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Accounting resource: The responsibilities of a director.

"It's not always obvious what being a company director actually entails and the responsibilities it brings. This briefing aims to highlight the duties that every director should be aware of."

Alan Ross, Tax Director, Wilson Partners Ltd

In brief:

Directors hold a position of trust on behalf of the company's shareholders. Their main duty is to manage the company for the benefit of those shareholders and not for any individual shareholder or group of shareholders.

"It would seem sensible that directors should have read and understood the company's articles to enable them 'to act within its powers'."

"The protection of a limited liability company may not protect directors if they are found to have wrongfully or fraudulently traded."

"It is beyond the scope of this paper to list all the various matters for which directors can be held liable and so if in any doubt, professional advice should always be sought."

Alan Ross, Tax Director, Wilson Partners Ltd

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The responsibilities of a director

Statutory duties:

As with many UK legal rules the duties owed by directors come from Common Law having evolved as a result of different rulings, comments and decisions made in court cases over the years. The Companies Act 2006 brought together some of those rulings with particular relevance to 'conflicts of interest' such that there are now seven statutory duties as follows (S172-S177 Companies Act 2006):

1. To act within powers:

The usual example of this duty concerns the issue of shares. The issuing of shares in order to raise money for the entire company is acceptable but not if for any other purpose, for example, to increase the number of shares to benefit one particular director.

It would therefore seem sensible that directors should have read and understood the company's articles to enable them 'to act within its powers'.

2. To promote the success of the company

Directors must act in a way which they consider, in good faith, would be most likely to promote the success of the company for the benefit of all shareholders, having regard to:

- The likely consequences of any decision in the long term
- The interests of the company's employees
- The need to foster the company's business relationships with suppliers, customers and others
- The impact of the company's operations on the community and the environment
- The need to maintain a reputation of high standards of business conduct and
- The need to act fairly as between shareholders of the company

3. To exercise independent judgement

A director of a company must exercise independent judgement. This duty is the overall method of decision-making that hopefully will ease any conflict of interest.

4. To exercise reasonable care, skill and diligence

This means the care, skill and diligence that would be exercised by a reasonably diligent person; higher standards are expected from directors responsible for decisions on matters for which they have specialist or professional knowledge.

5. To avoid conflicts of interest

A director must avoid a situation in which he has, or can have, a direct or even indirect interest that conflicts or may potentially conflict with the interests of the company.

This duty is particularly relevant in any property, information or opportunity transaction. Such transactions need to be authorised by the nonconflicted directors on the board, subject to the necessary quorum for a directors meeting excluding the director with the conflict of interest; that director is not allowed to vote on the transaction. Such a conflict may be encountered by non-executive directors who are more likely to hold multiple directorships.

6. To not accept benefits from third parties

Conflict of interest may arise on the acceptance of a benefit given by virtue of the directorship. 'Benefits' can be monetary or non-monetary in nature. This does, however, bring into question as to how far to take the acceptance of corporate hospitality or gifts.

7. To declare interests in any proposed transaction or arrangement

This duty requires the declaration of any interest, not only in a situation where a 'conflict' may arise but any interest of a director or any person connected with the director, for example, his/her spouse/children.

The nature and extent of the interest must be declared to the other directors unless they are already aware or 'ought reasonably to be aware' of the interest. Chapter 3 Companies Act 2006 covers declaration of existing transactions or arrangements; failure to declare can result in a fine.

Other legal duties:

There are other laws that can lead to prosecution against directors in their personal capacity for certain actions undertaken whilst fulfilling that role. Examples of this include:

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Company directors' disqualification act 1986:

A director can be disqualified in the following circumstances:

- The director has been guilty of three or more defaults in complying with companies legislation regarding the filing of documents with the Registrar of Companies during the preceding 5 years.
- He or she is, or was, a director of a company that has at any time become insolvent and that his/her conduct as a director of that company makes him/her unfit to be concerned in the management of a company;
- The director is found to be guilty of wrongful or fraudulent trading as defined in the Insolvency Act 1986 (see below).

Insolvency act 1986:

Wrongful Trading:

If a company has gone into insolvent liquidation and before that liquidation took place a director knew, or ought to have known, that there was no reasonable prospect that the company could avoid the liquidation, then the court may declare that the director make a personal contribution to the company's assets.

However, the director will not be made personally liable in circumstances where he/she can show that he/she took every step prior to the liquidation to minimise the potential loss to the company's creditors.

Fraudulent Trading:

Under this heading the court may also require a director to make a contribution to the company's assets if, in the course of the winding up of a company, a director was knowingly a party to the carrying on of the company's business with the intent to defraud the creditors.

Health and safety at work etc act 1974:

Health and safety law places duties on organisations and employers, and directors can be personally liable when these duties are breached: members of the board have both collective and individual responsibility for health and safety. If a health and safety offence is committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the organisation, then that person (as well as the organisation) can be prosecuted under the Act.

Corporate manslaughter and corporate homicide act 2007:

Under this Act, an offence will be committed where failings by an organisation's senior management are a substantial element in any gross breach of the duty of care owed to the organisation's employees or members of the public, which results in death. The maximum penalty is an unlimited fine and the court can additionally make a publicity order requiring the organisation to publish details of its conviction and fine.

Summary

This paper is only a brief summary of the duties, responsibilities and liabilities an individual will assume on being appointed a director of a company. It is beyond the scope of this paper to list all the various matters for which directors can be held liable and so if in any doubt, professional advice should always be sought.
Whilst many directors are also shareholders of the businesses in which they are involved this does not reduce their responsibilities.

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