2 or Chapter 3 of this Part of the Act.

Chapter 2: Individuals and Firms

Sections 1212 and 1213: Eligibility for appointment

1547. These sections are restatements of sections 25 and 28 of the 1989 Act adapted so as to apply in relation to statutory auditors. The sections provide that for a person or firm (defined in section 1261) to be eligible for appointment as a statutory auditor, the person must be a member of a recognised supervisory body and be eligible for appointment

under the rules of that body. Section 1217(2) clarifies that references to such members include references to persons who are not members but who are subject to the body's rules. (Section 1217 and Schedule 10 address the recognition of supervisory bodies, and lay down the requirements they must meet to be recognised.)

1548. **Section 1213** provides that no person may act as a statutory auditor if he is ineligible. It specifies that, on becoming ineligible, the auditor must resign his office and give notice in writing. Failure to comply with this requirement is an offence, conviction of which can result in a fine (*subsections (3) and (4)*). If the auditor continues to act as a statutory auditor after conviction (*subsection (5)*), or continues to fail to give notice that he is ineligible for appointment as a statutory auditor (*subsection (6)*), he commits a further offence for which a daily fine may be imposed after conviction (*subsection (7)*). *Subsection (8)* provides a defence if the person did not know or had no reason to believe that he was, or had become, ineligible.

Section 1214: Independence requirement

1549. This section restates section 27 of the 1989 Act and indicates circumstances where a person may not act as a statutory auditor on grounds of lack of independence. Under *subsection (2)* this includes persons who are officers or employees of the audited entity, or the partner or employee of such a person. Under *subsection (3)*, this includes where the person is an officer or employee of a subsidiary of the audited entity. *Subsection (4)* allows the Secretary of State to make regulations regarding other connections between the audited entity and the statutory auditor by virtue of which a person will be regarded as lacking independence.

Section 1215: Effect of lack of independence

1550. This section sets out the consequences of the prohibition from acting as a statutory auditor on grounds of lack of independence, as defined in section 1214. They replicate the effect of ineligibility as explained for section 1213.

Section 1216: Effect of appointment of a partnership

1551. This section is a restatement of section 26 of the 1989 Act. The effect of the section is to ensure that when a partnership constituted in England and Wales, Northern Ireland, or any other country or territory in which a partnership is not a legal person, is appointed as a statutory auditor under this Part, the appointment may continue even if a partner leaves the partnership. For a partnership or other person to be considered as appropriate for the appointment to continue, they must be eligible for appointment as a statutory auditor and not be prohibited (as indicated in section 1214(1)). Without this provision, the appointment would cease every time the membership of the partnership changed.

Section 1217: Supervisory bodies

1552. This section restates section 30 of the 1989 Act and defines a supervisory body as a body established in the UK which maintains and enforces rules regarding the eligibility of persons appointed as statutory auditors and the conduct of statutory audit work. *Subsection (4)* introduces Schedule 10, which specifies the requirements supervisory bodies must meet in order to be recognised, and the process for doing so.