

Accountancy Update

July 2010

Time is of the essence

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Case notes

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In *Macquarie International Investments Limited v Glencore UK Limited*, the Court of Appeal, including Lord Justice Jackson and the Master of the Rolls, treated compliance with the relevant accounting standards as strong evidence that the accounts in question presented a true and fair view of the assets and liabilities of a company. [More...](#)

Court considers the effectiveness of a limitation of liability clause

In a case involving the alleged negligent valuation of shares, the court considered the effectiveness of a limitation of liability clause contained in an accountant's engagement letter. The court also considered an alleged conflict of interest. [More...](#)

Round-up

Our Round-up section includes reports on recent steps towards a review of the role of the audit, the latest on the implementation of the Jackson recommendations on civil litigation costs, and the Law Society's intervention in the dispute over whether legal professional privilege should be extended beyond the legal profession. [More...](#)

View all

Firm news

Our June Breakfast Briefing, which looked at the issue of fraud and the duty to detect it in the context of audit services, was topical and well attended. If you were unable to attend, but would like a copy of the Briefing papers, please email us at seminars@rpc.co.uk. [More...](#)

Any comments or queries?

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As part of our commitment to corporate social responsibility we are proud to support Mencap as our current Charity of the Year (www.mencap.org.uk).

This is a summary of recent developments. It should not be regarded as a substitute for advice on how to act in any particular case. For further information please contact one of the authors.

Time is of the essence

Although the Bribery Act 2010 (the Act) does not become law until the Autumn, it introduces new criminal offences applicable to commercial organisations (corporates and partnerships) and a business operations specific defence which requires action now. Richard Burger (Senior Associate) and Harriet Boughton (Associate) from RPC's Regulatory Group explain what you need to know about the new Act and what you can do now by way of preparation.



The new legislation leaves little time for senior management and, in particular, their professional advisers to assess how to implement the Act, design and/or adapt anti-bribery and corruption systems, roll out staff training and finally stress test these new controls.

The key new offences:

- giving/receiving a bribe
- bribing a foreign public official
- a corporate offence for failing to prevent bribery
- a D&O offence.

Giving/receiving a bribe

The remit of the first two offences is deliberately wide, the substance being any 'financial or other advantage' which may be offered or accepted with the intention of improper performance. The offences can be committed through direct contact or actions or through a third party's contact or actions. It does not matter whether the advantage is for the benefit of the person receiving the bribe or another.

A person will be subject to the scope of the offences if performing a function or activity of a public nature, or an activity connected with a business, or if the activity is performed in the course of employment or by or on behalf of a body of persons (whether corporate or unincorporated).

Further conditions are that the person performing the function or activity is:

- i) expected to perform it in good faith
- ii) expected to perform it impartially
- iii) is in a position of trust by virtue of performing it.

The performance is improper if any person who is subject to the scope of the offence is deemed to have undertaken such function or performed any activity in breach of the expectations set out under (i) – (iii) above, in the eyes of a 'reasonable person' under the UK legal test. It does not matter if the function undertaken or the activity performed has no connection with, or is performed/undertaken outside, the UK.

Bribing a foreign public official

The elements of the offence are:

- an intention to influence the Foreign Public Official in his official capacity

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- an intention to obtain or retain business, or an advantage in the conduct of business
- the official is not permitted or required by written law to be so influenced.

[Back to contents](#)

There is no requirement of improper performance, criminal intent or corruption. There is no exception for any facilitation payment, no matter its size or if such payment is customary; all such payments are illegal. This goes beyond the US Foreign Corrupt Practices Act.

Failing to prevent bribery

A commercial organisation is guilty of an offence if a person associated with it bribes another person intending:

- (a) to obtain/retain business for that organisation or
- (b) to obtain/retain an advantage in business for the organisation.

An offence is committed if any director, employee or agent of a firm bribes another person with the intention of obtaining/retaining an advantage in the conduct of business for the firm, regardless of where the bribe takes place, if that organisation carries on any activity in the UK.

Adequate procedures

A defence is available if the organisation can prove that “adequate procedures” were in place to prevent such conduct. Without these, a UK business could be found criminally liable for an act of bribery by an overseas director, employee or agent, of which it had no knowledge. There are clear risks for firms operating as part of a global network.

The Ministry of Justice will provide generic guidance on “adequate procedures” within the next six months. However, the consensus of opinion is that businesses should not wait for this guidance to be published, as each business/sector/industry will require their own bespoke “adequate procedures”.

Further concerns remain about criminal liabilities arising from joint ventures, sub-contractors and distributors where “adequate procedures” are not in place to prevent an innocent counterparty also incurring criminal liability under the Act.

Criminal liability for directors

Senior management convicted of a principal offence are liable for up to 10 years’ imprisonment, a fine, or both. Additionally, if certain offences (giving or receiving a bribe and/or bribing a foreign official) are proved to have been committed with the consent or collusion of a senior officer or person acting in such a capacity of the body corporate, the senior officer or person (as well as the entity) is guilty of the offence, provided the senior officer or person has a close connection with the UK.

Double blow

For Financial Services Authority (FSA) regulated firms there is a double blow, with the FSA renewing its interest in anti-bribery and corruption.

The FSA recently published the findings of its review into anti-bribery and corruption systems and controls in the commercial insurance

[Back to contents](#)

intermediaries sector. The review was harsh, with criticism that there were inadequate anti-bribery and corruption systems and controls in place. As a result of the review a number of insurance brokers are subject to supervisory or enforcement action.

[Back to contents](#)

The **insurance sector** will wish to benchmark itself against this review, but other financial services firms should also self-assess themselves against the FSA's findings, certainly those in the wealth/investment management sectors, as the FSA has signalled its intention to extend the scope of its review to **investment banking**.

As the FSA and the Serious Fraud Office jockey for position within the new Economic Crime Agency, a flexing of muscle over anti-bribery and corruption could well see more FSA enforcement action and criminal investigations/prosecutions.

Preparation

Firms may wish to consider the following areas to meet the requirements of the "adequate procedures" of the Act:

- **Board/Executive partnership responsibility for the anti-corruption programme:** senior management should take responsibility for establishing a culture within a company/firm in which corruption is eradicated, and for the effective design and implementation of the firm's anti-corruption programme
- **Compliance function:** a senior officer should be directly accountable for oversight of the anti-corruption programme
- **Ethical code of business conduct:** firms should have a clear code of conduct which includes an anti-corruption element and should publicise this internally, and on their website
- **Risk management:** procedures should be established to assess the risks of corruption arising in an organisation's business
- **Employment procedures:** consider whether the firm needs to vet employees
- **Gifts and hospitality policy:** implement a gifts and hospitality policy providing guidance to employees on giving and receiving gifts and entertainment, and monitor this activity
- **Training:** codes of conduct should be properly embedded throughout the business via training
- **Due diligence:** Before entering into any business relationship or project, the organisation should carry out due diligence on the country in which the business is to be conducted, on its potential business partners, agents used and on the proposed project or transaction to identify as far as possible the risk of corruption
- **Decision-making process:** formalise the firm's decision-making processes, so that where a greater risk of corruption is perceived to exist, the decision is taken by a suitably senior officer
- **Financial controls:** put in place financial controls to minimise the risk of the firm committing a corrupt act against another individual or organisation (eg employees, clients, business partners, sub-contractors or suppliers), or of any corrupt act being committed against the firm
- **Supply chain management:** use procurement and contract management procedures which minimise the opportunity for corruption by sub-contractors and suppliers

[Back to contents](#)

- **Reporting and investigation procedures:** implement whistle-blowing procedures which enable employees to report corruption in a safe and confidential manner to a responsible senior officer or partner of the firm.

Firms that do not already have anti-bribery and corruption systems and controls in place will have to move quickly to keep in line with an Act with sharp edges.

Whilst the Act was overdue, its speedy enactment and the lack of guidance on “adequate procedures” places pressure on UK business in an area where criminal and/or regulatory sanctions can be imposed.

Case notes

Compliance with accounting standards is strong evidence that the accounts present a true and fair view of the assets and liabilities of a company

In *Macquarie International Investments Limited v Glencore UK Limited*¹ the Court of Appeal, including Lord Justice Jackson and the Master of the Rolls, treated compliance with the relevant accounting standards as strong evidence that the accounts in question presented a true and fair view of the assets and liabilities of a company.

Macquarie purchased a group of companies (the Group) from Glencore. After the purchase, it had to pay a liability of £2.4m in respect of a charge which ought to have been paid by one subsidiary. The parent and subsidiary were unaware of the liability because of a data entry error made by a third party. Group accounts were prepared in early 2006 without reference to, and in ignorance of, the missed charge. The purchase was completed in September 2006, and the error was not drawn to Glencore's attention until November 2006.

The sale agreement contained various warranties, including warranties that the accounts were “prepared in accordance with Relevant Accounting Standards” and gave “a true and fair view of the assets and liabilities of the Group”. Macquarie claimed that the failure to disclose the missed charge amounted to a breach of warranty.

Macquarie argued that, even though the reporting process was carried out in accordance with the relevant accounting standards, the outcome of that process – the draft audited accounts – did not present a true and fair view of the assets of the Group or the subsidiary as there was an undisclosed liability of £2.4m.

Jackson LJ considered that both the management accounts and the draft audited accounts gave a true and fair view. The Group did not know and could not reasonably have discovered the missed charge at the relevant time, and there was no evidence of the missed charge available before the draft audited accounts were signed off which would have enabled the charge to be included in the accounts. It could not be said that the Group or



[Back to contents](#)

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[Back to contents](#)

[Back to contents](#)

its accountants made an “error” within the meaning of FRS 3 paragraph 63 (an error of such significance as to destroy a true and fair view) which required or permitted the accounts to be reopened or restated.

Lord Neuberger (the Master of the Rolls) agreed, and said that: *“...if, according to the accounting practices and policies used to prepare the Management Accounts, there was no reason to take into account, or even refer to, the missed meter charges, then the failure to do so cannot render those accounts ‘misleading’, let alone ‘misleading in any material respect’”*.

Macquarie’s appeal was dismissed.

Court considers the effectiveness of a limitation of liability clause

In a case involving the alleged negligent valuation of shares², the court considered the effectiveness of a limitation of liability clause contained in an accountant’s engagement letter. The court also considered an alleged conflict of interest.

PwC were engaged to advise in relation to the proposed disposal of companies controlled by the claimants. PwC’s engagement letter contained a limitation of liability clause, which limited its liability to no more than the higher of five times the aggregate fees paid and payable, or £1m.

In the event, the issue of the cap was irrelevant as the damages awarded did not exceed the cap, but Vos J considered its reasonableness in his judgment. He held that the limitation of liability clause would, in the circumstances of the case, have satisfied the requirement of reasonableness (under section 2(2) of the Unfair Contract Terms Act 1977). He gave the following reasons:

- Although PwC was in the stronger bargaining position, the claimants were powerful and experienced business people, and their companies had considerable commercial influence. They were aware of the possibility of going elsewhere for valuation advice and had contacted another firm before deciding to instruct PwC. They chose to use PwC, knowing that it employed limitation clauses, because they wanted that firm in particular.
- The claimants knew, or ought reasonably to have known, of the limitation of liability term. They were not to be regarded as *“innocents abroad”* and were entirely capable of protecting their own interests. They knew and understood that accountancy firms customarily limited their liability using clauses of this kind, but chose not to discuss or negotiate the limitation.

The claimants also alleged that there was a conflict of interest. The portfolio of shares was acquired by Barclays, and the claimants alleged that PwC was conflicted as it wanted the future refinancing work from Barclays, and had Barclays’ interests in mind.

[Back to contents](#)

Vos J gave short shrift to those arguments, pointing out that: *“major accountancy firms, like major legal firms, frequently attract business by acting against their prospective client. They do that by impressing that prospective client with their professionalism and competence, not by showing that they are willing to act against the interests of their own client. If the prospective client once thought that its prospective adviser had a propensity to act in breach of fiduciary duty, it would, if well-advised, run in the other direction”.*

Round-up

The future role of audit

The role, and indeed the very nature, of audit is under scrutiny. The FSA and FRC have recently published a joint discussion paper *‘Enhancing the auditor’s contribution to prudential regulation’*. The paper was prompted by the financial crisis and considers how the auditing profession can work with the regulators to contribute to prudential regulation in the future.

The Paper *“questions aspects of the quality of audit work relevant to prudential regulation – in particular, whether the auditor has always been sufficiently sceptical and has paid sufficient attention to indicators of management bias when examining key areas of financial accounting and disclosure which depend critically on management judgement”*. It outlines the FSA’s concerns about how auditors fulfil their legal obligation to report to the FSA; considers changes which could increase the effectiveness with which auditors undertake their work; and examines the regulatory environment in which auditors operate and suggests measures to enhance how auditors contribute to prudential supervision. The deadline for Responses to the Discussion Paper is 29 September 2010.

The report comes as part of a wider call to discuss whether the value of the audit can be enhanced. The ICAEW Financial Services Faculty has also published proposals seeking to improve the usefulness of audit – specifically that auditors and banks must, in the wake of the financial crisis, both interact better and do more to explain the value of audits to outsiders. Meanwhile, the Future of Banking Commission Report recommended that *“fundamental questions [be] asked about the purpose of the audit”*.

The next year is likely to see a marked increase in scrutiny over the role of audit and audit practices alike. The message appears to be *“something needs to change – watch this space”*.

Decision by accounting rule-makers to delay harmonisation attracts EU criticism

The International Accounting Standards Board and the US Financial Accounting Standards Board have pushed back the deadline for global harmonisation, originally set for June 2011. It is hoped that, following calls from the G20 for the process to be completed by June 2011, harmonisation will be achieved by the end of 2011. The decision to delay has drawn criticism from Michael Barnier, European Union internal market commissioner. The European Commission agree, saying that: *“the important decisions should be discussed*

Footnotes

- 1 [2010] EWCA Civ 697
- 2 *Dennard and others v PricewaterhouseCoopers* [2010] EWHC 812 (Ch)



[Back to contents](#)

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[Back to contents](#)



Round-up continued...

and taken. That's why the Commissioner would like the issue to be discussed as quickly as possible at the monitoring board".

Ministry of Justice reports on progress of implanting Jackson report recommendations

In our February Update we commented on the recommendations of Lord Justice Jackson's Review of Civil Litigation Costs. The Ministry of Justice is currently conducting a high-level assessment of the economic, policy and legal implications of the key recommendations on different bodies, from individual court users and their legal representatives to the Government itself. Views have already been sought from across other Government departments with a key interest in the recommendations. A more detailed route map will be published once Ministers have decided on the way forward.

FRC publishes final version of UK Corporate Governance Code for companies with a premium listing

On 28 May 2010, the FRC introduced changes to the UK Corporate Governance Code. Widely opposed in the corporate world, these changes mean that directors of FTSE 350 companies will now face an annual vote if they are to remain in their positions, rather than the three-year term they previously enjoyed. The move was supported by Sir David Walker, author of the Walker Review on corporate governance, in the wake of the financial crisis, who said: *"the capability of board members and the dynamic of the boardroom are critical in the setting of corporate strategy and oversight of its execution"*, adding that the measure should introduce welcome *"additional encouragement and discipline"* to shareholders. Other changes include better explanation of companies' business model, alignment of performance-related pay to the long-term interests of the company, and new boardroom principles.

FRC head calls for greater powers to share information within the FRC

Stephen Hadrill, chief executive of the FRC, has said, in an interview with the Daily Mail, that he wants greater powers to share information within the FRC: *"There are weaknesses in our powers that we would like to see addressed. Legal restrictions stop us sharing information not only with outside bodies, but even within the FRC. For example, one part of the FRC may be looking at a company's accounts while another part may be looking at its audit, but they cannot confer"*.

Law Society intervenes in Prudential appeal case

In December 2009 we reported on the case of *Prudential Plc & Anor v Special Commissioner* in which Prudential sought (unsuccessfully) to extend the scope of legal professional privilege (LPP) beyond the legal profession. The Law Society has now been granted permission to intervene in the appeal of the case, over concerns about the potential scope for any professional giving advice on an area of the law to claim LPP, irrespective of whether they are regulated or members of any organised and disciplined association and irrespective of their role in the administration of justice. Law Society President Robert Heslett said: *"the case has the potential consequence of giving anyone who describes him/her self as a*

[Back to contents](#)

[Back to contents](#)

tax accountant or other professional the ability to withhold vital information from bodies such as HMRC, when LPP is intended to have a very specific purpose. The boundaries of LPP must remain clear. Extending it risks creating uncertainty over what can and cannot fall under LPP”.

[Back to contents](#)

Firm News

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