

# Duties of a Company Director

Business Information Factsheet

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## Introduction

In order for a limited company to operate, its shareholders delegate the day-to-day management responsibility to a board of directors who then have the power to take business decisions and enter into contracts on the company's behalf.

To protect shareholders, directors are subject to various restrictions and controls imposed by legislation and the company's articles of association. These include general and administrative duties imposed by Part 10 of the Companies Act 2006 ('the Companies Act'). See BIF 459, A Guide to the Companies Act 2006, for more information.

This factsheet looks at the role of a company director in private limited companies and considers their basic duties, responsibilities and potential liabilities. It also outlines some of the implications of the Companies Act for company directors.

As this is a complex area of legislation, company directors should seek professional advice where necessary to ensure that they comply with all aspects of the law.

## What is a company director?

The main functions of a director are to manage the company's business and exercise all the powers of the company.

Directors exercise their powers on behalf of the company and are directly responsible to the shareholders. They have an obligation to ensure that they promote the success of the company for the benefit of all shareholders, even if they are appointed to represent a specific shareholder (such as a venture capital fund).

The law makes no distinction between different types of director, although companies often do. The various types of directors are:

- **Executive director** - In addition to their duties on the board, an executive director is generally an employee of the company and responsible for agreed day-to-day activities. The company's directors may appoint a managing director - an executive director who is given powers to make certain decisions on the board's behalf.
- **Non-executive director** - A non-executive director is not involved in the day-to-day work of the company, but is a member of the board and assists in strategic decision-making. It is considered good practice to have at least one non-executive director to provide a more objective viewpoint on decisions affecting the business. Non-executive directors usually have relevant commercial experience and are formally selected by the company. They have the same legal duties as executive directors. See BIF 322, A Guide to Appointing Non-executive Directors, for more information.

- **Alternate director** - An alternate director is a person, generally another director or person approved by the board, appointed to act in the place of a specific director if they are absent from a meeting. The power to appoint an alternate director must be written into the articles of association. The appointment of an alternate director should also be notified to Companies House.
- **De facto director** - Any person who has assumed the status and performs the role of a director can be considered to be a director even if they have not been properly appointed and are not formally named as a director.
- **Shadow director** - A person, such as a major shareholder, whose directions or instructions are normally acted on by the directors of the company. The absence of a formal appointment as a director does not exclude a shadow director from any legal obligations.

The appointment of directors is normally formalised in a service contract and the company is also required to notify the registrar at Companies House within 14 days of the appointment by completing form AP01 ([www.gov.uk/government/publications/appoint-a-director-ap01](http://www.gov.uk/government/publications/appoint-a-director-ap01)). Forms can be filed online using the Companies House WebFiling system.

Some companies' articles of association require one-third of the directors to be retired (and re-elected, if necessary) each year. Others do not require elections: appointments are made by the shareholders, who also have the statutory power to remove a director by majority vote.

## Who can be a director?

There is no requirement for a director to be a shareholder of the company, but in small private companies it is usual for the major shareholders of the company to be appointed as directors too. It is possible to be a director of more than one company, although it is important to avoid any potential conflict of interest.

The Companies Act stipulates that all companies must have at least one 'natural person' (ie an individual) as a director, not just another company acting as a director.

A person who is an undischarged bankrupt cannot be a director. There is no maximum age limit, but directors must be aged 16 or over.

## Duties of a director

Formal and specific powers and rules are set out in the memorandum and articles of association (the constitutional documents of the company), which are set down when a company is formed. Directors may make any decisions necessary to run the company provided they do not infringe the memorandum and articles of association or the Companies Act.

Under the Companies Act, directors have a duty to:

- **Promote the success of the company** - Directors must consider all of the long-term consequences and implications of their decisions for:
  - Employees.
  - Customers.
  - Shareholders.

- Suppliers.
  - The community.
  - The environment.
  - The company's reputation.
- **Act within their powers** - Directors must follow the rules and restrictions set out in the constitution of the company and use the powers delegated to them by shareholders only for the benefit of the company.
  - **Exercise independent judgement** - A director must take responsibility for their own decisions and exercise appropriate judgement on any information that assists in reaching these decisions. Directors must not be swayed in their judgements by acting in the interests of others, but must act in the interests of the company.
  - **Exercise reasonable skill, care and diligence** - Directors are expected to have knowledge of all areas of the business, or engage specialists to help them. For example, a director with skills in a particular area, such as a qualified accountant, will be expected to have more knowledge of the financial aspects of the business than a director who is not qualified, and who may employ an accountant to help them.
  - **Avoid conflicts of interest** - Directors must avoid situations where a conflict of personal or financial interest could occur, for example where a director has interests in another company they plan to do business with.
  - **Not accept benefits from third parties** - Directors must not accept benefits from a third party that are offered as a direct result of their directorship.
  - **Declare any interest in a proposed transaction or arrangement** - This means shareholders can decide whether to enter into a transaction once they are aware the director has an interest in it.

## Breach of directors' duties

If a director breaches these duties, they may face legal claims brought by:

- **The company** - Companies can seek to remedy a director's breach of duties in several ways, including:
  - Seeking an injunction to prevent the director carrying out or continuing the breach.
  - Claiming compensation where the director has been negligent.
  - Terminating the director's contract.
  - Cancelling a contract in which a director had an undisclosed interest.
- **A shareholder, acting in the name of the company** - Shareholders can take legal action in the company's name to recover any losses the company has incurred as a result of the director's actions. This is known as a derivative action. Shareholders cannot make claims for personal losses they may have suffered as a result of a director's breach of duty.

- **A liquidator or administrator** - If a company is insolvent and a breach of duty is discovered, the liquidator or administrator has an obligation to consider bringing a claim against the directors concerned.

In order to protect themselves should a decision be challenged in the future, directors should document the factors considered in reaching decisions. This will normally be covered in the minutes of board meetings, which all companies are required to keep and retain for at least ten years.

## Compliance responsibilities of a director

Company directors are legally responsible for ensuring that the company meets all its legal reporting obligations. These responsibilities include:

- Preparing financial statements.
- Maintaining statutory books and registers including a PSC Register, which is a new register that has been introduced in order to identify and record the people who run companies in the UK and to increase transparency about who owns and controls these firms. (PSC = People with Significant Control)
- Updating the PSC Register every time any circumstances change and informing Companies House of the changes.
- Filing an annual confirmation statement (which has replaced the annual return) with Companies House.
- Keeping accounting records.

Directors are responsible for the submission of statutory documents to Companies House, and must provide notice of changes in the company's structure, PSCs and board of directors. In particular, they are held personally responsible for the submission of accounts, with late filing resulting in a fine.

Traditionally, it has been the company secretary who has performed these vital administrative duties. However, since April 2008, private companies are no longer required to have a company secretary, but may still choose to have one. If the company chooses not to have a company secretary, it may operate with just one director, who will also need to perform the duties of a company secretary. For more information, see BIF 23, Duties of a Company Secretary.

Directors should also be aware that they may be held responsible for the consequences if their decisions go against the requirements of legislation, including employment, health and safety and environmental law. For example, directors may be liable for offences committed under health and safety legislation by authorising a decision that puts people at risk. All firms must carry out regular risk assessments and have a health and safety policy in place. Both must be in writing if five or more people are employed. Go to [www.hse.gov.uk/pubns/indg417.pdf](http://www.hse.gov.uk/pubns/indg417.pdf) for guidance on directors' responsibilities and see BIF 2, An Introduction to Health and Safety Regulations, for more information.

Directors should ensure that the company complies with all anti-discrimination laws and must be aware of European legislation. Directors should ensure that their employees act within the law.

Directors are also responsible for ensuring that the correct amount of tax, National Insurance and VAT is paid, and that it is paid on time. Go to [www.gov.uk/business-tax](http://www.gov.uk/business-tax) for details. See BIF 341, An Introduction to Business Regulations When Starting Up, for more information.

## Conflicts of interest

Directors must take care not to find themselves in a conflict between their duties to the company and any other outside responsibilities they may have, as they have a formal duty to avoid conflicts of interest. For example, a conflict of interest might arise if someone holds directorships in potentially competing companies. Should they have any personal interest in a potential undertaking, such as a contract or sale, they must disclose this to the board. Failure to disclose interests can lead to substantial penalties.

## Use of company assets

Since October 2007, the restrictions on a company providing loans to its directors have been relaxed. The Companies Act now permits a company to make a loan to a director up to a value of £10,000 without prior approval from shareholders. Directors' loans for larger amounts must be approved by shareholders in advance. The director or the company may be liable to pay tax on the amount loaned. Go to [www.gov.uk/directors-loans](http://www.gov.uk/directors-loans) for more information.

## Liability for actions and disqualification

Under the Insolvency Act 1986 and the Company Directors Disqualification Act 1986, directors must be able to demonstrate they acted properly in the event of the company becoming insolvent. Both of these Acts have been amended by the Insolvency Act 2000, which strengthened the rules covering the disqualification of unfit directors.

Under the Insolvency Act 1986, directors may be held personally liable for a company's debts if the company has gone into liquidation and it can be proved that the directors knew, or ought to have concluded, that there was no reasonable prospect of the company avoiding liquidation. This is classed as the offence of 'wrongful trading' and resigning as a director in advance of insolvency does not remove responsibility.

A director will not be liable if it can be shown that every step was taken to minimise the loss to the company's creditors. Therefore, directors should ensure that they are always aware of the company's trading position and financial status and record the consideration they have given to the company's future prospects. Management accounts should be reviewed regularly at board meetings.

Directors have unlimited liability for fraud or negligence. Directors can take out insurance cover to protect themselves against liability to the company, shareholders and third parties if a claim of negligence is brought against them.

Personal liability insurance is widely used by directors to protect their personal assets and to cover the cost of their defence. Policies typically cover directors and senior managers and, depending on the policy, can extend to protect other employees too.

It is an offence to 'recklessly or knowingly' make a written or oral statement to an auditor that is misleading, false or deceptive, and relates to information that the auditor is entitled to know under the Companies Act. If a director is found guilty of this offence, they will be liable to a fine

and imprisonment for up to two years. It is also an offence to fail to respond to an auditor's request for information, unless it is not feasible to provide the information at that time.

Under the Companies Act, directors are only liable to the company for statements contained in the directors' report and will only be liable if these statements are untrue, misleading or were made recklessly or in bad faith.

## Enforcement of the law

Under the Companies Act, Companies Investigations (CI), which is part of the Insolvency Service, has the power to investigate companies that are suspected of corporate abuse. CI will receive information about the behaviour of a company and will assess that information to decide whether it would be appropriate for them to investigate the company more thoroughly.

If CI decides further investigation is required, they will ask the company to provide them with documents and information in order to determine whether there are grounds for action in the wider public interest. They do not carry out criminal investigations, but the investigations may provide the basis for police action.

The police are responsible for upholding the law in relation to the criminal activities of companies. Go to [www.gov.uk/government/collections/insolvency-service-investigations-and-enforcement-what-we-do-our-outcomes-and-complaints](http://www.gov.uk/government/collections/insolvency-service-investigations-and-enforcement-what-we-do-our-outcomes-and-complaints) for more information.

## Hints and tips

- It is not considered adequate for company directors to base commercial decisions on informal conversations. Regular board meetings should take place with pre-prepared agendas. All discussions and decisions should be recorded and circulated to all directors, even if they did not attend a meeting.
- Companies House can prosecute directors for failing to deliver accounts and confirmation statements to the registrar on time. It has the power to disqualify a director for persistent failure to deliver statutory documents.
- It is increasingly important for directors to understand and comply with their duties, now that the Companies Act gives shareholders the right to sue directors for negligence and bring claims on behalf of the company in certain circumstances.
- Shareholders have a right to see directors' service contracts. If the contract is for a fixed term of more than two years, it should be approved by an ordinary resolution.

## Further information

BIF 2 An Introduction to Health and Safety Regulations

BIF 23 Duties of a Company Secretary

BIF 69 A Guide to Preparing and Submitting Company Accounts to Companies House

BIF 167 A Guide to Setting up a Private Company Limited by Shares

BIF 199 An Introduction to Company Insolvency and Liquidation

BIF 322 A Guide to Appointing Non-executive Directors

BIF 341 An Introduction to Business Regulations When Starting Up

BIF 459 A Guide to the Companies Act 2006

## Books

'The Company Director's Desktop Guide'

David Martin

2015

Thorogood

Website: [www.thorogoodpublishing.co.uk/business](http://www.thorogoodpublishing.co.uk/business)

'The Director's Handbook: Your Duties, Responsibilities and Liabilities'

Institute of Directors (IoD)

2010

Kogan Page Ltd

Website: [www.koganpage.com](http://www.koganpage.com)

'Rights and Duties of Directors'

Martha Bruce

2016

Bloomsbury Professional

Website: [www.bloomsburyprofessional.com/uk/](http://www.bloomsburyprofessional.com/uk/)

## Useful contacts

Companies House provides registration and filing services for companies, as well as useful publications and information.

Tel: 0303 123 4500

Website: [www.gov.uk/government/organisations/companies-house](http://www.gov.uk/government/organisations/companies-house)

The Institute of Directors (IoD) is a membership organisation for company directors. It provides information, as well as training materials and courses for non-executive directors.

Tel: (020) 7766 8866

Website: [www.iod.com](http://www.iod.com)

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