

Directors' responsibilities

Company directors are responsible for the management of their companies. But they act on behalf of the owners, and must consider their interests in everything they do. They also have responsibilities to the company's employees, its trading partners, and the state.

As a director, you need wide powers to help the company become a strong and profitable business. 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.

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

- They are often selected from among the shareholders and can be employees of the company.
- They are sometimes required, under the company's Articles of Association, to retire by rotation, or after a set period of time.

1.2 Subsequent appointments must follow procedures set out in the Articles of Association.

- For example, retiring directors may offer themselves for re-election at the AGM, the shareholders' annual general meeting.
- 1.3** If you are appointed 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 all the same legal responsibilities as the other directors.
- 1.4** Even if you have never been appointed a director, you could be classed as a **shadow director** if the other directors are 'accustomed to act' under your instructions.

It could also happen if you resign your directorship but continue making decisions and giving instructions to employees.

- As a shadow director you would carry the same legal responsibilities, and be subject to the same penalties, as other directors.

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

- Auditors (or reporting accountants — see **4.2**) may not be appointed directors of the companies for which they act in their professional capacity.
- 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 the court which imposed the bankruptcy (see *Insolvency*).

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 what limits there are 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 powers, the company may have an action against them.
- You can only change the company's main 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 main 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 who had been a finance director for several years would 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, though it is dangerous to turn a blind eye.

3 Fiduciary responsibilities

As a director, you must act in good faith in the interests of the company as a whole.

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.

- For example, it might be in the interests of the shareholders for the directors to declare a large dividend. But if the company faced a cash shortage this would conflict with the interests of the company.
- You must also consider the interests of other stakeholders such as creditors and employees.

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 from a contract you won because you are a director of the company, you might be forced to hand it over to the company.

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

“You may think that a director of a small business just manages the company on a day-to-day basis. That's true, of course, but don't forget that as a director you also have certain legal responsibilities. And if you breach them, you could land up in hot water. So if you want to be sure of carrying out your duties correctly, consider taking expert advice.”

Jenny Davison,
Arian Associates

“If the directors agree a contract which is outside the objects clause, the third party who agreed the contract can still enforce it.”

Steve Connor,
Shepley Window Systems Company

- For example, if you have interests in another company with which your company is planning to do business.
- You should not vote on such a deal. If you do, your vote should be disregarded.

3.5 If you personally plan to enter into **substantial deals** with the company, they must be approved by the shareholders in a general meeting.

- For example, if you want to sell property to or buy property from the company.

3.6 You must declare any **shareholdings** you have in the company, and any dealings in the shares, within five days.

- This obligation extends to shares held by your spouse and any children under 18.

Wrongful trading

You will be guilty of wrongful (or, perhaps, even fraudulent) trading if you allow the business to carry on, and incur debts, when you know or should know there is no reasonable prospect that the company will be able to repay them.

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 that it will move into profit, and doubts about whether its assets will cover its liabilities or whether it can pay its debts when they fall due, the company is probably trading wrongfully.

B The value placed on the **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 the case with intangible assets, such as goodwill.

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

- They rank ahead of most other debts, including the bank.

D As a director, you could be **personally liable** for the company's debts if you knew (or should have known) there was no real prospect it could have repaid them.

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

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

4 Duties under company law

As a director, you are personally responsible for ensuring that the company complies with company law. These duties are usually delegated to the company secretary (see **Role of the company secretary**), but you must ensure that they are carried out. From 6 April 2008, it will no longer be obligatory to have a separate company secretary. The company director will be able to hold both positions – company director and company secretary.

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 the director may be personally liable, or disqualification as a director or even a 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 £5.6 million do not need to have their accounts audited.
- Directors are required to sign declarations that they have not hidden any material information. If they are later found to do so, they face fines or imprisonment.

4.3 The annual accounts must be presented for **board approval** and a director must sign the balance sheet.

- The board must also approve and sign off the directors' report.

4.4 Directors must ensure that the report and accounts are considered at a **general meeting** of the company (usually the AGM).

4.5 As a director, you must ensure that **minutes** are taken at board meetings, giving a record of all decisions taken.

- This could protect you if you face legal action later (see **6**).

“The number of boards taking out directors' and officers' liability insurance has rocketed in recent years. It is a sensible and effective precaution.”
Ian Frater, Eviva

5 Other legal duties

5.1 You must comply with **employment law** in dealings with employees. (See **Employment law: the basics**.)

- You (personally) can be sued for unfair dismissal, racial or sexual discrimination or unfair work practices.
- 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** (NI) 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 acts which are illegal, 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 financial difficulties.

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

7.3 Make sure that **minutes** are maintained.

- 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 Memorandum and Articles.

- Do not leave yourself open to criticism or even dismissal in any boardroom battles.

7.5 Whenever possible, avoid giving **personal guarantees** on company loans or overdrafts.

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

7.6 Ensure the company takes out directors' and officers' **liability insurance**. (See **Litigation and insurance**.)

- This will pay for legal expenses if you are sued for negligence or breach of duty. But it may not protect you against actions for dishonesty, or in the event of the company failing.

Expert contributors

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Further help

There are other Directors' Briefing titles that can help you. These briefings are referred to in the text by name, such as **Insolvency**.

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