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REVISION OF BRITISH COMPANY LAW

*By Mary E. Murphy**

The English Company Acts, revised at periodic intervals to place limited liability enterprise under State scrutiny, have been subjected to recent detailed criticism by a committee of inquiry under Mr. Justice Cohen, a Judge of the King's Bench Division of the Supreme Court of Judicature.¹ This Committee, composed of distinguished members of the bar, economists, accountants and business men, was appointed by the Board of Trade to consider and report what major amendments were desirable in the Companies Act, 1929, and in particular to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded investors and the public. Its report, published in June 1945, has elicited wide comment in both Britain and America as it provides one of the best reviews of traditional and contemporary accounting and corporate practice in the former country. In addition, the Committee proposes reforms, some conservative, others drastic, for blatantly outmoded or illegitimate business procedures, but it has skillfully avoided "placing unreasonable fetters upon business which is conducted in an efficient and honest manner," while making sure that "as much information as is reasonably required shall be available to shareholders and the public."²

The Labor Government has accepted the recommendations of the Cohen Committee in full and is preparing a Bill to give effect to them. Before this measure is introduced in Parliament, however, companies are urged to bring their practices in line with the Committee's proposals, a suggestion which has been followed by a number of prominent firms.

The Cohen Committee expresses satisfaction that the great majority of public and private limited liability companies is managed honestly and of marked benefit to the nation's trade and industry. The fullest practicable disclosure of information concerning the activities of companies in its opinion will lessen the opportunity for abuse and coincide with an aroused social consciousness. The Amendment Committee's suggestions have been aimed at aiding

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¹See Minutes of Evidence taken before Company Law Amendment Committee, London, H. M. Stationery Office, 1943, for details of this inquiry.

²Report of the Committee on Company Law Amendment, Cmd. 6659, pp. 115.

shareholders to exercise a more effective general control over the management of their companies, although they indicate that this aim will be attained "more by selection of the proper governing body of each company than by the provisions of any statute."

A serious problem confronting the formulators of Company Law is the dispersal of capital among an ever increasing number of small shareholders who direct little attention to their investments. English law has always assumed that the owners of a limited company's capital would take an active interest in their property, and do all that could be expected of prudent men and women to safeguard their corporate interests and to exercise their joint controlling powers to their firm's best advantage. Company Law has succeeded admirably in its function of tapping remote sources of capital and channeling them into large vats for feeding the country's industry and trade. But it has had to cope with the wide separation of individual shareholders, the physical impossibility of bringing the entire number or even a majority of shareholders together in one place, the difficulty of creating and maintaining a corporate spirit among the owners of corporate enterprises, the concentration in company management of functions which were properly those of proprietors but which were left unexercised, and the tendency on the part of managements to provide the minimum of information to stockholders who have shown little desire to utilize it. As a means of improving this state of affairs the editor of the *Financial News*, in testimony, suggested the establishment of a new office, under the Crown, of Public Shareholder, who would hold one share in every company, and the organization of a Shareholders' Advisory Committee and of Company Commissioners to maintain regular contact with the board of directors on behalf of shareholders.

When the Consolidating Act was passed in 1862, 2,479 companies had registered under the 1856 Act which established the principle of limited liability in England.³ From that day forward, the increase in the number of joint stock companies has been great although in this development the major emphasis has been placed upon the private rather than upon the public company from the viewpoint of numbers if not from that of capital involved.⁴

³Shaman, H. A., *The Coming of General Limited Liability*, Economic History, January 1931, pp. 267-91.

⁴A private company restricts the right to transfer its shares, limits the number of its members to fifty excluding persons in the employ of the company, and prohibits an invitation to the public to subscribe for any shares or debentures it may issue. In practice, a private company rarely exceeds two to six members, and frequently consists of only the promoter and his wife or son or daughter.

The rise of the English accounting profession is closely connected with the growth of limited liability companies. As the number of such companies rose from 9,000 in 1885 with £482,000,000 paid-up capital to 182,500 in 1944 with £5,987,000,000 in paid-up capital, auditors established professional societies, set up qualifying examinations, and outlined standards of conduct.⁵ The correlation of Company Law with company practice has become increasingly complex and numerous bodies, including the Trade Union Congress, recognizing this dilemma, have suggested that provision be made for a standing Consultative Committee to afford the Board of Trade a continuous examination of the operation of the Act so that any amendments required can be suggested and put into effect with a minimum delay.

Modern accounting practice in relation to the form and presentation of reports and accounts far exceeds the standard prescribed by the Companies Act 1929, and professional accounting societies have encouraged this tendency by every conceivable means.⁶ There has been great agitation in the last ten years to subject the profit and loss account to the same statutory requirements in regard to circulation, inspection and filing as the balance sheet, with the additional obligation that the auditors' report should relate not only to the balance sheet but also to this account. Some observers, in fact, have contended that private companies should be required to publish an annual balance sheet and profit and loss account, while others have emphasized that the law should provide a standard form for financial statements of all companies and should define some of the more important accounting terms used.⁷ The Institute of Chartered Accountants, however, has continued to urge maximum disclosure in accounts although holding out against standardization of financial statements. Statutory guidance should be extended to the profit and loss account, in its opinion, with

⁵These data do not include debentures, bonds, mortgages and bank loans as part of share capital, and they do not include the capital of firms incorporated under Parliamentary Acts such as apply to railways, public utilities and public welfare companies.

⁶The first measure covering the registration, incorporation and regulation of joint stock companies was placed on the statute books in September 1844. This Act differs widely from the 1929 measure but it is interesting to note that it embodied the principle of investors' protection by means of publicity. It required directors to prepare a "full and fair balance sheet" and to appoint auditors for an annual inspection of the firm's accounts. A balance sheet and auditors' report were required to be sent to every shareholder at least ten days before an ordinary meeting, and these documents had to be filed with the Registrar of joint stock companies.

⁷See testimony of representatives of the *Economist*, Minutes of Evidence 16, April 18, 1944.

auditors' duties enlarged to cover that document as well as the consolidated accounts of holding companies.

Close examination of English Company Law reveals that although many restrictions are imposed upon the limited company, especially as to account maintenance, the requirements are not onerous. Before the passage of the 1929 Act no legislative measure prescribed the form and content of the balance sheet or required that a profit and loss account be submitted for a company in general meeting. Under this Act, also, English companies were required for the first time to keep proper books of account with respect to "all sums of money received and expended, and the matters in respect of which the receipt and expenditure take place; all sales and purchases of goods by the company; and the assets and liabilities of the company." The Law is silent, however, as to the requisite professional qualifications of auditors depending, instead, upon the profession's standards to protect the public interest. Again, Company Law states no requirements as to the profit and loss account, and its provisions for the balance sheet are generally held to be inadequate. Individual proprietorships and partnerships do not need to present accounts covering their financial positions and operations. Public utilities, banking and insurance companies, and deposit, provident and benefit societies must present their accounts in statutory form but assurance companies, covered by the 1909 Companies Act, are excluded from the 1929 measure. The more important statutory enactments covering the form and content of financial statements and the activities of the auditor follow:

Industrial and Provident Societies Acts 1893-1928

Friendly Societies Acts 1896-1929

Industrial Assurance Acts 1923-1929

(Under the above Acts auditors are appointed by Lord Commissioners of H. M. Treasury)

Companies Clauses Consolidation Act 1845

Railway Companies Act 1867

Regulation of Railways Act 1860

Railway Companies Act 1911

Railways Act 1921

Gas Works Clauses Acts 1847 and 1871

Gas Regulation Act 1920

Waterworks Clauses Acts 1847

Electric Lighting Acts 1882-1909

Electricity Supply Acts 1916 and 1926

Assurance Companies Act 1909

Building Societies Acts 1874 and 1894

Trustee Savings Bank Act 1893

Public Trustee Act 1906
Judicial Trustee Act 1896
Trustee Act 1925
Licensing Act 1910
Municipal Corporation Acts 1882 and 1933
Public Health Act 1875
Local Government Acts 1888, 1894, 1899 and 1933

An investigatory committee in 1927 held against drastic amendment of the prevailing Company Law under the premise that shareholders should be permitted to formulate the accounting requirements of their firms. Its report stated that "it is often forgotten that it may be in the best interests of shareholders for accounts to be prepared in a certain form and we consider that undue interference by the legislature in the internal affairs of companies is to be avoided, even if some risk of hardship in individual cases is involved."⁸ Since the 1929 Act came into force public attention has been directed to the heavy losses which investors, many of whom subscribed for their shares on the basis of unsatisfactory prospectuses, suffered in the slump which followed the 1928-29 boom. Neither this measure nor the Revised Rules of the London Stock Exchange governing the grant of official quotations and permission to deal had come into force in time to affect the prospectuses in question. The issue arose, also, whether the exemption of private companies from the obligation to file accounts with the Registrar of Companies should be permitted to continue. The practice of placing shares in the names of nominees for the real owners was followed to conceal the core of control, and it led to a widespread demand that the real ownership should be disclosed.

Current legal requirements as to the contents of accounts to be presented to shareholders are generally considered to be far too meagre. The tendency of showing a number of diverse items in one lump sum, and thereby obscuring the real position of the assets and liabilities and the results of trading, makes it difficult and often impossible for a shareholder to form a correct view of the financial position and earnings of the company in which he is interested. London Stock Exchange requirements, although they go beyond the law, are applied with discretion and they do not apply to companies with issues already quoted or, in the case of holding companies, to units below the first degree. In general, the Exchange requires approximately the same amount of balance sheet and profit

⁸Report of Company Law Amendment Committee, Wilfred Greene, Chairman, Cmd. 2657, p. 74.

and loss data as is required by the Government, and this information is limited and not uniform in type. At the end of each accounting period, listed companies must submit a balance sheet, such as is circulated to shareholders, and a profit and loss statement which has been laid by the auditor before the annual meeting. All companies admitted to future listing must file a consolidated balance sheet and a consolidated profit and loss account.

The London Stock Exchange does not vouch for the soundness of the issues listed on its boards but it does ascertain that Company Law is generally followed. On the other hand, the responsibility of accountants relative to security issues is restricted to the preparation of vital financial information to be submitted to the Exchange by the issuing company. As prospectuses must be prepared for all public offerings of securities, in accordance with the prescribed legal form to be filed at Somerset House and with the Exchange, the accountant has an important task to complete. To those issues which are introduced to the public through the "granting of permission to deal by any recognized Stock Exchange in Great Britain," the statutory prospectus and registration provisions do not apply and no prospectus, in fact, need be compiled, distributed or filed. In such a case the Committee of the Stock Exchange, rather than a Government agency, assumes responsibility for listing.

None of the very large banks, popularly known as the Big Five, except in very rare cases, consider themselves as "fathering" issues in any way or responsible for them beyond seeing "that the prospectus complies generally with the law and that the issues on their face are respectable."⁹ The common practice of Clearing Banks, however, when considering whether to allow their names to appear upon a prospectus (or on an Offer for Sale or an advertisement for Stock Exchange purposes) is for the banks concerned to satisfy themselves as to the respectability of the directors of companies and the soundness of the issue; to scrutinize the document to see whether the requirements of the Companies Act relative to the prospectus have been complied with; and to examine the document with the object of being satisfied, as far as possible, that the prospectus is not obviously misleading and that the parties named in it are capable of fulfilling underwriting contracts. They also estimate whether the promotion profits and expenses shown in the prospectus appear reasonably proportionate to the amount of the

⁹Macmillan Report 1931, paragraph 388.

issue and ascertain whether the company appears to have sufficient capital to carry out the program outlined in the prospectus.¹⁰

One problem attacked by the Cohen Committee was the legal provisions governing the preparation of financial statements. Under the 1929 Act, it was possible to lump together on a balance sheet such diversified assets as land, buildings, plant, machinery, ships, water transports, copyrights, development account and investments. Stock, stores, debts, work in progress, unfinished contracts, bills and cash was another possible classification which would meet the law. On the balance sheet of one well-known company the profit and loss item shows a total on trading account of nearly £1,000,000 which is stated to include "dividends from subsidiary and associated companies, loan interest and transfer fees, after deducting interest on debenture stocks and mortgages, directors' fees, salaries, wages, rents, rates, taxes, war damage premiums, repairs and other expenses, and after providing depreciation and reserves for contingencies."

Company directors under the prevailing law can use any of the following obscure approaches to accounts: first, adoption of technical language which although conveying meaning to accountants and directors may afford a totally different meaning to investors and financial experts; second, combination of assets the value of which is expressed in one or more aggregate figures with no information as to the composition of the item; third, employment of systems of valuation which do not agree with statement values under certain conditions; fourth, omission of the real relation of a company's profit and loss account to current earnings; fifth, use of secret reserves; sixth, omission of information regarding subsidiaries; seventh, failure to report contingent liabilities; eighth, omission of data occurring between date of statements and date of their presentation to shareholders.

A typical English profit and loss account is stated below and it affords some knowledge of the unfortunate abbreviated feature of contemporary statements of this nature:

| | |
|----------------------------------|--------------------------------|
| To directors' remuneration | By profit from trading account |
| To provision for depreciation | after meeting working ex- |
| To interest on debentures | penses |
| To income tax | By income from investments |
| To balance being profit for year | |

¹⁰See Minutes of Evidence 10, January 2, 1944, for testimony of Committee of London Clearing Banks. By way of contrast, testimony of Committee on General Purposes of the London Stock Exchange, Minutes of Evidence 12, February 11, 1944, should be examined.

It is not uncommon for a company to show in the profit and loss account some such omnibus item as "trading profit, including income from investments after making provision for expenses of management, depreciation, bad debts, and so forth." In such a case shareholders have no means of ascertaining the revenue from investments, that is, capital invested in such companies, the expenses of management, depreciation or bad debts, or the gross profit on trading.

English auditors have no responsibility for building up the income figure. A single item may contain operating results, dividends and non-recurring income, and neither the amount nor the method of calculating depreciation need be given. Dependence traditionally has been placed upon the ethical standard of company directors and auditors rather than upon the written law in regard to profit and loss disclosure. The first legal decision of any consequence as to the responsibility of the English auditor for the profit and loss account was handed down in the *Royal Mail Case*.¹¹ On the basis of this case, it appears that the profit and loss account should present a true and correct view of the profits of a business for the period under examination with unusual items separated from those of a normal, recurring nature. Other points raised at this trial included the following: first, the law holds that a statement is capable of misleading the readers even though it contains no specific inexactitude of fact; second, a balance sheet which is not accompanied by a detailed and frank profit and loss account may be misleading relative to the position of the company and is unlikely to be a sound guide to the current value of its shares; third, auditors upon whom shareholders and the public rely for protection are handicapped partly because their exact responsibility for the profit and loss account is undefined and partly because their influence upon directors is not based upon defined statute and power of intervention but upon the personal relationship of two people, each to the other.

After giving detailed consideration to the deficiencies in Company Law relating to both the balance sheet and the profit and loss account the Cohen Committee prepared a number of important recommendations covering these two statements. These included the following:

1. Section 124 (1) should be amended to provide that the balance sheet shall provide a true and fair view of the affairs of the Com-

¹¹Brooks, Collin, *Royal Mail Case*, London, William Hodge and Co., 1933.

pany. For this purpose it shall classify under headings appropriate to the business of the company the share capital, reserves, provisions, liabilities and assets of the company, shall distinguish between the amounts respectively of the fixed and of the current assets, and shall state how the amounts at which the fixed assets are stated have been ascertained. Fixed assets should be defined as assets not held for sale or for reconversion into cash and current assets as cash and assets held for conversion into cash. Where ascertainable there shall be shown separately the cost of fixed assets under each heading in existence at balance sheet date, and the accumulated amount provided or written off for depreciation in respect thereof, the difference being recorded in the assets column.

2. Investments in subsidiary companies shall continue to be shown separately as provided by Section 125 of the 1929 Act. Other investments shall be shown separately under the classifications of trade investment (other than investment in subsidiary companies), other quoted investments and other unquoted investments provided that in the case of the last-named the market value shall be stated in a footnote if it differs from the balance sheet amount.
3. There shall also be shown separately the nominal amount of any debentures of the company held by the company; the amount of premiums on share capital; the aggregate, if material, of any capital reserves, defined as any amounts which, whether or not they were originally set aside as provisions to meet any diminution in value of assets, specific liability, contingency or commitment known to exist at the balance sheet date, are not retained for that purpose and are now regarded as free for distribution to the profit and loss account; the aggregate, if material, of other reserves, defined as any amounts which, having been set aside out of revenue or other surpluses, are free because they are not retained to meet any diminution in value of assets, specific liability, contingency or commitment known to exist at the balance sheet date; the aggregate, if material, of provisions which, not being provisions for diminution in value of assets, have been set aside out of revenues or other surpluses, and are retained to meet, in cases where the amounts cannot be determined with any substantial accuracy, any specific liability, contingency or commitment known to exist at the balance sheet date. The Committee states, however, that amounts retained as provisions, whether for the foregoing purposes or for diminution in value of assets, shall not exceed such amounts as in the opinion of the directors are reasonably required for the purpose; if the Board of Trade is satisfied that such disclosure would be prejudicial to the company's interest and is not required in the public interest, the amounts concerned need not be shown separately but may be included under other headings if appropriate words are introduced to indicate that provisions of this character are

included therein; bank loans and overdrafts whether secured or not; the net amount of any dividends recommended by the directors.

4. Where during the period covered by the profit and loss account any material amount is added to capital reserves, other reserves or provisions, or where any amount, if material, standing to the credit of any such reserves or any surplus standing to the credit of such provisions is used, the amount involved, the source from which they have been provided or the manner in which they have been used shall be stated in the balance sheet unless the same shall appear in the profit and loss account or any statement annexed thereto.
5. The following matters must be dealt with in a note on the balance sheet or in a statement or report annexed thereto: a) Where in the opinion of the directors the current assets do not have a value realizable in the ordinary course of business of the company of at least the amount at which they appear in the balance sheet, a statement to that effect must be furnished; b) Where any material part of a company's assets or liabilities comprises foreign exchange assets or liabilities, the basis of conversion from foreign currency into sterling for balance sheet purposes must be given; c) The general nature, and where practicable, the amount, if material, of contingent liabilities not provided for in the balance sheet and particulars of any charge given over the company's property for the debt of another person and also the amount thereof; d) The gross amount of arrears of fixed dividends on any class of stock and the date to which such dividends were last paid; e) Where a company has given options over its share capital, the number of shares affected, the class of share, the option price, and the date for exercise thereof must be given; f) The amount or estimated amount of commitments for capital expenditure, if material, so far as not provided for in the balance sheet; g) The basis on which provision for United Kingdom income tax has been made; h) In the case of a holding company, the aggregate of any shares in, and of any debentures of, the holding company held by subsidiary companies must be stated; i) Corresponding figures from the immediately preceding balance must be provided.

Note: Such banking companies and discount companies as the Board of Trade may designate shall be exempted from complying with the requirements outlined in the first four paragraphs stated above, but the balance sheet of these exempted companies shall indicate by appropriate words where reserves and provisions are included under other headings. Assurance companies shall be exempted from the first four paragraphs stated above.

The Amendment Committee added to the Companies Act a provision that the profit and loss account shall provide a true and fair indication of the earnings of the period covered by the account, dis-

closing any material respects in which it includes extraneous or non-recurrent transactions or those of an exceptional nature. It is further provided that if a material change is made in the basis on which the account or any item therein is calculated, in comparison with the previous year, attention must be called to the change and to the effect thereof by means of a note on the account. The profit and loss account, according to Committee recommendations, should include the following information :

1. Amount of profit or loss before charging or crediting the items enumerated, but after crediting or charging, if the company thinks fit, its revenue from or provisions for losses of subsidiary companies.
2. Provision for depreciation of fixed assets, provided that if allowance is not being made by means of a depreciation charge, the method of making such provision or the fact that no such provision has been made, shall be stated.
3. Interest on debentures and other fixed loans.
4. Amount of United Kingdom taxation on profits, subdivided where practicable into income tax, and national defense contribution or excess profits tax or any other tax which may be assessed on profits. In any event the basis of provision for U. K. income tax must be disclosed.
5. Amounts provided for the redemption of share capital and loan capital.
6. The aggregate, if material, of any amounts set aside to reserves.
7. The aggregate, if material, of any amounts set aside as provisions as defined in the outline above, provided that in any case where the Board of Trade is satisfied that disclosure of any such provision would be prejudicial to the company's interests and is not required in the public interest, the amount concerned need not be shown separately if appropriate words are introduced to indicate that a provision of this character has been made in arriving at the profit or loss for the period.
8. Income from, less provisions for losses of, subsidiary companies, except insofar as it is included under 1 above.
9. Income from other trade investments.
10. Income from investments other than trade investments.
11. The aggregate, if material, of amounts withdrawn from reserves.
12. The aggregate, if material, of amounts withdrawn from provisions as defined in these recommendations.
13. Profits or losses of a non-current or exceptional nature, if material in amount.
14. Dividends paid or proposed, disclosing whether such amounts are stated before or after deduction of income tax.

The profit and loss account shall also contain or cover by way of note the following further information:

15. Emoluments of directors, including contributions made on their behalf to any pension scheme, and the aggregate amount thereof paid by the company.
16. The aggregate amounts of any compensation paid to directors or former directors of the company, for loss of office or in connection with or arising out of their retirement from the company or from any of the other companies subdivided to show the amounts paid respectively by the company, by such other companies, and by any other person.
17. The aggregate amounts of any pensions paid to directors or former directors of the company subdivided to show the amounts paid respectively by the company and by any of the other companies but there need not be included in such amounts any pensions paid under a pension scheme if the company's contributions to such scheme would be emoluments of the director or former director.
18. Corresponding figures for the immediately preceding period.
Note: Banking and discount companies shall be exempted from complying with this section except as regards the requirements in 14, 15, 16, 17 and 18 above, but the profit and loss account of such companies shall indicate by appropriate words the manner in which the disclosed profits or losses have been arrived at; and assurance companies shall be exempted from complying with 2, 5, 6, 7, 11, 12 and 13 above.

The Committee also recommended that Section 129 of the Companies Act 1929 be amended so as to extend the signature provisions to the profit and loss account and to require this account to be annexed to the balance sheet. Section 122 would be amended by altering the opening words to read "every company shall cause to be kept such books of account as are necessary to exhibit a true and fair view of the state of the company's affairs and to explain its transactions." A subsection would be added as follows: "Where a company carries on business at one or more places outside Great Britain there shall be kept at the registered office of the company in Britain or at such other place in Britain as the directors may decide, such accounts and returns from the business so carried on as shall disclose with reasonable accuracy the financial position of such business at intervals not exceeding three months and shall enable the company to prepare the balance sheet and profit and loss account required by this Act."

In only one respect disappointment, in some quarters, has been expressed. The Committee decided that compulsory disclosure

should commence with net earnings, before depreciation, taxes, provisions, debenture interest, reserves and dividends, but after expenses of production, selling and distribution, administration and management. The suggestion has not been adopted, therefore, that disclosure should begin with a sales turnover figure. This decision apparently was reached on the ground that publication of figures of that nature could not have been made in sufficient detail to achieve useful ends without adding too much detail to published accounts. However, the Committee stated that such figures might be of assistance to individuals responsible for framing general economic policy—the State—but for shareholders and creditors, for whom it is the purpose of published accounts to provide data, it was believed essential that the form in which information was conveyed should be one that could be easily understood.

Although many reforms were introduced in England by the Companies Act 1929, the subject of the accounts of holding companies and their subsidiaries was not satisfactorily settled. Under contemporary legal regulations, holding companies are not required to publish a consolidated balance sheet or separate statements for their subsidiaries.¹² Although the law requires that an auditor must specify how the total profits or losses of subsidiaries have been dealt with in the accounts of holding companies and whether the losses have been provided for by either the holding or the subsidiary company, there is no requirement that the amount of the profits or the losses be disclosed. When an item in a balance sheet is titled "Investments in Subsidiary Companies" there is no indication as to the assets of those companies and the reader has no knowledge as to whether they are current or fixed.

The Cohen Committee prepared elaborate recommendations for consolidated accounts and these are summarized below:

1. A company shall, whether it is a company within the meaning of the Companies Act or not, be deemed to be a subsidiary company of another company (a holding company) if it is either:
 - a. A company in respect of which the holding company possesses

¹²Where a company holds shares in a subsidiary company there must be annexed to the balance sheet of the holding company a statement stating how the profits and losses of the subsidiary, or, where there are two or more subsidiary companies, the aggregate profits and losses of those companies, have, so far as they concern the holding company, been dealt with in, or for the purposes of, the accounts of the holding company, and in particular how, and to what extent, provision has been made for the losses of the subsidiary company either in the accounts of that company or of the holding company, or of both; and how losses of a subsidiary company have been taken into account by the directors of the holding company as disclosed in its accounts.

- power to appoint or remove or procure the appointment or removal of a majority of the directors either directly through the beneficial ownership of the whole or any part of its share capital or indirectly through the beneficial ownership of the whole or any part of the share capital by any other company or companies or through a combination of these means including power liable to suspension in the event of default in the payment of dividends to persons other than the holding company and its subsidiary companies, but not including power arising by virtue only of the provisions of a debenture trust deed or by virtue of shares issued for the purpose in pursuance of those provisions; or
- b. A company in respect of which the holding company possesses power to appoint or remove or procure the appointment or removal of a majority of the directors of another company by some other means than as stated in a. above and is directly or indirectly the beneficial owner of any part of the share capital of such other company; or
 - c. A company in which more than one-half of the equity share capital is owned beneficially by the holding company and its subsidiary companies.
2. A holding company shall annex to its annual accounts a consolidated balance sheet and a consolidated profit and loss account which shall be drawn up as far as practicable in a manner similar to that prescribed in the provisions of the new Act relating to the accounts of companies. The consolidated balance sheet shall combine the information contained in the balance sheet of the holding company with the information contained in the balance sheets of the subsidiary companies after eliminating inter-company shareholdings and indebtedness and shall allow the aggregate interest, if any, in the share capital and reserves (including profit and loss account balances) of subsidiary companies of shareholders other than companies the accounts of which are consolidated. The consolidated profit and loss account shall combine the information contained in the profit and loss account of the holding company with the information contained in the profit and loss accounts of the subsidiary companies after eliminating inter-company transactions and dividends and shall show the extent of the profit and loss, if any, attributable to shareholders in subsidiary companies (other than companies the accounts of which are consolidated) and the balance of the consolidated profit or loss, attributable to the interests of the holding company. The balance sheets of subsidiary companies shall as far as practicable be made up as at the date of the balance sheet of the holding company. If the directors consider that in order to present a true and fair view of the state of affairs and of the profit or loss of the company and its subsidiary companies, the consolidated accounts require adjustment, they should make such adjustments as appear to them to be appropriate. If the directors are of the

opinion that it is impracticable or misleading to include in the consolidated accounts the relative information contained in the accounts of any subsidiary company, they shall exclude such information.

Note: The Board of Trade shall have power to exempt any banking or discount company or an assurance company from consolidating with its accounts the accounts of any subsidiary company which carries on a business different from that of the holding company, if and so long as, in the opinion of the Board, the relationship of subsidiary company and holding company is temporary only.

3. The directors shall annex to the consolidated balance sheet a statement giving the reasons why they consider it is not practicable in the case of any subsidiary company whose balance sheet is not made up as at the date at which the balance sheet of the holding is prepared, for the balance sheet of such subsidiary to be made up as at that date; giving the reasons why in their opinion it is impracticable or would be misleading to include in consolidated accounts the relative information contained in the accounts of any subsidiary company; showing in respect of subsidiary companies whose accounts are not included in consolidated accounts, the net aggregate amount attributable to the interests of the holding company so far as not dealt with either in the consolidated accounts or in the accounts of a holding company which does not annex consolidated accounts to its annual accounts:
 - a. Of the profit or loss, for the period covered by the profit and loss accounts of such subsidiary companies made up to dates within the period covered by the profit and loss account of the holding company, and,
 - b. So far as practicable, of the aggregate profit, or net income, including reserves, other than capital reserves, or loss, since acquisition of such interests by the holding company and its subsidiary companies;and giving particulars of any qualifications in the auditors' reports upon the accounts of subsidiary companies where such accounts are not included in consolidated accounts.
4. The consolidated balance sheet shall show the information regarding subsidiary companies whose accounts are excluded from consolidation, which is required under the Act to be included in the balance sheet of every company, and the consolidated profit and loss account shall show the income from, or provisions made for losses of, subsidiary companies whose accounts are excluded from consolidation, in respect of the period covered by their profit and loss accounts made up to a date within the period by the profit and loss account of the holding company.
5. The Board of Trade may, on the application or with the consent of a company, alter the requirements stated in 1. above, for the

- purpose of adapting them to the circumstances of that company.
6. In the case of a holding company the auditors shall examine the consolidated balance sheet and the consolidated profit and loss account, and any statements required to be annexed to them, and shall make a report on them to the members of the holding company, and the report shall state whether, in the opinion of the auditors, the consolidated financial statements are properly drawn up in accordance with the provisions of the new Act from the balance sheets and profit and loss accounts of the holding company and of the subsidiary company, the accounts of which have been consolidated, after giving effect to any adjustments made by the directors; the adjustments, if any, made by the directors are appropriate, or any other adjustments are required, according to the best of their information and the explanations given to them by the directors of the holding company; the reasons given by the directors in a statement annexed to the consolidated balance sheet relative to the impracticability of preparing consolidated accounts; the particulars given in respect of the profits and losses and the qualifications in the auditors' reports upon the accounts of subsidiary companies excluded from consolidation, have been properly compiled from the information contained in such accounts and the auditors' reports thereon.
 7. A subsidiary company shall disclose in its balance sheet the total amount which it owes to the holding company and to companies which are subsidiaries of such holding company, and the total amount which is owing to it from such companies.

It is apparent from the above provisions that the Committee attaches to consolidated accounts the same obligations as have in the past applied to the statutory accounts of all companies. In fact, they are considered part of the annual accounts and are to be signed by the directors who signed the accounts of the holding company. Auditors will be required to report on the consolidated accounts and on any statements annexed to them. These recommendations are in line with the Committee's general policy of providing directors with freedom of action but to align them, and the auditors, with definite statements given over their signatures. The publication of consolidated accounts in England would be a substantial step in the direction of fullest disclosure of financial information. It would seem, however, that the Committee, in addition to stating that directors must explain why they consider consolidation would be misleading, should also insist that they establish their case.

The Amendment Committee did not make any recommendations on the accounting questions involved in consolidation although it decided to adopt the presentation of a single consolidated account as the solution of the problem of condensation. It has foreseen,

however, that, where a single holding company controls subsidiaries operating in a number of distinct industries, or carrying on completely different functions, questions will arise in which consolidation by groups ought to be insisted upon as a substitute for, or in addition to, the entire consolidation. If the foregoing Committee recommendations are adopted there will gradually emerge detailed information as to the activities of industrial groups in such detail as to aid those investors, and investment counselors, who desire to pursue a policy of long term investment.

Under the Companies Act 1929 the auditor was required to furnish for the prospectus a report with respect to the profits of each of the three financial years preceding its issue, the rates of dividend paid on each class of shares in each of those years, and the classes of shares on which they had or had not been paid. In addition, the accountants who were named in the prospectus had to report upon the profits for each of the three preceding financial years of any business which was to be purchased out of the proceeds of the issue. The Companies Act did not specify the form and content of the report which the accountant must prepare; it invariably concisely stated the profits earned and provided basic information for the potential investor. The auditors' responsibility for this data was restricted to individuals who were the original allottees of shares and who were induced to buy because of the prospectus. He has no legal liability for negligence relative to this prospectus under prevailing Company Law.

The Cohen Committee recommendations relative to prospectuses include the following:

1. There shall be delivered to the Registrar of Companies for registration with every prospectus a copy of all material contracts mentioned in the prospectus, a statement signed by the auditors showing any adjustment made by them and the written consent of any expert to the inclusion in the prospectus of any extract from his report.
2. A report must be prepared by the company's auditors with respect to the profits or losses of the company for each of the five financial years immediately preceding the issue of the prospectus or for each of the years since the incorporation of the company, if this occurred less than five years prior to such issue, and, if no accounts have been prepared for any part of such period ending on a date three months before the issue of the prospectus, containing a statement of that fact. In making such report, the auditors shall prepare such adjustments as are in their opinion necessary for purposes of the prospectus. In the case of an issue by a holding company, a similar report with respect to the profits

- and losses of the company and of its subsidiaries, so far as such profits and losses are attributable to the interests of the holding company. With respect to the rates of the dividends, if any, paid by the company for each class of shares in the company for five years, giving particulars of the shares on which dividends have been and have not been paid. Relative to the assets and liabilities of the company, a report with respect to these items of the company and of its subsidiaries, with auditors preparing any necessary adjustments.
3. If the proceeds of the issue of the shares or debentures are to be applied directly or indirectly in the purchase of a business or of shares in a company which is or will become a subsidiary, a report shall be made by the accountants named in the prospectus relative to the profits or losses of the business for five financial years immediately preceding this prospectus, with the accountants making any necessary adjustments.
 4. Any expert named in the prospectus, such as bankers, brokers, solicitors, and accountants, shall be liable to pay compensation for untrue or misleading statements included in the prospectus.
 5. It shall be illegal to include any copy or summary of, or extract from, experts' reports on property acquired without the written approval of the experts.
 6. Experts will be civilly liable relative to any forged statement to any persons subscribing for shares on the faith of a prospectus containing their statement unless they can show that they had reasonable grounds for believing the statement to be true up to the time of allotment of the shares. It is also recommended that a director who has signed the prospectus containing a false statement shall be liable both civilly and criminally unless he can prove that he did not know the statement was false and could not by taking reasonable precautions have ascertained its falsity. If this recommendation is carried into law it will represent a serious encroachment on the principle of English law that a man is innocent until he is proved to be guilty.
 7. A minimum compulsory interval of two days shall occur between the publication of the prospectus and the opening of the lists to enable intending investors to obtain expert advice and to permit the publication of newspaper comment. The company is required to apply to the Stock Exchange within two days after issue of the prospectus for permission to deal and, if this is refused, to cancel allotments and return subscriptions.

The Cohen Committee devoted considerable section of its report to improvements in the prospectus and the general handling of issues. In dealing with the subject of prospectus information it supports the London Stock Exchange in exacting requirements beyond those legally enforceable and expresses the view that "if any reform of the law of libel were possible which encouraged freedom

of comment without opening the way to unjustified defamation, it would undoubtedly afford an additional weapon against the type of promoter who is averse to disclosure of all material facts."¹³ But it urges the Stock Exchange to continue its good work and the public to secure amendment of the libel law. The Committee has attempted to place the investor in the position of a shareholder who has received accounts over a period of years, and in those cases where such detail is not available a close approximation must be provided.

Auditors have never been considered responsible for English company accounts, as this duty accrues to directors.¹⁴ It is the former's task to take the balance sheet prepared by the directors and to audit this document, commenting upon it in their report. The exact nature of the auditors' work is left to their judgment, based upon the theory that they are deemed to be skilled in their profession. A review of cases tried in English courts, covering the duties and responsibilities of auditors, leads to the following conclusions:

1. An accountant must honestly satisfy himself that the accounts show a true and correct view of the financial position of the concern.
2. He must examine the books and satisfy himself that they are correct.
3. It is not part of his duty to take stock.
4. The auditor is entitled to rely upon the opinion of experts where special knowledge is required.
5. He need not necessarily be suspicious.
6. It is not part of his duty to give advice.
7. If he is not satisfied upon any material point he must report clearly to shareholders or partners.
8. He must verify the existence of assets so far as is reasonably possible.
9. In case of a company he must see that the memorandum and the articles are carried out.
10. If he is negligent he may be liable in damages.
11. What is reasonable care depends on the circumstances but the general standard of the profession must be considered, also.

¹³A Departmental Committee is investigating the law of defamation in England and the desirability of mitigating by legislation the rigor of the common law liability for libel on the part of publishers of newspapers. See *Langlands v. Leng* (1916) S. C. (H. L.) at p. 110.

¹⁴For substantiation of this view see decision of Mr. Justice Bennett in *re Catterson and Son, Ltd.*, reported in the *Accountant* of February 27, 1937, pp. 308-311.

12. In a private firm the auditor must have the scope of the audit in writing.
13. The auditor is not liable for tracking out ingenious and carefully laid schemes of fraud.
14. If he wilfully certifies accounts knowing them to be false he is criminally liable.
15. The auditor incurs a risk by not disclosing secret reserves.
16. The auditor is responsible for the profit and loss account and must see that it does give a fair view of the earnings of the period and that profit and loss accounts are prepared on the same basis each year.

Legal cases, as a whole, hold the auditor responsible for the expert performance of his duty, and judges or juries assess damages if he fails to exercise the skill of an ordinarily skillful practitioner. Lord Justice Lindlay handing down the opinion in *re London and General Bank* (No. 2) 1895 outlined the duty of the auditor by stating: "He must be honest, that is he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case." And Lord Justice Lopes in *re Kingston Cotton Mills Co., Ltd.* (No. 2) 1896, 1 Ch. 231, drew attention to the fact that the auditors' duties should not be too onerous as the work is great and the salary small. The decision of Mr. Justice Sterlin in *re Leeds Estate Building and Investment Co. v. Shepherd* 1887, 36 Ch. D. 787, enlarged the duties of auditors beyond the mathematical accuracy of the balance sheet.

The main differences between the audit of a firm and a limited company from the English point of view are stated below:

Firm

1. Governed by specific instructions from clients and partnership articles (if any). Partnership Act 1890 and/or Limited Partnership Act 1907 must be consulted for rights of partners if no agreement is in existence.
2. Extent of work may be varied, enlarged or restricted by partners.

Limited Company

1. Governed by statute, i.e., Companies Act 1929, special act or charter, and effect of legal decisions.
2. Rights and duties of auditors cannot be restricted by articles but may be enlarged. Auditor must conform to Sec. 134 of Companies Act 1929.

*Firm**Limited Company*

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| <p>3. Written partnership agreement may not be available or shown to auditor.</p> <p>4. Auditor reports or certifies in accordance with terms of his appointment.</p> <p>5. May be sole trader, or general or limited partnership.</p> <p>6. Treatment of profit and/or losses depends upon specific instructions.</p> <p>7. Auditor may be liable at common law for negligence, etc., but may contract himself out of liability.</p> | <p>3. Auditor must know the contents of articles of company (<i>Leeds v. Shepherd</i> 1887) and ascertain what duties are cast upon him. He may be liable to damages suffered as a result of his non-detection of ultra vires acts. (<i>In re Republic of Bolivia</i> 1913.)</p> <p>4. Auditor reports to members in terms of Sec. 134 or under Sec. 113 certifies the statutory report as correct (as far as it relates to shares allotted, cash used in respect of such shares, and receipts and payments on capital account).</p> <p>5. Company may be public or private; auditor should see that restrictions are not transgressed, e.g., number of members in case of private company.</p> <p>6. Auditor must see that accounts distinguish between losses of fixed or floating capital; profit and dividends; and classes of capital profits, e.g., where company has adopted the double account system.</p> <p>7. Auditor liable to common law liability. He may be held liable under Sec. 276 for misfeasance where he is held to be an officer of the company. Exoneration from liability contained in articles is of no effect.</p> |
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The Cohen Committee's recommendations for the revision of Company Law relative to auditors are as follows:

1. If no auditor is appointed or deemed to be appointed at an annual general meeting, the company shall inform the Board of Trade who shall appoint an auditor for the company for the current year.
2. A retiring auditor, if willing to act and eligible for appointment under Sec. 133 of the 1929 Act, shall be deemed to be reappointed

unless some other person is duly appointed in his place or a resolution that he shall not be reappointed is duly passed and notice of intention to propose such resolution has been given by a member to the company not less than 28 days before the annual general meeting. If such notice is given, the company shall forthwith send a copy of any such notice to the retiring auditor who shall have the right to send a written statement of his views to the shareholders at the reasonable expense of the company.

3. The remuneration of the auditors of a company shall be fixed either by the company in general meeting or in such manner as may be prescribed by the company in general meeting except that the remuneration of an auditor appointed before the first annual general meeting, or of an auditor appointed to fill a casual vacancy, may be fixed by the directors, and that the remuneration of an auditor appointed by the Board of Trade may be fixed by the Board. Provided that where the remuneration is not fixed by the company in general meeting, the amount thereof shall be stated as a separate item in the profit and loss account of the accounting period to which the audit relates.
4. None of the following persons shall be eligible for appointment as auditor of a company:
 - a. A person who is not a member of any body membership of which has been designated by the Board of Trade as qualifying its members to audit the accounts of companies or who has not been designated by the Board of Trade as qualified to audit the accounts of companies;
 - b. A director or other officer or employee of the company or of any of its subsidiary companies or of a company which is a holding company in relation to the first-named company, or of any of the subsidiary companies of such holding company;
 - c. A person who is a partner of or in the employment of a director or other officer or employee of the company or of any of the companies referred to in sub-paragraph b;
 - d. A body corporate.

For the purpose of this subsection an auditor shall not be deemed to be an officer of the company.

5. The auditors shall make a report to the members on the accounts examined by them, and on every balance sheet and profit and loss account laid before the company in general meeting during their tenure of office, and the report shall state:
 - a. Whether in their opinion proper books of account have been kept or, in the case of a company with branches whose books have not been examined by the auditors, whether proper books of account have been kept at the principal office and branches visited by the auditors and proper accounts and returns adequate for purposes of their audit have been received from other branches;

- b. Whether or not they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit;
 - c. Whether the balance sheet and profit and loss account referred to in the report are in agreement with the books, accounts and returns, and whether in their opinion and to the best of their information and according to the explanations given to them the accounts are properly drawn up in accordance with the provisions of the new Act and exhibit a true and fair view of (1) the state of affairs of the company as at the date of the balance sheet and (2) the profit and loss for the period ended on that date; and
 - d. In the case of a holding company which does not annex consolidated accounts to its annual accounts whether in their opinion the reasons given by the directors for not presenting consolidated accounts are satisfactory and whether the particulars given in respect of the profits or losses and the qualifications in the auditors' reports upon the accounts of subsidiary companies have been properly compiled from the information contained in such accounts and the auditors' reports thereon.
6. Every auditor of a company shall have a right of access at all times to the books, returns, accounts, and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanations as are in his opinion necessary for the performance of his duties.
 7. The auditors of a company shall be entitled to receive notice of and attend any general meeting of the company and to make any statement or explanation they desire at such meeting.

The Cohen Report's recommendations as to auditors and their duties emanate from within the profession itself. They are based on the assumption that the auditor's duties involve his responsibility to the client and to the Revenue authorities, and a recognition that the interests of the community are involved, to a greater or lesser degree, in every business which operates under the protection of Company Law. As to qualifications which should be possessed by the auditor in the future, it may happen that the proposals for co-ordination of all practitioners, now under consideration by the accounting profession, may afford a better method of determining who may be considered qualified to serve. It is interesting to note, however, that "for reasons of reciprocity some provision must be made to allow accountants with adequate qualifications obtained abroad to act as auditors." The problem of reciprocity between accounting societies in various parts of the world has increased in importance during the last few years. Perhaps it is not too much to hope that the discussions on this point arising on this Report

may lead all accountants to accept the desirability of ultimately creating a coordinated standard of accountancy in all parts of the globe.

A considerable section of the Amendment Committee's Report is devoted to enhancing shareholders' control over their companies. Some of the increased duties and penalties imposed upon directors have already been mentioned in the preceding discussion of reports and prospectuses although no mention has been made of directors' remuneration. The Greene Committee in 1926 refused to disclose more than directors' joint fees, although at that time there was widespread demand for total emoluments of each individual. The best contemporary opinion in England is that directors should be permitted to fight out their individual problems among themselves, that what really concerns the public is the total cost of the higher direction of a business. Some witnesses before the Cohen Committee who considered the problem from this viewpoint also wanted the main items of production costs and the total remuneration of the higher executives reported. The Committee, however, rejected this view in favor of one that all such questions were matters which should be left to the discretion of the directors but that, since the directors fixed their own total remuneration, this item ought to be disclosed. They have, therefore, suggested not only a total figure but the splitting up of the sum into fees and salaries, expenses not admitted as such for tax purposes, contributions to pension schemes for directors, payments of pension to directors otherwise than from the pension scheme, and payments by the company for loss of office as a director or in any other capacity. There is also an additional obligation placed upon the individual director to disclose any payment received from outside interests in connection with the loss of his office, as in the case of the merger of the company with another firm.

Relative to actions of a director which may be influenced by special inside knowledge of the business, the law compels him, if he is interested in a contract with his company, to disclose the fact to his fellow directors. The Cohen Committee, however, considers directors should disclose any such contracts as are of material importance to shareholders if any member of the board has a substantial interest in them. As to dealings by directors in the shares of companies in which they are interested, the Committee held that inside information is seldom improperly used by the directors themselves, but that the equally undesirable practice of supplying friends

with information is more usual. Actual dealings of directors, in its opinion, should be recorded and available for inspection by the Board of Trade, although the record is only to be made available to shareholders for two weeks before the annual general meeting. Apparently it is not to be made public.

There are a number of additional recommendations as to directors. These include facilitation of the removal of a director, a plan for attempting to enforce retirement of aged directors, and a total ban on companies, other than lending firms, making loans in any form to directors.¹⁵

The 1929 Companies Act contains no provisions for proxies and their validity under English law depends on the articles of association of the particular company. Directors of a company customarily invite shareholders to sign proxies in their favor but the London Stock Exchange has stipulated that companies should outline their proxies so that the shareholder may vote for or against the proposal unless it is business of a routine nature. The Amendment Committee has permitted the Exchange to continue to supply regulations but it does recommend that a shareholder should have an unqualified right to appoint as his proxy anyone he wishes, whether or not he is a shareholder, and that such proxy should have the right to speak and vote.

One of the most interesting proposals of the Committee is the suggested abolition of the doctrine of *ultra vires*. A contract made by the directors on a subject not within the scope of the company's objectives, as set forth in its Memorandum of Association, is under English law today *ultra vires* the company and beyond the powers of the directors. The Committee considers that the doctrine no longer serves a useful purpose, and proposes its abolition.

The Committee considered whether the 1929 Act should be amended to enable shares of no par value to be issued. As there is little demand for and much opposition to any such proposal, its members have offered no change in procedures. After detailed study of the exemption conferred on private companies from having to file accounts, the Committee believes this exemption to be justified. It recommends that the accounts of any subsidiary which is a private company should be dealt with in the consolidated accounts published by the holding company in the same manner as any subsidiary public company. It further recommends that, in general, private

¹⁵For detailed recommendations covering directors see Cohen Committee Report, pp. 50-53 and pp. 84-87.

companies should be required in the future to file accounts and circulate them to their shareholders. It has, however, relieved from this obligation small family businesses incorporated as companies.

There is a widespread feeling in England at the present time that the ease with which directors and other individuals hide their interest in securities is greatly aided by the use of nominee holdings. The Committee is in agreement as to the desirability of disclosure of those persons who are the beneficial owners of holdings, if it can be achieved without a volume of work completely out of line to the benefits involved. It recommends, first, that all transfers should contain a declaration whether the transferee is the beneficial owner (existing owners are to be asked to make a corresponding declaration), but no obligation is placed upon the nominee to disclose the beneficial owner, because it is felt this would involve too much work. Second, beneficial owners of one per cent or more of any class of capital of a company are required to make a declaration of ownership of any shares held in the name of nominees. Any person who fails to make this declaration, or offers a false statement, or votes in respect of holdings for which a declaration should be made, is to be liable to maximum penalties of six months' imprisonment and a fine of £500. A third recommendation of the Committee is that where very definite information is thought desirable, the Board of Trade shall be empowered to make a full investigation. It appears, on the face of past facts, that the Board would not undertake investigations without a large amount of evidence. If what is required, as many believe, is some method by which voting power is withheld from those who have not established their beneficial ownership, no suggestion so far offered affords any real solution.

The specific proposals of the Amendment Committee covering nominee shareholdings may be stated as follows:

1. Every transfer of shares shall contain a declaration by the transferee stating whether or not he will be the beneficial owner of the shares comprised therein.
2. Every company shall on the day of issuing the notice convening the first annual general meeting of the company to be held more than one month after the coming into force of the new Act, send to every registered holder of shares, who has not signed a declaration as transferee under 1. above, a notice requiring him within two months after receiving such notice to sign and deliver to the company a declaration whether or not he is the beneficial owner of the shares registered in his name.

3. If any person who has signed a declaration of beneficial ownership ceases to be beneficial owner of any share comprised in such declaration, while remaining the registered holder, he shall be bound forthwith to send to the company a declaration of cesser of such ownership.
4. If any person who has signed a declaration that he holds the shares registered in his name as a nominee, ceases so to hold any of them, while remaining the registered holder, he shall be bound forthwith to send to the company a declaration to that effect.
5. Every company shall on the day of issuing the notice convening the annual general meeting of the company (other than the first annual general meeting after the coming into force of the new Act) send to every registered holder of shares, a notice drawing attention to the requirements set out under the detailed recommendations.
6. Where any person is directly or indirectly the beneficial owner of one per cent or more of the issued capital of the company or of the issued shares of any class and where any of such shares are not registered in his name, he shall send to the company within two months of the date of the coming into force of the Act or within 10 days of the date on which he becomes such owner, whichever is the later date, a declaration stating the number and class of shares of the company of which he is such owner and the names of the registered holders of the shares and if any charge occurs in the matters covered by such declaration, he shall send to the company within 10 days of the day on which the change occurs, a declaration stating the change:

Provided that the Board of Trade may grant exemption from this provision where it seems to it expedient in the national interest to do so.

7. A person shall for the purpose of this section be deemed to be the beneficial owner of a share if he is absolutely entitled to the share; or entitled absolutely or conditionally to require the transfer of the share to himself or to any person nominated by him; or entitled directly or indirectly to control the exercise of the voting right in respect of the share.
8. Every company shall on the day of issuing the notice convening the first annual general meeting of the company to be held more than one month after the coming into force of the new Act, and on the day of issuing the notice convening subsequent annual general meetings of the company send, to every registered holder of shares, a notice drawing attention to the requirements outlined in this Report.
9. Any person failing to make any declaration requiring to be made under the above provisions; or making a declaration under the above provisions which is false in any material par-

ticular; or voting in respect of any share as to which any declaration requiring to be made under points 1, 3 or 4 has not been made or has falsely been made; or instructing or allowing any person to vote or voting in respect of any share in respect of which he is under an obligation to make a declaration under paragraph 6 but has failed to do so or has made a false declaration shall be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding £500 or both.

If default is made in sending any notice required to be sent pursuant to paragraphs 2, 3 or 8 above, the company and every director or manager or secretary who is knowingly a party to the default, shall be liable to a default fine.

10. Every company shall keep its register of members, and compile the list of members required under Sec. 108 (1) each in two parts, one part relating to members who have signed declarations that they are the beneficial owners of the shares registered in their names, and the other part relating to members who have signed declarations that they are not beneficial owners of the shares registered in their names.
11. Every company shall keep in one or more books a record of the names and addresses of the persons who have signed declarations under paragraph 6, the number and class of shares of which they have notified the company that they are directly or indirectly the beneficial owners, the names of the registered holders of the shares and any changes notified to the company in the matters covered by such declaration. Provisions as to inspection and the right to copies shall apply similar to those specified in Sec. 98 (1) and (2). Every company shall file with the annual return required under Sec. 108, particulars showing the names and addresses of the persons who have signed declarations under paragraph 6 and that number and class of shares of which they have notified the company that they are directly or indirectly the beneficial owners, and the names of the registered holders of the shares, as at the date of the annual return.
12. Notwithstanding anything in the paragraphs above, the company shall, for all purposes of company administration, be entitled to treat the registered owner as the legal owner of the shares registered in his name.
13. If the Board of Trade considers it necessary in the public interest to investigate the ownership of shares in any company, it may appoint an inspector to conduct such investigation. The inspector should report to the Board who should forward a copy of his report to the company and should be at liberty to publish such report or file a copy thereof with the Registrar of Companies.

14. When the Board of Trade has appointed an inspector to conduct an investigation as regards any company under paragraph 13, the Board may at any time and from time to time direct that company not to pay dividends on, or to permit the exercise of any rights (including the right of transfer) attached to all or any of the shares in the company specified in such direction and may revoke, vary or suspend any such direction.

It will be noted that the Committee did not require the disclosure in the case of nominee holdings of the name of the beneficial owners. This is to save the additional work which would thereby fall on registrars of companies without necessarily compelling the disclosure of the identity of the real owners. The objective will be achieved if another recommendation is adopted which proposes that every person who directly or indirectly owns one percent or more of the capital or on any class of shares in a company will be required to file a declaration of such ownership and details of such declarations will be available for public inspection. These proposals will prove difficult to enforce and the Committee emphasizes their deterrent effect as the real recommendation for their adoption. In order to deal with those cases where a knowledge of the true ownership is necessary in the public interest, the Board of Trade is to be provided with drastic powers of inquiry and inspection.

The Company Law Amendment Report, when viewed in its entirety, is seen to stress that the future system of British private enterprise must operate with complete honesty and with full publicity. When considering all aspects of business and accounting practice, including company managements, the Committee has attacked each subject with equal intensity except, perhaps, that of the increasing use of nominees for shareholdings. So widespread, in fact, has this procedure become that in 1943 over 600,000 individual holdings of stocks and shares were registered in the name of nominees of the joint stock banks alone. Drastic action is called for either by the prohibition altogether of the nominee plan (except for attorneys and trustees) or nominees should be compelled by law to disclose to the companies the names of their beneficial owners. The Cohen Committee rejected these alternatives, recommending that shareholders be required to state, on signing a transfer or direction to the company, whether they are beneficial owners or not; that if any person is directly or indirectly the beneficial owner of one percent or more of the issued capital he must make a full declaration to the company and disclose his holdings. In addition, the Board of Trade would be provided with drastic powers to in-

investigate the ownership of shares whenever it is considered desirable in the public interest. These recommendations will not mean the end of the growth of the nominee scheme and they will provide company secretaries with a great deal of extra work because of the necessity of maintaining a separate register for nominees.

In relation to other matters the Cohen Committee's proposals are drastic, especially as to the secretiveness of company accounts and the responsibility of directors. It was not generally known, before the Committee inquiry, that the proportion of private to public companies has been steadily increasing in recent years. Between 1934 and 1944, for instance, the number of private companies rose from 115,603 to 169,205, with a capitalization of £1,935,000,000 at the latter year, while the number of public companies fell from 14,852 to 13,303 with capitalization for these firms standing at £4,052,000,000. The great advantage of the private company, the fact that it need not file its accounts with the Registrar of Companies, has led many public companies to convert their subsidiaries into private companies. The Amendment Committee has suggested that no private company can claim exemption from filing accounts if its membership includes a body corporate (other than a corporation sole), or if a body corporate is beneficially interested in its shares. Although this recommendation permits the private family company to go unhampered, it stops abuses on the part of public firms. In addition, holding companies are to disclose full information about their subsidiaries by publishing consolidated accounts. On the presentation of accounts generally the Committee follows the suggestions of the Institute of Chartered Accountants, coming out strongly against hidden reserves.

One major weakness of the Companies Act 1929 was that directors were only liable for untrue statements in a prospectus. The Amendment Committee recommends that they should be liable at civil law also for misleading statements and for the omission of material information which may be misleading. It will also make the expert liable for any untrue or misleading report which he formally allows the directors to include in a prospectus. Advertisements for "placings" are to be put on the same footing as prospectuses.

As to directors, the Committee has decided to compel full disclosure of directors' interests at board meetings and in the prospectus, requiring a register to be maintained of their transactions in their companies' shares or stocks which must be open for inspec-

tion fourteen days before the annual general meeting. This change will not prevent an unscrupulous director from taking advantage of inside information to make a profit on the Stock Exchange for he will be able to inform a friend and ask him to do the buying and selling for his account.

The Cohen Committee has made a decided effort to strengthen the hands of shareholders against directors. It suggests that twenty-one day's notice be given of the annual meeting instead of seven; that directors must come up for reelection singly, and that any director can be removed from office by an ordinary resolution; that if shareholders holding not less than 5% of the votes (or 100 shareholders holding not less than £11 each) give due notice of an intended resolution, the directors will be forced to circulate it with the annual report; and that shareholders be permitted to appoint proxies to attend company meetings and to speak on their behalf. In cases where directors abuse their powers and privileges, these provisions will aid shareholders. From the public point of view, however, the enlarged powers to be afforded the Board of Trade to investigate the affairs of a company, whenever it considers it desirable in the community interest or is requested by a responsible body of shareholders, are vastly important.

In framing its Report, the Company Law Amendment Committee has avoided making any proposal which would restrict honest business management, and it has endeavored to provide every possible impetus to increase publicity of financial facts. The balancing of these objectives, each with its proper emphasis and with relation to the Nation's expanding peacetime economy, transforms what might otherwise have been a dry State Paper into a well-conceived approach to the reform of major deficiencies in prevailing Company Law. The incorporation of the Cohen Committee's recommendations in British statutory law should be facilitated both by their moderate tone and by the gravity of the business, accounting, financial and managerial weaknesses they seek to correct.