



EXEMPTION FROM AUDIT BY PARENT GUARANTEE

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This is a guide to the exemption from audit under s479A-479C of the Companies Act 2006

This guide has been prepared by ICAEW's Business Law department with input from relevant experts from its committees or other groups supporting its work. The department is the professional and public interest voice on business law matters for ICAEW.

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INTRODUCTION

This is a guide to the exemption from audit under s479A-479C of the Companies Act 2006 (the Act).

This guide applies in relation to accounting periods starting on or after 1 January 2021 at which point it supersedes our earlier guidance on the subject (Tech 07/13BL).

This guide is concerned with the requirements for obtaining the exemption and its effect. It provides no advice or recommendations as to the use of the exemption. Directors of parent undertakings should check that they have power to provide the guarantee and consider their general duties as appropriate (see ICAEW's [Guide to Directors' Duties and Responsibilities](#)). This will include weighing up the benefits of using the exemption compared with the costs of giving that guarantee, in particular the risk that the guarantee may be called upon. They may wish to take their own legal advice based on the specific facts and circumstances. Some subsidiaries will require audits for contractual or regulatory reasons.

Relevant sections of the Act are provided in the Appendix for reference purposes.

QUESTIONS AND ANSWERS

1. Which entities can use the exemption?

The exemption under s479A-479C of the Act applies to companies formed and registered under the Act.

There is no limit on the size of a company for the purposes of the exemption. A subsidiary within a small group or a dormant subsidiary may qualify for exemption from audit under other provisions without the need for a parent guarantee.

Certain types of company are excluded under s479B of the Act (see the Appendix), including traded companies (ie a company any of whose transferable securities are admitted to trading on a UK regulated market) and authorised insurance and banking companies.

These exclusions refer to the status of the subsidiary company seeking to use the exemption. There is no concept of an 'ineligible group' (eg, the fact that the company's parent undertaking or fellow subsidiary is an authorised insurance company does not affect the company's own eligibility for the exemption), but conditions apply regarding the status of the parent company (see below).

Similar provisions also apply (with certain modifications) to Limited Liability Partnerships.

2. What are the conditions for exemption?

For the subsidiary to be exempt, the conditions set out in s479A must be met. See the Appendix for full details, but, in summary:

- the parent undertaking is established under the law of any part of the United Kingdom;
- all of the members of the company agree to the exemption;
- the parent undertaking gives a guarantee under section 479C;

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- the company is included in the relevant consolidated accounts in accordance with the specified applicable accounting standards;
- the parent undertaking discloses in the notes to the consolidated accounts that the company is exempt from the requirements of the Act; and
- the directors of the company deliver to the registrar on or before the date that they file the accounts for that year the documents set out in the Act (see further below regarding filing requirements for the agreement of members).

3. What are the formalities for members agreeing to use the exemption?

The members of the subsidiary must consent unanimously. Members will include:

- holders of ordinary shares (including the immediate parent undertaking which need not be the undertaking that is providing the guarantee);
- holders of preference shares or non-voting shares;
- holders of any shares that are presented as liabilities for financial reporting purposes (the Act being concerned with the legal status of the shares and of their holders as members).

Separate consent will need to be given for each year the exemption is used because:

- under the Act consent must be specific to the financial year in question;
- the exemption is from an obligation (to have an audit) arising each financial year so to give consent in advance of a financial year, on a prospective basis, might give rise to a claim of invalidity and therefore be inadvisable.

A single document may evidence consent by a parent in relation to multiple subsidiaries. However, separate copies of the document should be filed at Companies House for each subsidiary claiming the exemption.

There is no prescribed form in which consent must be given but the company will need evidence that consent was obtained. A written resolution signed by all the members would be satisfactory but is not the only way in which consent may be evidenced.

There is no facility in the Act for a member to withdraw consent for a particular financial year once it has been given. However, the exemption is subject to the requirements of s476 of the Act, which allows members holding 10 per cent of any class of shares to require an audit by giving notice to the company at least one month before the end of the financial year in question. This could be used by one or more members in effect to 'withdraw their consent'.

4. When do the formalities for obtaining the exemption need to be completed in any year?

The formalities for obtaining the exemption do not need to be completed before the subsidiary's year end and need only be completed before the subsidiary's accounts are filed. However, the consolidated accounts of the parent providing the guarantee must refer to the guarantee being given and the name of the subsidiary and this may impose an earlier effective deadline. In practice, a decision would have to be made early enough to be taken into account when planning whether to carry out a statutory audit or only the work needed to support the audit of the parent's consolidated accounts.

5. What are the requirements in relation to the parent?

The parent undertaking must be established under the law of any part of the UK. The guarantee does not have to be provided by the ultimate parent undertaking and could be provided by an intermediate parent undertaking although that parent undertaking would have to prepare consolidated accounts.

The consolidated accounts must be drawn up under accounting standards specified in the Act (UK GAAP or UK-adopted IFRS would, for instance, be acceptable for this purpose) (s479A).

The notes to the consolidated accounts of the parent undertaking must disclose that the company (ie, the subsidiary) is exempt from the requirements of the Act relating to the audit of individual accounts. It is therefore necessary to state the name of each subsidiary for which a guarantee has been given.

Companies House **guidance** states that the parent's consolidated accounts should show the subsidiary companies' names and registered numbers in a prominent place. This could be done by adding a column for the registered number to the listing of subsidiary companies.

6. What are the requirements for filing the written notice of agreement of members?

There is no prescribed form for the written notice of agreement by the members of the company. Companies House **guidance** states that the notice of agreement by members must show the subsidiary company's name and registered number in a prominent place.

7. What does a subsidiary using the audit exemption need to disclose in its own accounts?

The exemption has effect subject to s475(2) and (3) (requirements as to statements contained in balance sheet).

Companies House **guidance** includes example wording for the subsidiary taking the exemption to include in its balance sheet which is as follows:

- For the year ending(dd/mm/yyyy) the company was entitled to exemption from audit under section 479A of the Companies Act 2006 relating to subsidiary companies.
- the members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476;
- the directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts.

8. How is the guarantee given?

The guarantee is effected by delivering the s479C statement to Companies House. The guarantee is created by the operation of s479C rather than by contract. No contract is required between the parent giving the guarantee and the parties who benefit from the guarantee.

9. What are the requirements for the statement referred to in s479C?

The statement under s479C must be authenticated by the parent and must specify:

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- the name of the parent undertaking
- its registered number (if any);
- the name and registered number of the subsidiary company in respect of which the guarantee is being given;
- the date of the statement; and
- the financial year to which the guarantee relates.

The requirement for a statement referred to in s479C will be met by filing a correctly completed Companies House Form AA06 with the registrar. Form AA06 indicates that it must be authenticated by being signed on behalf of the parent undertaking rather than merely indicating the name of the parent undertaking.

10. What is the effect of the guarantee?

A guarantee given under s479C has the effect that:

- the parent undertaking guarantees all outstanding liabilities to which the subsidiary company is subject at the end of the financial year to which the guarantee relates, until they are satisfied in full; and
- the guarantee is enforceable against the parent undertaking by any person to whom the subsidiary is liable in respect of those liabilities.

Where the guaranteed liability is an amount outstanding on an account that may be partially repaid and redrawn several times after the year end, such as a bank overdraft facility, there is case law¹ that monies repaid on the account are presumed to discharge the earliest debits on the account (ie, first in, first out) unless there is contrary intention or a specific direction for appropriation by the debtor

11. What is the scope of 'outstanding liabilities' covered by the guarantee?

The question of scope is one of law and not accounting and readers should seek legal advice where appropriate. Whilst the obvious source of meaning for 'liabilities' is insolvency law, which brings in all types of pecuniary obligation, including contingent and prospective liabilities (eg, respectively, a litigation liability and future rentals on a lease), it is uncertain whether and, if so, to what extent a court would restrict the set of guaranteed liabilities as a result of the reference to 'outstanding liabilities'. Ultimately these uncertainties would be resolved by the courts. In the meantime, it would be prudent for companies that are contemplating the giving of such a guarantee to establish the population of the relevant subsidiaries' liabilities, including contingent and prospective liabilities since it is possible that they may be exposed to some or all of them.

12. What is the effect of a change of ownership of the company after guarantee given?

The guarantee remains in force until the liabilities in question are settled in full. There is no provision to revoke the guarantee or novate it to another party. If a parent undertaking disposes of a subsidiary for which a guarantee has been given, it will remain liable under that guarantee until all the liabilities have been settled. It could seek an indemnity from the purchaser of the subsidiary but would remain liable to the creditors of the former subsidiary.

¹ Clayton's case [Devaynes v Noble (1816) 1 Mer 572]

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If the new parent also entered into a guarantee under s479C for a subsequent financial year and liabilities outstanding at a previous balance sheet date remained outstanding, it is possible that the same liabilities may have been guaranteed by more than one parent. A creditor might claim against either guarantor. The guarantor against which the claim is made is given no rights by the Act against the other guarantor but may have an equitable right of contribution from other guarantors of the same outstanding liabilities.

13. Does the guarantee fall away if the company later decides to have an audit for the year in question?

No. Once the guarantee has been given by delivering the s479C statement to Companies House, there is no provision in the Act for the parent's liability to cease except on the full satisfaction of the subsidiary's liabilities that had been covered by the guarantee given previously. Therefore, reverting to an audit would not bring an end to those liabilities.

14. Are there any special considerations for charities?

S479A-C of the Act concerns exemption from audit requirements under the Act. Charitable companies are also subject to audit requirements under the Charities Act 2011 (and related regulations) and a parent company guarantee under s479A-C of the Act would not exempt a charitable subsidiary from those requirements.

Where the subsidiary is not a charity but the parent undertaking proposing to give a guarantee under s479C is a charity, the parent undertaking should consider carefully whether it is able to do so under charity law and regulation. Charity Commission guidance (CC35) states that 'The trading subsidiary must be set up in such a way as to protect the parent charity and its assets from the risks involved in the trading. The need to protect the charity's assets from any significant risk involved in non-primary purpose trading is paramount'.

15. Do the accounts of the subsidiary still have to be prepared and filed at Companies House?

Dormant companies may be exempt from audit under s480 of the Act. However, dormant subsidiary companies that, essentially, fulfil the conditions for exemption from audit by parent guarantee are also exempt from the requirement to prepare and/or file accounts at Companies House (s394A-C and s448A-C respectively). Form AA06 referred to in question 9 above should indicate which of the exemptions is being claimed.

16. For a company with a premium listing in the UK, could entering into a guarantee require shareholder approval as a class 1 transaction?

LR 10.2.4 requires certain indemnities and similar arrangements to be treated as class 1 transactions and therefore to require shareholder approval. However, this does not apply to an agreement or arrangement with a wholly-owned subsidiary undertaking of the listed company. It therefore appears that provided the subsidiary in question is wholly-owned, entering into a guarantee under s479A-C would not be a class 1 transaction.

Where the arrangements involve a subsidiary that is not wholly owned, it appears that the arrangements may be a class 1 transaction because the guarantee is unlimited. Companies considering entering into guarantees in respect of non-wholly owned subsidiaries should obtain their own legal advice or consult their broker and/or the UKLA.

APPENDIX

(S479A-C Companies Act 2006)

The following are sections of the Companies Act 2006 as amended by statutory instruments made on or before 30 October, 2020 and in effect on 1 January 2021.

Amendments include those related to the UK leaving the European Union, which take effect at 11.00pm on 31 December 2020 (being the end of the implementation period). For accounting periods beginning on or before 31 December 2020, readers should refer to the version of the Act applying at that time.

The text is provided for convenience of readers only in the absence of a government provided consolidated text and should not be relied upon for formal purposes. Users should check the current version of the Act at the time of use.

479A Subsidiary companies: conditions for exemption from audit

1. A company is exempt from the requirements of this Act relating to the audit of individual accounts for a financial year if—
 - a) it is itself a subsidiary undertaking, and
 - b) its parent undertaking is established under the law of any part of the United Kingdom

2. Exemption is conditional upon compliance with all of the following conditions—
 - a) all members of the company must agree to the exemption in respect of the financial year in question,
 - b) the parent undertaking must give a guarantee under section 479C in respect of that year,
 - c) the company must be included in the consolidated accounts drawn up for that year or to an earlier date in that year by the parent undertaking in accordance with—
 - i) if the undertaking is a company, the requirements of Part 15 of this Act, or, if the undertaking is not a company, the legal requirements which apply to the drawing up of consolidated accounts for that undertaking, or
 - ii) UK-adopted international accounting standards (within the meaning given by section 474(1)),
 - d) the parent undertaking must disclose in the notes to the consolidated accounts that the company is exempt from the requirements of this Act relating to the audit of individual accounts by virtue of this section, and
 - e) the directors of the company must deliver to the registrar on or before the date that they file the accounts for that year—
 - i) a written notice of the agreement referred to in subsection (2)(a),
 - ii) the statement referred to in section 479C(1)
 - iii) a copy of the consolidated accounts referred to in subsection (2)(c),
 - iv) a copy of the auditor's report on those accounts, and
 - v) a copy of the consolidated annual report drawn up by the parent undertaking.

3. This section has effect subject to—
 - section 475(2) and (3) (requirements as to statements contained in balance sheet), and
 - section 476 (right of members to require audit).

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479B Companies excluded from the subsidiary companies audit exemption

A company is not entitled to the exemption conferred by section 479A (subsidiary companies) if it was at any time within the financial year in question—

- a) a traded company as defined in section 474(1),
- b) a company that—
 - i) is an authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company, or
 - ii) carries on insurance market activity, or
 - iii) is a scheme funder of a Master Trust scheme within the meanings given by section 39(1) of the Pension Schemes Act 2017 (interpretation of Part 1), or
- c) a special register body as defined in section 117(1) of the Trade Union and Labour Relations (Consolidation) Act 1992 (c 52) or an employers' association as defined in section 122 of that Act or Article 4 of the Industrial Relations (Northern Ireland) Order 1992 (S.I. 1992/807) (NI 5).

479C Subsidiary companies audit exemption: parent undertaking declaration of guarantee

1. A guarantee is given by a parent undertaking under this section when the directors of the subsidiary company deliver to the registrar a statement by the parent undertaking that it guarantees the subsidiary company under this section.
2. The statement under subsection (1) must be authenticated by the parent undertaking and must specify—
 - a) the name of the parent undertaking,
 - b) the registered number (if any) of the parent undertaking,
 - c) [deleted]
 - d) the name and registered number of the subsidiary company in respect of which the guarantee is being given,
 - e) the date of the statement, and
 - f) the financial year to which the guarantee relates.
3. A guarantee given under this section has the effect that—
 - a) the parent undertaking guarantees all outstanding liabilities to which the subsidiary company is subject at the end of the financial year to which the guarantee relates, until they are satisfied in full, and
 - b) the guarantee is enforceable against the parent undertaking by any person to whom the subsidiary company is liable in respect of those liabilities.

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