

CORPORATE LAWS & GOVERNANCE

PROFESSIONAL 1 EXAMINATION - AUGUST 2020

Section A:

You are required to answer **three** questions from this section, (Questions 1, 2 and **either** 3 or 4). Should you provide answers to **both** Questions 3 and 4, only the answer for Question 3 will be marked.

Section B:

You are required to answer **one** question from this section. Should you provide answers to each question in this section, only the answer for Question 5 will be marked.

TIME ALLOWED:

3 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:

During the reading time you may highlight text and write notes on the examination paper, however, you may not commence writing on the answer field until your Supervisor tells you to do so. Please read each Question carefully.

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

CORPORATE LAWS & GOVERNANCE

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SECTION A

Answer both Questions 1 and 2 and either Question 3 or 4.

1. Churchill Pharmaceuticals Ltd. (Churchill) has recently been approached by Mountbatton Sciences DAC (Mountbatton), which have expressed an interest in buying the company. After extensive negotiations, the directors/shareholders of Churchill, Raleigh and Devlin, agreed to sell their shareholding in the company in return for an equivalent shareholding in Mountbatton and subject to them both being appointed to the Board of Directors of Mountbatton as non-executive directors. Mountbatton made this agreement conditional on Churchill purchasing the 500,000 €1 redeemable preference shares issued by the company in favour of Philmore Investments and cancelling them. Churchill Pharmaceuticals Ltd. has agreed to this condition and Raleigh and Devlin have contacted you for advice regarding these matters.

REQUIREMENT:

- (a) (i) Analyse the nature of a redeemable share. (2 marks)
- (ii) Advise Raleigh and Devlin as to how Churchill Pharmaceuticals Ltd. can finance the redemption of these shares. (2 marks)
- (iii) Explain how this redemption should be accounted for in the company's financial statements (2 marks)
- (b) Excluding the redemption of redeemable shares, advise Raleigh and Devlin of any FOUR other statutory exemptions, contained in the Companies Act 2014, which permits a company to purchase its own shares. (4 marks)
- (c) Raleigh and Devlin have been given the option of receiving either ordinary or preference shares in Mountbatton Sciences DAC but are unsure of the distinction between these classifications of shares, and which is likely to be a better investment option in the long term. Critically examine any THREE differences between ordinary and preference shares and assess which is likely to be considered a better long-term investment option. (7 marks)
- (d) Mountbatton Sciences DAC has also offered Raleigh and Devlin the option of purchasing 100,000 €1 ordinary shares in the company, on a partly-paid basis, upon their appointment to the Board as non-executive directors. Evaluate the nature of a partly-paid share and advise Raleigh and Devlin as to when their liability arises in respect of these shares. (3 marks)
- (e) Raleigh and Devlin are aware that Mountbatton Sciences DAC will have to amend its Articles of Association to increase the number of non-executive directors to sit on their Board, in order to facilitate their appointment to these positions. Outline the procedures that must be followed to effect an alteration to the Articles of Association, and the applicable rules that underpin these procedures. (5 marks)

[Total: 25 marks]

2. Dale is the sole director and Blake is the company secretary of Hamptons Catering DAC (Hamptons). Last year, Dale obtained a loan on behalf of Hamptons for €400,000 from the Roscommon Prudential Bank. The purpose of this loan was to finance the expansion of the company and, in particular, to lease new business premises in order to expand their patisserie division. Blake was instrumental in overseeing the expansion of the business, and hired contractors to refit the new premises, as well as additional kitchen staff. When dealing with contractors and staff Blake referred to herself as a director of Hamptons, although she has never been formally appointed as such.

In December 2019, Blake had an accident in one of Hamptons kitchens, when she slipped on some oil that had been spilled on the floor. As a consequence of this accident, she tore her anterior cruciate ligament (ACL), and was unable to work for six weeks. Arising from this accident and other personal problems, Blake incurred some significant personal debt. She became anxious to clear this debt and as a consequence, established her own wedding cake business. However, Blake used Hamptons bakers (and ingredients) to make these cakes, without making them aware that this work was for her own personal business and not for customers of Hamptons. This issue was discovered when the accountant of Hamptons noticed a significant quantity of missing stock, based on the volume of orders being completed. Upon closer investigation, Blake was seen on the company's CCTV on at least 20 different occasions taking cakes from the company and placing them into her own car. When Dale confronted Blake with this footage She broke down and admitted to the fraud. Consequently, she immediately tendered her resignation as company secretary. Dale believes the actions of Blake have caused losses to Hamptons of approximately €6,000 in terms of both labour and materials.

In May 2020, there was a serious incident at a corporate event catered by Hamptons. Within a couple of hours of feeding the staff at this event, a huge number of them starting complaining of nausea, fever, vomiting and stomach cramps and had to be taken to hospital for treatment. The hospital subsequently diagnosed them as suffering from both cholera and a campylobacter infection. An investigation by the Department of Health traced both of these bacterial infections to Hamptons and under-cooked poultry meat, as well as fish and shellfish sourced from contaminated waters. As a consequence, Hamptons received a substantial fine from the Department of Health and had to compensate the affected workers for their medical costs. Furthermore, the negative publicity generated by this incident has resulted in the cancellation of numerous catering contracts, and the company is now in financial difficulty. This has resulted in Hamptons defaulting on the loan in favour of the Roscommon Prudential Bank in the last month. The shareholders of Hamptons have now decided to effect the removal of Dale as they believe that the bacterial incident, as well as Blake's fraud, could have been prevented if he had been monitoring suppliers and staff more effectively. In addition, they consider that the loan with Roscommon Prudential Bank is unenforceable as Dale did not have the authority to create this contract, as a provision in Hamptons Articles of Association states that any borrowing in excess of €200,000 requires a resolution of the shareholders of the company at a general meeting. No such approval was sought by Dale in respect of this loan.

The shareholders of Hamptons have now contacted you seeking advice.

REQUIREMENT:

- (a) Assess whether Blake would be viewed as a company director and describe how she would be classified. Comment also on the potential ramifications for Blake if she were to be classified as a company director. (3 marks)
- (b) Critically examine whether the contract created by Dale for the €400,000 loan from Roscommon Prudential Bank is enforceable against Hamptons Catering DAC by reviewing the law in relation to the indoor management rule. (8 marks)
- (c) State any FOUR fiduciary duties owed by a director to a company and assess whether the actions of the Dale and Blake are in breach of their duties to the company. (6 marks)
- (d) If the actions of the Dale and Blake are in breach of their duties the shareholders of Hamptons Catering DAC have heard that a Disqualification Order may be imposed upon them. Critically assess the effect of a Disqualification Order, commenting specifically on any THREE grounds (excluding breach of duties) upon which such an Order may be imposed. (5 marks)
- (e) The shareholders of Hamptons Catering DAC are aware that, upon Dale's removal, a new director will need to be appointed to the company. Advise them of any THREE persons deemed ineligible to accept this appointment. (3 marks)

[Total: 25 marks]

- 3.** Hammond Medical Research Ltd. (Hammond) has recently developed a device which is capable of checking the blood glucose levels of Type 1 Diabetic patients and administering the correct dosage of insulin to these patients. This invention is significantly less invasive and more accurate than devices currently on the market. The launch of this product has been a financial success for the company, and they have been nominated for a number of both national and international innovation awards. To capitalise on this success, the company's business advisor has suggested that the company convert to a public limited company and make an initial public offering (IPO) of their shares onto the Irish stock market. The company is aware that if it converts to a public limited company and obtains an IPO that it will have to appoint a statutory auditor and an audit committee. The managing director of Hammond, Whelan, is anxious about this appointment as he has been diverting €50,000 in funds from the company for the last five years, which he has been disguising as an unsuccessful research project. He has been putting these funds into his own private pension account to facilitate his early retirement. Whelan is aware that his deception is likely to be viewed as fraudulent trading and is unsure how the auditor will react if or when this fraud is discovered.

Notwithstanding his personal concerns, Whelan has been tasked with appointing an auditor and audit committee by the company and briefing the Board on various aspects relating to such appointments. He has contacted you seeking advice.

REQUIREMENT:

- (a) Review the prerequisite requirements to act as a statutory auditor to an Irish company. (5 marks)
- (b) Critically evaluate the duty of the auditor to investigate the financial affairs of a company, commenting also on the prescribed content of an auditor's report. (9 marks)
- (c) Analyse the role of an audit committee in a public limited company. (3 marks)
- (d) If the statutory auditor appointed to Hammond Medical Research Ltd. discovers Whelan's fraudulent trading, assess the obligations imposed upon the auditor by virtue of the Companies Act 2014. (3 marks)

[Total: 20 marks]

4. Raven is a drummer, and in 2016 she was hired as a session musician by French and Little Recordings (FLR) to play the drums for one of their new solo artists, who was recording her first album. Raven's contract with FLR, provided that she was employed as an independent contractor, at a rate of €300 per 6-hour day, and €60 per hour for any additional hours worked thereafter. Her contract also stated that she was responsible for her own taxation and social insurance affairs. Upon completion of the album, Raven was engaged to work with another artist on the same terms and conditions. Thereafter, she was asked to undertake a 6-month European tour with the first artist, for an agreed fee of €40,000 plus expenses. During this tour, Raven was provided with free travel, accommodation, meals and drinks as well as replacement drum equipment, as required. On completion of this tour Raven went back into the studio with other FLR artists and has undertaken three additional tours, including Australia, South America and parts of Asia for other artists of the business, all on the same terms and conditions of employment. In fact, since 2016, Raven has been kept in the continuous employment of FLR and has been so busy with the work assigned to her, that she has not been in a position to undertake work for any other recording company.

Since commencing employment with FLR, Raven has been provided with replacement drum equipment, as and when required. She has also been invited to their end of recording sessions and tour parties and has received a bonus payment when any albums that she worked on went 'platinum'. However, she does not have a staff parking space in the car park of FLR, nor does she have a staff admittance card to the studio. Instead, she is allocated a temporary admittance card for every recording project she has worked on, but always has to sign in with reception on a daily basis.

Three months ago, Raven discovered she was pregnant as she was about to start a year-long world tour with a FLR rock band. She undertook the tour nonetheless, and last week she contacted FLR to inform them that she was 18 weeks pregnant, and, as a consequence, she would be unable to complete the current tour beyond her 30-week pregnancy period. She then questioned whether she was entitled to maternity leave and payment from FLR as she was aware that other female employees of the company had received their full salary while on maternity leave. However, the Human Resources (HR) Manager of FLR notified Raven that because she is employed as an independent contractor, under a contract for services, she has no entitlement to maternity pay from the company.

Raven is really distressed by this news, as despite what it states in her contract, she has always considered herself to be an employee of FLR. She has now contacted you seeking advice.

REQUIREMENT:

- (a) Excluding statutory protection, analyse the importance of the distinction between being employed under a contract of service and a contract for services, under any TWO headings. (4 marks)
- (b) Critically review any THREE of the tests used by the Courts to make this distinction, using case law to support your answer. In light of this review, determine whether Raven is likely to be classed as being engaged under a contract of service or a contract for services in this situation. (12 marks)
- (c) If Raven is classed as an employee, discuss any FOUR employment rights that are bestowed upon her by virtue of any of the employment law statutes. (4 marks)

[Total: 20 marks]

SECTION B
Answer either Question 5 or 6.

- 5.**
- (a)** Evaluate the issues which the Board of a current public limited company should consider with regard to the composition and responsibilities of the remuneration committee. In particular, your answer should refer to the committee's responsibility to assure shareholders that executive remuneration is appropriately structured and disclosed.
(20 Marks)
- (b)** Outline the objectives, role, responsibilities and powers of the Irish Auditing and Accounting Supervisory Authority (IAASA) as set out in statute.
(10 marks)
- [Total: 30 marks]**

OR

- 6.** You have been invited to give a presentation to a group of US investors on the system of corporate governance followed by Irish and UK companies.

REQUIREMENT:

Your presentation should include:

- (a)** An evaluation of the UK Corporate Governance Code's (2018) best practice guidance on the requirements and role of the board chairman.
(12 Marks)
- (b)** A critical discussion of the principles-based approach to corporate governance adopted in Ireland and the UK as compared to the rules-based approach taken in the US (as reflected for example in the Sarbanes-Oxley Act (2002)).

Your discussion should refer to the advantages and disadvantages of the principles-based framework relative to the rules-based framework.

(18 marks)

[Total: 30 marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

CORPORATE LAWS & GOVERNANCE

PROFESSIONAL 1 EXAMINATION - AUGUST 2020

SOLUTION 1 (Compulsory Question):

- (a) **Redeemable Shares:** These are shares issued by the company and later redeemed at some date in the future at a fixed rate – in effect they are a form of a loan to the company. They may be issued as redeemable shares or converted into redeemable shares (Section 83 CA 2014) (0-2 marks). Redeemable shares may only be redeemed: (1) out of profits available for distribution, or (2) alternatively, if a company intends to cancel these shares upon redemption, they may be redeemed from a fresh issue of shares (section 105(2)(a)-(b) CA 2014) (0-2 marks). Upon redemption the issued share capital account is reduced by the amount of the redemption and an equivalent sum is transferred to the Capital Redemption Reserve Account, which is part of the un-denominated capital of the company (0-1.5 marks).
- (b) **Statutory Exemptions Permitting a Company to Purchase its own Shares:** Section 102 CA 2014 permits a company to purchase its own shares in the following situations: (1) the transfer or surrender to the company, other than for valuable consideration (Section 102(a)), (2) pursuant to a Court Order (such as an application for oppression by a minority under Section 212), (3) pursuant to a merger or division of the company under Chapter 3 or 4 of Part 9 of CA 2014 – in addition, (4) a PLC may also purchase its own shares through a market purchase (approved by an ordinary resolution) or (5) an off-market purchase (approved by a special resolution) in certain situation (Sections 1074-5) (any 4 = 0-4 marks).
- (c) **Distinction between Ordinary and Preference Shares:** (1) Ordinary shareholders are the main risk takers in the company as they bear the burden of the company's fortunes as they are the last to be paid upon the liquidation of the business, whereas preference shareholders are less risky than ordinary shares in that they are generally paid in priority to ordinary shares, (2) ordinary shareholders are generally only paid dividends following payment to the preference shareholders, (3) ordinary shareholders are paid a variable dividend, which varies in accordance with the profit/performance of the company – this right is not cumulative, whereas preference shareholders are issued with a fixed percentage return on investment – this right is normally cumulative, so if no profit is declared in any particular year, the right to a dividend may accumulate to the next profit period (and up to a maximum period of six years), and (4) ordinary shares are generally voting shares and these shareholders can influence company policy by exercising voting rights at general meetings (AGM/EGM) relating to company business, whereas preference shares generally have no ability to influence company policy as they have no voting rights (any 3 x 2 = 0-6 marks).
- Conclusion:** On the assumption that Mountbatton Sciences DAC is successful and generating profits, then ordinary shares are the better investment option as they receive a variable dividend and have the potential for capital growth (0-1.5 marks).
- (d) **Partly-Paid Shares:** These are shares purchased without paying the full amount due on subscription (0-1 marks). If Raleigh and Devlin purchase partly paid shares and a call is made for payment of the balance due, they are contractually obliged to pay the outstanding amount. If Mountbatton Sciences DAC goes into liquidation then any sums outstanding on foot of partly paid shares are automatically called for payment. Therefore, their liability in respect of these shares arises on a pre-agreed future date, or on the liquidation of the company (0-2 marks).
- (e) **Alteration of the Articles:** Any alteration to the Articles must be effected by the passing of a special resolution of the members, and in accordance with Section 977 (DAC) and 1015 (PLC) CA 2014. This special resolution necessitates convening an extraordinary general meeting (EGM) with 21 days clear notice, and approval by a 75% majority of voting shareholders in attendance at that meeting (0-2 marks). In effecting the alteration the following rules apply: (1) the alteration may not override the provisions of the Companies Acts, the Memorandum of Association and the general rules of law, and (2) the alteration to the Articles must be made bona fide and in the best interests of the company as a whole (as per *Allen v Gold Reefs of West Africa* [1990]) – in effect the question asked is if the alteration is in the interest of the “individual hypothetical member” (2 = 0-3 marks).

SOLUTION 2 (Compulsory Question):

- (a) **Classifications of Director:** Blake is likely to be viewed as a director and classified as a de facto director. This is a director who is not formally appointed as a director, but acts as having undertaken the role of a director. De Facto directors were historically defined in the cases of *Re Lynrowan Enterprises Ltd* (2002) and in *Re Hydrodam (Corby) Ltd* (1994) and Section CA 222 CA 2014 now defines a de facto as a person who occupies the position of director of a company but who has not been formally appointed as such (0-2 marks). Even though Blake has not been officially appointed as a de jure director, in the event of a breach she will be liable as if she were properly appointed (0-1 mark).
- (b) **Indoor Management Rule:** The validity of the contract between Roscommon Prudential Bank and Hamptons Catering DAC needs to be determined by an application of the indoor management rule – as the company has acted in breach of its own Constitution. Under the terms of the indoor management rule where a third party contracts with a company they are entitled to presume that things done within a company are done according to correct procedures as required by the company's Constitution. In other words, an outsider is entitled to presume that issues of internal management have been transacted in a procedurally correct manner. This rule originates from the case of *Royal British Bank v Turquand* (1856). In this case the company's Constitution required prior shareholder approval for loans in excess of a defined threshold. Despite this provision, the directors borrowed money in excess of the threshold without the approval of the shareholders, and then argued that the loan from the Royal Bank was invalid (due to the breach). The Court held that the Bank, as outsiders were entitled to presume that issues of internal policy, such as the taking of votes, had been done according to the correct procedures. Therefore, as the borrowing was within the company's general powers and the Bank had no way of checking if an ordinary resolution had been passed, the Court held that the loan was valid and accordingly it had to be repaid. However, it is important to note that the indoor management rule does not apply in cases where the facts should make the outsider enquire further, for example, where there are suspicious circumstances. In *AL Underwood Limited v Bank of Liverpool & Martins* (1924) Underwood had a personal account with the defendant bank. He also ran a company under the name AL Underwood Limited, in which he was the major shareholder and only company director. Underwood paid company cheques into his personal account. When the company got into financial difficulty the Receiver sued the bank for the money lodged into Underwood's personal account. The bank held that it was entitled to assume that that the account into which the cheques were paid was an internal issue of the company. The Court held that the lodging of company cheques into a personal account was so unusual that the bank should have made further enquiries. Therefore the bank could not rely on the indoor management rule to invalidate the contract (0-7 marks).

Conclusion: Based on the application of this rule the contract between Roscommon Prudential Bank and Hamptons Catering DAC is enforceable as the Bank is entitled to presume that Hamptons complied with the requirements of its own Articles in creating this contract (0-1 mark).

- (c) **Fiduciary Duties of a Company Director:** As per Section 228 of the Companies Act 2014, these can be summarised as follows: (1) directors must exercise their powers bona fide in the best interest of the company as a whole, (2) directors must exercise their powers for the purposes for which they were conferred, in furtherance of the company's Constitution and for lawful purposes, (3) directors have a duty to avoid conflicts of interest between themselves and the company, (4) directors are required to act honestly and responsibly in relation to the conduct of the affairs of the company, (5) directors are prohibited from using company property, information or opportunities for their own person benefit or for any other person's benefit, (6) directors must exercise due care, skill and diligence in the performance of their duties, (7) directors have a duty to maintain independent judgment in the performance of their duties, except where otherwise permitted by the Constitution of the company or where it is approved by an ordinary resolution of the members in a general meeting, and (8) directors have regard to the interests of its members in the performance of their duties (any 4 = 0-4 marks).

Conclusion: Blake has breached her duties, as (1) she did act in good faith and in the best interest of Hamptons Catering DAC (she acted in her own personal interest), (2) she did not act honestly and responsibly, and (3) she utilised company property for her own benefit (any 2 = 0-1 mark). Dale also breached his duty, in that acting in contravention of the Articles, he failed to exercise their powers for the purposes for which they were conferred (0-1 mark).

- (d) **Disqualification Order:** This is an Order brought against directors, auditors, company officers, liquidators, or receivers which disqualifies them from taking part in the promotion, formation, or management of any company, either directly or indirectly for up to 5 years, or any other such period as the Court may direct (0-2 marks). The grounds for imposition of this Order may be discretionary or mandatory. The discretionary grounds, in accordance with Section 842 CA 2014 include: (1) where a person is found guilty of fraud while acting as a company promoter, officer, auditor, receiver, liquidator or examiner, (2) where a person is guilty of fraudulent or reckless trading, (3) where a person is unfit to be involved in the management of a company by reason of their past conduct as a company promoter, officer, auditor, receiver, liquidator or examiner, (4) where a person is unfit to be involved in the management of a company, following an inspectors report under the Companies Acts, by reason of their past

conduct as a company promoter, officer, auditor, receiver, liquidator or examiner, (5) where a person is persistently in default of the filing requirements of the Companies Acts (three or more defaults in a five year period prior to the application), (6) where a person has been disqualified in another jurisdiction or is guilty of conduct in another jurisdiction, which would have resulted in disqualification in this jurisdiction, (7) where a person has been restricted as a director and the company of which he was a director is liquidated, within five years of the behaviour prompting the restriction, (8) where a person commits two or more offences in respect of failing to keep proper books of account, (9) where they have been the director of a company which has been struck off the Register of Companies for failure to submit one or more annual returns, unless the company had no liabilities at the time of strike-off, or where the liabilities have since been fully discharged, and (10) where the High Court at its absolute discretion considers that such disqualification is fair and equitable, and is in the best interests of the company. The automatic grounds include: (1) where a person is convicted of any offence under the Companies Act 2014, or any offence involving fraud or dishonesty (Section 839), (2) where a person is convicted of acting while disqualified, (3) where a person is convicted of acting while restricted, except in the limited circumstances permitted by company law, (4) where a person is a director of a company and there has been a failure to notify the Companies Registration Office, either at the time the company's Constitution was being registered or when there was a change in the Register of Directors, that the person was disqualified in another jurisdiction, and failed to provide the requisite details (Section 840-841) (any 3 = 3 marks).

- (e) **Director Ineligibility:** The Companies Act 2014 prohibits the following people from acting as company directors: (1) un-discharged bankrupts (Section 871(1) CA 2014 – breach is classed as a category 2 offence), (2) corporate bodies, (3) the auditor of a company or its holding company, (4) a minor (under the age of 18 – Section 131 CA 2014), (5) a disqualified person – or (6) in certain situations a restricted person, and (7) a person who already holds more than 25 directorships (any 3 = 0-3 marks).

SOLUTION 3 (Optional Question):

- (a) **Prerequisite Requirements to Act as an Auditor:** The auditor must be (1) qualified (trained by or a member of a Prescribed Accountancy Body recognised by IAASA, and in possession of a practising certificate, Section 1441 CA 2014) (0-1 mark), (2) the auditor must be registered with the CRO (0-1 mark), and (3) the auditor must be independent in that he cannot be: (1) an officer or servant of the company, (2) an ex-officer or ex-servant of the company, within a period in respect of which accounts would be audited by them if they were appointed auditor, (3) a parent, spouse, brother, sister or child, partner or employee of an officer of the company, (4) a person who is disqualified from being an auditor of the company's holding or subsidiary company, (5) any former directors who are subject to a disqualification order, (6) a body corporate – although a statutory auditor or audit firm may now undertake statutory audit work through corporate bodies, and (7) a person in whose name a share in the company is registered, whether or not that person is the beneficial owner of the share (any 3 = 0-3 marks).
- (b) **Auditor's Duty to Investigate:** An auditor is obliged, as part of his statutory duties, to investigate the financial affairs of the company and report to the members on these affairs at the AGM (Section 391 CA 2014). According to Lord Justice Lopes in *Re Kingston Cotton Mills Co. (1896)*: "[a] auditor is not bound to be a detective, or, as was said to approach his work with suspicion, or with a foregone conclusion that there is something wrong. He is a watchdog, not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and rely upon their representations, provided he takes reasonable care." This duty requires the auditor to protect the interest of those who appointed him. But he can assume the servants of the company are acting honestly and he can rely on their statements – unless evidence indicates otherwise. In doubtful cases he should investigate matters thoroughly. But he is also not expected to act with a suspicious mind (as per Lord Denning in *Fomento (Sterling Area) Ltd. v Selsdon Fountain Pen Co. Ltd. (1958)*) (0-4 marks).
- Auditors Report:** In accordance with Section 336 CA 2014 the auditor's report must include statements regarding the following matters: (1) whether the auditor received adequate information and explanations from the company necessary for the purpose of the audit, (2) whether the company's accounting records and returns correspond with the balance sheet and profit and loss account, (3) whether, in their opinion, the accounting records of the company were sufficient to permit the financial statements to be readily and properly audited, (4) whether in their opinion the annual financial statements give a true and fair view of the financial state of affairs of the company, (5) whether the accounts are in compliance with the relevant financial reporting framework and the requirements of legislation, and (6) whether the information given in the directors' report for the financial year is consistent with the statutory financial statements (any 5 = 0-5 marks).
- (c) **Role of an Audit Committee:** In accordance with Section 167(6) CA 2014 the main role of an audit committee includes the following: (1) monitoring of the financial reporting process, (2) monitoring of the effectiveness of the company's systems of internal control, internal audit and risk management, (3) monitoring of the statutory audit of the company's statutory financial statements, and (4) the review and monitoring of the independence of the statutory auditors and in particular the provision of additional services to the company (any 3 = 0-3 marks).
- (d) **Reporting Obligations on the Auditor:** Section 393 CA 2014 provides that where an Auditor comes to the opinion based on reasonable grounds that a company or its officers or agents have committed a Category 1 or 2 offence under the Companies Acts, he must notify the Director of Corporate Law Enforcement providing details – compliance with this section is not regarded as a contravention of an Auditor's professional or legal duties, and default is classed as a Category 3 offence (0-2 marks). Therefore, as fraudulent trading is a category 1 offence the auditor would have a statutory obligation to report Whelan's actions (0-1 mark).

SOLUTION 4 (Optional Question):

- (a) **Importance of the distinction between an Employee and a Contractor:** this distinction is important for a variety of reasons including the following: (1) protective employment legislation – this only applies to employees who have rights pursuant to legislation such as the Unfair Dismissals Act, Minimum Notice Act, Redundancy Payments Act, Maternity and Adoptive Leave Acts, Payment of Wages Act etc – none of these pieces of legislation bestow rights on independent contractors, (2) vicarious liability – in general terms an employer is vicariously liable for the actions of employees but not independent contractors, (3) preferential payments on liquidation – when a company is placed in liquidation any salary (up to a maximum of €10,000) owed to an employee and any untaken annual leave is classed as a preferential debt – whereas any monies due to an independent contractor is classed as an unsecured debt, and (4) the tax and social welfare code also differentiates between them – employees pay tax on a PAYE basis – whereas contractors are self-assessed – in addition, employees have access to certain payments under the social welfare code (such as disability allowance, unemployment assistance (job seekers benefit) where their working week is reduced to 3 days or less, or where they lose their job) which are not available to independent contractors (any 2 x 2 = 0-4 marks).
- (b) **Tests to distinguish between an Employee and a Contractor:** (1) Control Test: this test questions whether the employer controls all aspects of the employees work – in effect have they control over the work done, the method of completion, the means employed to achieve the result, and the time and place the task is to be done – there are inherent problems with the test in the context of professional workers – who are subject to limited control – such as in *Tierney v An Post* (2000) wherein even though the worker was under the control of An Post he was still not classified as an employee, (2) Integration Test: this test asks whether the worker is employed as part of the business, and whether the work done is integral to the business – it also looks at whether other workers assume that the worker is an employee based on how integrated they are in the business and their access to facilities and resources – the application of this case was illustrated in *Re Sunday Tribune (in Liquidation)* (1984) and in *Kelly v Irish Press* (1985) in the context of journalist/editors who were described as contractors but integrated into the business – the main problem with the integration test is the difficulty in its application to small businesses where most workers irrespective of status are integrated, (3) Enterprise Test: this test questions whether the person has engaged himself to perform services as a person in business on his own account – it asks whether the worker has made a financial investment in the work, can he reap a reward/profit from effective performance of the job, and whether there is a financial risk in undertaking the work – in *McDermott v Loy* (1982) the lack of entrepreneurship indicated an employee relationship – problems with the enterprise test arise in the context of employees paid on a commission basis – who can profit from the effective performance of their job but are still classed as employees, and (4) Mixed/Reality Test: in this test all factors are considered equally (although there is more focus on control in the mixed test) and an overview is taken – relevant factors include: method of pay, right to select and dismiss, ability to delegate performance of duties, provision of training and equipment, level of financial risk undertaken by the worker, whether the worker has the opportunity to profit from effective management of the task – the application was seen in *Mahon v Henry Denny & Sons Ltd* 1997 where the worker was classified as a employee by taking a holistic view of all aspects of the working relationship, and in particular the fact that she could not alter her earnings which were fixed by the employer (any 3 x 3 marks = 0-9 marks) .
- Conclusion:** Despite the fact that some of the tenets of Raven's employment may indicate that she is a contractor (no parking space or admittance card, signing into the building, responsible for her own tax and social insurance), nonetheless the Court is likely to classify Raven as an employee as: (1) there is some evidence of integration, in that she is invited to social events at the end of recording sessions and tours, and all her costs and expenses while in tour are covered by them, and (2) there is no evidence of entrepreneurship as her equipment is maintained and replaced by them and they have opted to pay her a bonus payment in additional to her agreed fee – so there is no financial risk in her undertaking this employment (0-3 marks).
- (c) **Statutory Rights if Raven is an employee:** (1) the right to maternity leave (26 weeks plus 16 optional weeks), plus statutory or contractual pay, (2) the right to parental leave (26 weeks from September 2020 - 22 weeks prior to September 2020), parents leave (2 weeks) and carers leave (104 weeks per eligible person), (3) the right to annual leave (20 days per full-time employee) and public holidays, (4) the right not to be unfairly dismissed (pursuant to the Unfair Dismissals Act 1977-2015), (5) the right not to be discriminated against or bullied/harassed at work (Employment Equality Act 1998-2015), (6) the right to a redundancy payment, where a genuine redundancy situation arises (2 x length of service + a bonus week x weekly salary (capped at €600)), and (7) the right to notice depending upon the terms of the contract or legislation upon termination of employment (any 4 x 1 (or similar) = 0-4 marks).

SOLUTION 5

(a) Answer should refer to:

- Remuneration committee composition and responsibilities: (6 Marks)
- Remuneration structure (in particular performance related pay, bonuses and LTIPs) and related challenges/issues: (10 Marks)
- Required disclosures to shareholders (4 Marks)

Performance-linked remuneration serves to incentivise directors to ensure the company is managed in a manner consistent with shareholders' interests. Remuneration policies must incentivise directors to bear a prudent level of risk and compensate them for their efforts. The remuneration committee provides a means of monitoring the suitability of directors' remuneration. Independent directors are better able to exercise objective judgement and discretion when authorising executive remuneration. The UK Corporate Governance Code (2018) (the Code) thus advises that remuneration committees consist of independent directors. Any connections between executives and remuneration consultants contracted by the company should be disclosed. The committee's responsibilities include determining the policy for executive remuneration and setting remuneration for the chair, executive directors and senior management. In determining and monitoring remuneration arrangements, the committee should ensure risks are identified and mitigated, and establish that remuneration drives behaviour consistent with company purpose, values and strategy.

Directors' remuneration cannot rely solely on firm performance, which may suffer for reasons beyond directors' control. Hence, a basic fixed element should be determined, taking account of the company's size, industry and other circumstances. Bonus payments are a means of rewarding performance in the short-term; however, the potential for bonuses to encourage undue risk-taking by executives has led to the introduction of deferral or clawback mechanisms to ensure such payments serve to align the interests of executives with the long-term interests of the company and its shareholders. A further means of counteracting the incentivisation of short-term risk-taking is to establish a strong link between the remuneration, risk and audit committees.

Stock-based rewards to executives who achieve defined performance criteria may align their interests with those of shareholders in the long-term. By granting stock options to directors as part of Long-Term Incentive Plans (LTIPs), risk-bearing may be more uniformly allocated between directors and shareholders. In effect, directors will be more likely to work toward the long-term maximisation of firm value if they have the option to purchase a stake in the firm in the future at the current share price. Long-term incentives may be enhanced through the awarding of restricted shares. Under such an arrangement, shares acquired by a director, including shares acquired on the exercise of a stock option, are held in a trust established by the company for the benefit of the director for a specified period. During this period, the director is restricted from selling or otherwise disposing of the shares in any circumstances except in the instance of a takeover of the company. Consistently, the Code advises that share awards should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more.

The choice of performance metric should be a considered one. Common accounting and financial performance metrics are generally short-term in nature and not sufficiently comprehensive. Total Shareholder Return (TSR) and Economic Value Added (EVA) are advocated as potentially comprehensive measures. Measurement of performance relative to an appropriate index or peer group, over a three to five year period, may help to achieve context and yield more insight into the sustainability of performance. In practice, a range of measures tends to be used, particularly as the need to consider companies' non-financial performance increases, for instance, environmental and social performance is now widely acknowledged to impact a company's sustained success.

The Code guides that annual disclosures made regarding remuneration should provide the strategic rationale for executive directors' remuneration policies, structures, and the performance metrics used. The remuneration committee should explain how policies are applied and metrics employed. The appropriateness of remuneration should be justified and the extent of discretion used by the committee explained. The Second EU Shareholders' Rights Directive, yet to be implemented in Ireland, will require the annual remuneration report to be put to an advisory shareholder vote. Shareholders will have the right to vote on the remuneration policy at least once every four years, this vote may be advisory or binding.

(b) Answer should refer to:

- Statutory objectives or strategic goals: (3 Marks)
- Responsibilities: (3 Marks)
- Additional powers: (2 Marks)
- Differentiation from ODCE: (2 Marks)

The IAASA is an independent body whose role is to supervise and promote high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest in Ireland. Its statutory objectives as set out under Section 904 of the Companies Act (2014) are to

- Supervise the Prescribed Accountancy Bodies' (PABs) regulation of their members,
- Promote adherence to high professional standards in auditing and accountancy,
- Monitor whether the financial statements, or accounts of certain classes of companies and other undertakings, comply with the Companies Act (2014) (or, as the case may be, the Companies Act as applied by the 1993 Accounts Regulations) and, where applicable, Article 4 of the IAS Regulation, and
- Act as a specialist source of advice to the Minister for Jobs, Enterprise & Innovation on auditing and accounting matters.

The IAASA is responsible for examination and enforcement of certain listed entities' financial reporting. The body also promotes improvements in the quality of auditing of Public Interest Entities (PIEs) and oversees, investigates and penalises third-country auditors and audit entities. Its responsibilities further include supervision of PABs' regulation of their members and Recognised Accountancy Bodies' (RABs) regulation of statutory auditors. The IAASA publishes an annual list of statutory auditors that earn less than 15% of total audit fee income from PIE clients and makes decisions regarding the commencement by statutory auditors of successive audit engagements.

Where necessary, the IAASA has additional powers to require auditors not to take up an engagement with a PIE for at least four years after its last engagement with that same entity. It may also examine audit firms' mechanisms regarding the rotation of key audit partners, and enforce requirements around granting access to all relevant information concerning the audited entity to the incoming auditor, where a statutory audit or audit firm is replaced by another statutory auditor or audit firm.

While the Statutory Audits Directive Regulations 2016 (SI 312 of 2016) designates the Director of Corporate Enforcement with the power to take administrative measures or impose sanctions on directors of PIEs, it assigns certain functions to the IAASA regarding inspections, investigations and sanctions of statutory auditors, audit firms and audits of PIEs.

SOLUTION 6

(a) Answer should refer to:

- Chairman independence and separation from the CEO: (6 Marks)
- Nature of the chairman's role and responsibilities: (6 Marks)

The UK Corporate Governance Code (2018) (the Code) sets out that there should be a clear division of responsibilities between the leadership of the board, by the chairman, and the executive leadership of the company's business by the CEO. This is consistent with the view that a CEO who is also the chairman is likely to wield excessive power over decision-making, possibly to the detriment of shareholders' welfare. If, exceptionally, it is proposed by the board that the CEO chair the board, major shareholders should be consulted ahead of appointment. The chair should be independent on appointment and should not remain in post beyond nine years from the date of their first appointment. This is one aspect where corporate governance, as practiced in the UK and Ireland, differs to that in the US where an executive chairman is common.

The responsibilities of the chair and the CEO should be clear, set out in writing, agreed by the board and made publicly available. The chair should facilitate constructive board relations and promote effective contributions from all non-executive directors, ensuring that directors receive accurate, timely and clear information. The senior independent director serves to support the chairman by acting as a sounding board; yet, the senior independent director must also ensure that the chair's performance is satisfactory, meeting with the other non-executive directors in the chair's absence to assess their performance. To aid effective monitoring of management, the chair should hold meetings with the non-executive directors without the executive directors present. Accounting for the extent of responsibility conferred upon the chair, the Code strongly discourages the chair from assuming additional, and potentially excessive, responsibilities by chairing the remuneration committee or sitting on the audit committee. The former also serves to prevent the chairman from having any influence over his remuneration. To ensure independence is preserved upon succession, the Code advises that the chair should not chair the nominations committee when it is dealing with the appointment of their successor.

(b) Answer should refer to:

- Overview of the UK Corporate Governance Code and SOX (or more generally the principles-based vs the rules-based regime): (6 Marks)
- Three sets of relative advantages and disadvantages (e.g. Flexibility, Incentives to comply/consequences of non-compliance, Compliance costs): (3 x 4 Marks)

The Irish and London Stock Exchanges' Listing Rules require Main Market listed companies to adopt the UK Corporate Governance Code (2018) (the Code) on a comply-or-explain basis. Companies must include in their annual reports a statement of how they have applied the provisions of the Code in a manner that would enable shareholders to evaluate how the principles have been applied. Companies which have not complied with any of the relevant provisions must state those provisions, specify the period of non-compliance and provide reasons for non-compliance. In contrast, US listed firms follow a rules-based approach to governance under the Sarbanes-Oxley Act (2002) (SOX). As the rules are legally enforceable, full compliance is required. The managers and directors of non-compliant firms and/or their auditors may be subject to civil or criminal penalties ranging from fines to imprisonment.

Flexibility: The Code avoids taking a 'one size fits all' approach and many of its guidelines are set out in quite general terms to allow for variations in company size and circumstances. In contrast, the requirements of SOX are set out in precise legal terminology and make little distinction between small and large firms. In this regard, SOX may be seen to restrict managers' ability to adapt their boards and financial control systems to suit the company's circumstances. The resulting regulatory burden placed on smaller US listed firms may drain the resources they need to innovate and compete.

Incentives to comply: Under the principles-based regime, the possibility exists that companies view compliance as a box-ticking exercise and will provide boiler-plate or meaningless explanations for non-compliance. Such disclosures are discouraged in the Code; however, since companies do not face any legal penalties for poor disclosure, it is arguable that there are little disincentives against providing non-descript explanations. The ideal behind the Code is that it will become the norm for companies to follow its guidelines since deviations may raise questions among investors, leading them to voice their concerns with a company's board or sell their shares. In the

US, it is the judiciary rather than investors which monitors and penalises firms' governance shortcomings with the result that boards are punished even in the case of minor compliance failures.

Costs: SOX places a significant compliance cost upon companies. Smaller firms may need to recruit more directors and implement more sophisticated internal controls than what might truly be required. Indeed, it has led to the growth of the compliance advice consultancy profession which earns substantial fees from assisting companies ensure compliance with the Act. The requirements external auditors must fulfil, and the potential legal liability they face, can result in higher audit fees. It is argued that the extent of such costs may prevent companies from going public, thereby reducing market liquidity and efficiency. For UK and Irish firms, these costs are apt to be lower since they do not face the threat of legal penalties for non-compliance. Furthermore, the costs borne by national regulators where the principles-based approach is taken are also lower than those in rules-based regimes since governance violations are not dealt with by the courts.