

CORPORATE LAWS & GOVERNANCE

PROFESSIONAL 1 EXAMINATION - AUGUST 2016

NOTES:

Two envelopes must be used to enclose answers:

- Enclose answers to questions in **Section A in one envelope**, and
- Enclose answers to questions in **Section B in a second envelope**.

Mark clearly on each envelope the Section to which the answers relate.

Section A:

You are required to answer **three** questions from this section, (Questions 1, 2 and **either** 3 or 4). However, should you provide answers to **both** Questions 3 and 4, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for each of these two questions will be marked.

Section B:

You are required to answer **one** question from this section. However, should you provide answers to each question in this section, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for each of these two questions will be marked.

TIME ALLOWED:

3 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:

During the reading time you may write notes on the examination paper, but you may not commence writing in your answer book.

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

Start your answer to each question on a new page.

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.

List on the cover of each answer booklet, in the space provided, the number of each question attempted.

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Time allowed: 3 hours plus 10 minutes to read the paper.

Section A: You are required to answer **three** questions from this section.

Section B: You are required to answer **one** question from this section.

SECTION A

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

1.

- (a) Corbin is a recently qualified CPA. His father-in-law, Hamlyn, is the managing director and majority shareholder of an engineering company, Cegar Developments Ltd, and he has asked Corbin if he would like to become the company secretary of this business. Corbin is unsure as to the role of a company secretary and whether he is qualified to accept this position.

REQUIREMENT:

Explain the various classifications of persons who are ineligible to accept an appointment as a company secretary and discuss the main functions of a company secretary pursuant to the Companies Act 2014.

(7 marks)

- (b) Cegar Developments Ltd has been very successful in recent years and there is retained profit and surplus funds in the un-denominated capital account of the company. Hamlyn is considering using some of these funds to make a rights issue of shares. The Constitutional document of the company states that shares must be offered on a pre-emption basis, but Hamlyn wishes to avoid pre-emption, and proposes to allot a specified number of shares to Corbin if he agrees to act as the company's secretary.

REQUIREMENT:

Advise Hamlyn in relation to the following matters:

- (i) The meaning of the term 'rights issue'. (3 marks)
- (ii) The rules in relation to offering shares on a pre-emption basis. (4 marks)
- (iii) The methods that can be used to avoid the right of pre-emption and allow a direct allotment of shares to Corbin, if he agrees to become the company secretary of Cegar Developments Ltd. (2 marks)

- (c) Hamlyn is a non-executive director in another company, Wiatt Transport Ltd. In the last year, the company had an accumulated unrealised profit of €300,000 on its balance sheet. There was a revaluation of an asset in the amount of €100,000, and the company made a trading loss of €200,000 in the accounting period up to April 2016. In May 2016, following a general meeting of the company a decision was taken to issue dividends to the value of €150,000 to the company's shareholders. Hamlyn is concerned that this dividend payment may be classed as an unlawful distribution.

REQUIREMENT:

- (i) Critically analyse the rules regarding the payments of dividends, pursuant to the Companies Act 2014. (5 marks)
- (ii) Assess whether the dividend payment by Wiatt Transport Ltd is likely to be classed as an unlawful distribution, and discuss the consequences for Hamlyn if this payment is classed as an unlawful distribution. (4 marks)

[Total: 25 marks]

- 2.** Thorne was a director and shareholder in Harlow Recruitment Ltd for in excess of ten years. Two years ago, the company was placed in insolvent liquidation, owing debts in excess of €1.2m. During his time acting as a director the company had failed to submit on-time annual returns on three separate occasions, and to maintain statutory registers or proper books of account. As a qualified accountant, Thorne was held to be acting in breach of his fiduciary duty of care and skill to the company during his tenure as director and a Restriction Order was imposed upon him for a period of five years.

Thorne's brother Hooper has recently been appointed as executive director and CEO of Arden Cinemas Plc and following his appointment, he has asked Thorne if he is interested in becoming a non-executive director of this company. Thorne is very interested in accepting this appointment, but is conscious that he is still subject to a Restriction Order and doesn't wish to expose himself to any further liability arising from a breach of duties if he accepts this appointment. He is also aware that some new obligations have been imposed upon directors pursuant to the Companies Act 2014 and, as a consequence, he is seeking clarification regarding a number of matters prior to accepting this position.

REQUIREMENT:

- (a)** Explain the principal role of a non-executive director. (3 marks)
- (b)** Critically review the duty of care and skill imposed upon company directors and the consequent sanctions arising from a breach of this duty. (7 marks)
- (c)** The Companies Act 2014 requires certain prescribed companies to include a Directors' Compliance Statement in their directors' report. In this regard:
- (i)** Describe any SIX of the main issues that must be included in a Directors' Report in accordance with Chapter 9, Part 6 of the Companies Act 2014. (6 marks)
 - (ii)** List the prescribed companies that are subject to this duty (to include a Directors' Compliance Statement) regarding a compliance statement. (3 marks)
 - (iii)** Analyse the mandatory content of a Directors' Compliance Statement. (3 marks)
- (d)** Examine the criteria imposed by the Companies Act 2014 in order for a person subject to a Restriction Order to be lawfully entitled to act as a company officer. (3 marks)

[Total: 25 marks]

- 3.** Hayes is one of the founding shareholders in Damson Delights Handmade Chocolates Ltd (Damson), a company incorporated in 2010. Upon incorporation, the company's Constitution contained a provision appointing Hayes as the company's accountant for a period of ten years on an annual salary of €90,000. In recent months, the company has been the subject of a Revenue audit. During the course of this audit, the Revenue discovered a number of errors and discrepancies in the accounts which resulted in a demand for unpaid taxes amounting to in excess of €145,000. Following this audit, the directors of the company held a meeting with the company's solicitor. At this meeting the solicitor explained that due to the continued growth of the company, the Companies Act 2014 now requires that the company establish an audit committee. Arising from this discussion and the errors discovered by the Revenue audit the directors decided to remove Hayes as the company's accountant. They subsequently wrote to him informing him of their decision. They have since called a meeting to appoint an independent non-executive director to sit on this audit committee. Hayes is outraged by this action and has written to the company challenging its right to remove him.

Bronte is married to Hayes and she is one of the shareholders of Damson, holding 24% of the issued share capital in the company. When she received notice of this meeting she contacted the company secretary of Damson notifying him that she was not in a position to attend but requesting that Hayes attend as her proxy. The company secretary brought this matter to the attention of the Board of Damson and they decided that Hayes should not be allowed to act as proxy, in case he would use this meeting to air his grievances over his removal as the company's accountant. In the circumstances, Bronte has now received notification from the company that the right to appoint a proxy is suspended in respect of this meeting and that Bronte should attend this meeting personally if she wishes to vote on the proposed resolution in respect of her shareholding. Bronte is adamant that this action is in breach of her shareholder rights and has written to the company to this effect.

The directors of Damson have now contacted you for advice regarding these matters.

REQUIREMENT:

- (a) State the qualifying criteria that must be met before a private company limited by shares is required to establish an audit committee, and discuss the role of an audit committee. (5 marks)
- (b) In the context of company meetings, explain the meaning of the term proxy and outline the rules regarding the appointment of a proxy. (3 marks)
- (c) Critically appraise the legal effect of the company's Constitution, using case law to support your answer. In light of this discussion, analyse the potential success or otherwise of any legal action by Hayes and Bronte for breach of their rights under Section 31 of the Companies Act 2014. (8 marks)
- (d) Aside from their rights in relation to meetings, describe any other rights bestowed upon shareholders under Irish company law. (4 marks)

[Total: 20 marks]

OR

4. The Bluebird Vintage Car Hire Company Ltd (Bluebird) is owned and run by Nolan and Brayden. Three years ago, Nolan was diagnosed with a serious illness and as a consequence Brayden took over most of the day-to-day running of the company. Although Brayden is excellent at dealing with customers he is not proficient in the financial aspects of the business. Brayden's wife, Adeline, is a qualified accountant and he relied upon her to manage the financial affairs of the company. Eight months ago, one of the creditors of Bluebird rang Brayden threatening to make an application to place the company in compulsory liquidation if a debt due to his company of €17,000 for the provision of fuel on credit terms was not paid within fourteen days. When Brayden received this letter, he showed it to Adeline but she told him to forget about it and that she would deal with it. She then contacted this supplier and negotiated a schedule of payments in respect of the €17,000 outstanding and told the supplier that she would register this debt as a fixed charge if the supplier would withdraw its threat of liquidation proceedings and continue to sell the company fuel on credit terms. The supplier agreed to this and a fixed charge was registered in respect of the €17,000 debt on the company's motor vehicles.

Following this agreement, Bluebird made two agreed payments of arrears to the fuel supplier but then failed to make the subsequent agreed payments. The supplier again wrote to Brayden threatening liquidation. Following receipt of this letter Brayden called a meeting with Nolan and Adeline at which the financial position of the company was discussed. Adeline explained that the company was in serious financial difficulty and recommended selling the company. Reluctantly both Nolan and Brayden agreed to this and the assets of the company were sold to Fallon Car Hire and the company was liquidated. Upon the liquidation of the company, there was a deficit of €45,000 due to the unsecured creditors that was written off as a bad debt.

After the liquidation of the business Nolan's daughter Jules was surprised about the financial deficiencies of the company, given the number of cars that the business owned and the fact that the business premises only had a small mortgage. She asked her accountant to review the books and was shocked to discover that six of the vintage cars owned by the company had been sold to a hotel, owned by Adeline's father, three months prior to the sale of the business for substantially less than their book value. Upon further investigation, the accountant discovered that the hotel has since sold these cars back to Adeline for the same value it purchased them for. Additionally, the accountant discovered Adeline had sold them on to a number of vintage car enthusiasts for a price equivalent to the book value they had been recorded at in Bluebird's books (prior to their purchase by her father's hotel).

Jules then contacted Brayden and informed him of what she had discovered. Brayden told Jules that he and Adeline had a heated argument when he discovered a bank statement for an account in Adeline's name, that he was unaware that she had. This showed a payment of €100,000 from Fallon Car Hire directly to Adeline around the time of the sale of the business to it and other monies from the sale of the six vintage cars. Brayden told Jules that he had no idea of what Adeline was up to and that she has since left him and that he has no idea where she is.

Nolan, Jules and Brayden have since contacted the Gardaí (Police) but are unsure of the implications of Adeline's actions. They have also contacted you seeking advice.

REQUIREMENT:

- (a) Critically evaluate the law in relation to fraudulent trading and determine the potential liability of Nolan, Brayden and Adeline for this offence. (10 marks)
- (b) Assess how the agreement entered into by Adeline and the fuel supplier would be classified pursuant to the provisions of the Companies Act 2014, and examine the consequences of such an action for the fuel supplier. (5 marks)
- (c) Review how the collusive agreement entered into by Adeline and her father's hotel in respect of the sale of the vintage cars would be classified pursuant to the provisions of the Companies Act 2014, and examine the consequences of such an action. (5 marks)

[Total: 20 marks]

SECTION B
Answer One Question Only from either Question 5 or 6.

5. You have been asked by your line manager to prepare a presentation for the department training day.

REQUIREMENT:

Prepare the briefing notes for the presentation which:

- (a)** Discusses the role and functions of the Office of the Director of Corporate Enforcement (ODCE). (10 marks)
- (b)** Evaluates the main duties and responsibilities of the Audit Committee in assuring effective corporate governance arrangements. (18 marks)

Format & Presentation (2 marks)

[Total: 30 marks]

OR

6. You are a company secretary and the chairman of the board approached you for advice having read the following:

"The latest incarnation of the Code is much more focused on the principles and the framework within which good corporate governance should happen than before and the spirit of the Code is paramount"

(Source - David Mayhew CBE Vice Chairman, J.P. Morgan. Comply or Explain: 20th Anniversary of the UK Corporate Governance Code Financial Reporting Council 2012.)

REQUIREMENT:

- (a)** The chairman has asked you for a memo in which you critically evaluate a corporate governance approach based on principles in contrast to a rules-based approach. (16 marks)
- (b)** Evaluate the responsibilities of the Board as contained in the Corporate Governance Code 2014, in establishing an effective internal control system and discuss how this should be communicated to stakeholders. (12 marks)

Format & Presentation (2 marks)

[Total: 30 marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

CORPORATE LAWS & GOVERNANCE

PROFESSIONAL 1 EXAMINATION - AUGUST 2016

SOLUTION 1

- (a) Ineligibility to act as a Company Secretary: The following are ineligible to act as a company secretary: (1) a minor (a person under the age of 18) (Section 131), (2) an un-discharged bankrupt (Section 132), (3) a restricted person – subject to certain exceptions (Section 825), or (4) a disqualified person (Section 837) (any 3 = 0-3 marks).

Duties of a Company Secretary: These are set down in Section 226 CA 2014 (as well as other sections of the legislation) and include the following: (1) to ensure all documents are filed/lodged with the CRO in an appropriate and timely manner (such as the annual return, amendments to the Constitutional documents, changes to company officers, registered office etc), (2) to attend all Board meetings, (3) to convene meetings and provide members with due notice of general meetings, (4) to process proxy forms, (5) to oversee voting at meetings, (6) to record the minutes of meetings, (7) to correspond with shareholders regarding share issues (transfers, dividends etc...) and with debenture holders regarding interest payments, (8) to register fixed and floating charges, and (9) to maintain the statutory registers etc ... (any 4 = 0-4 marks)

- (b) (1) Rights Issue: This is a procedure through which a company raises new capital by offering new shares to its existing members on a pre-emption basis. In effect the shareholder is offered the right to buy a certain proportion of shares from a new issue at a fixed price. However, as an inducement to engage in the deal, it is not usual for the new shares to be offered at a discount on the current market value of the existing shares, although not on the nominal value of the shares (which would be in breach of company law). Shareholders have the right to participate in the rights issue or reject the offer, although shareholders who do not want to buy the new shares themselves still retain the right to sell the right to purchase to a third party (subject to the provisions of the company's own Constitution) (0-3 marks).

(2) Rules Regarding Pre-Emption: As mentioned this right gives existing shareholders the right of first refusal on any new shares being issued by the company (Section 69(6) CA 2014). The purpose of this right is to allow shareholders to retain their percentage shareholding in the company. The rules regarding pre-emption are as follows: (a) it is an irrevocable offer in writing for 14 days – during which period shares cannot be allotted to third parties, (b) the right only applies to ordinary shareholders, (c) the right does not apply to shares offered for non-cash consideration, (d) the right does not apply to the allotments of shares to the subscriber or subscribers to the company's Constitution upon incorporation, (e) the right does not apply to the allotments of shares to persons in pursuance of the terms of an employees' share scheme established by the company, or (f) to the allotments of bonus shares (any 4 = 0-4 marks).

(3) Avoiding Pre-Emption: In accordance with Section 69 the right of pre-emption may be removed by a company in either its Constitution or by a special resolution (0-2 marks).

- (c) (1) Rules Regarding Dividends: A dividend is a return to shareholders out of the company's distributable profits. The rules regarding the payment of dividends are governed by Section 124 CA 2014 as follows: (1) dividends are generally declared by an ordinary resolution of the members at a general meeting of the company, (2) although interim dividends can be declared (subject to Section 117), (3) there is no automatic right to a dividend (unless provided in the company's Constitution), (4) generally the declaration of the dividend and the amount paid is at discretion of the directors, as per *Bond v Barrow Haematite Steel Co. (1902)* – although they are paid at a fixed rate for preference shares and at a variable rates for ordinary shares, (5) no distribution can exceed the amount recommended by the directors, (6) members can sue for non-payment, where the dividend has been declared and after the date for payment has elapsed, (6) dividends are payable on paid-up amounts of shares only, (7) Section 117 requires that the payment must be made from distributable profits, (8) although dividends are generally paid in cash, Section 125(1) provides that they can also be paid other than in cash, (9) the directors may deduct from any dividend payable to any member, all sums of money (if any) immediately payable by him or her to the company on account of calls or otherwise in relation to the shares of the company, and (10) no dividend will bear interest against the company (Section 125(6)) (any 5 = 0-5 marks).

(2) Unlawful Distribution: This refers to a dividend payment made by a company that it should not have made – in this situation the payment is unlawful as the company had unrealised profit of €300,000 on its balance sheet and the company made a trading loss of €200,000, meaning that there was only €100,000 distributable profit and dividends of €150,000 were declared – the revaluation of an asset in the amount of €100,000 is not classed as distributable profit so it cannot be used to pay a dividend (0-2 marks). In accordance with Section 122 where an unlawful distribution occurs then any member who has reasonable grounds to believe that it was unlawful may be liable to repay this money to the company – therefore Hamlyn may be obliged to repay this amount, as he was suspicious that the distribution was unlawful (0-2 marks).

SOLUTION 2

- (a) **Non-Executive Director:** The characteristics of a non-executive are as follows: (1) these are directors appointed to manage the business on a transient basis – they are not employees of the company but more akin to consultants, (2) they are involved in the strategic management of the company at board level and are not involved in the operational running of the business, (3) they are appointed due to their expert knowledge, experience, attainment or skills, (4) their role is to act as monitors of the executive directors (by ensuring that they are acting within their powers and the companies objectives) and (5) to provide the board of directors with additional expertise and an objective view point (any 3 = 0-3 marks)
- (b) **Duty of Care and Skill:** In accordance with Section 228 CA 2014 directors are required to exercise reasonable skill, care and diligence in the performance of their duties. This requires them to act with the knowledge and expertise that may reasonably be expected of a person in the same position as the director, and the same knowledge and experience as the director. In addition to the legislation, the guidelines in relation to exercising this duty were also laid out in *Re City Equitable Ltd (1925)*. These require: (1) the directors must exercise the duty to a standard reasonably expected from a person of his knowledge and experience, (2) the director is not bound to give continuous attention to the affairs of the company and need only attend meetings when he can reasonably do so or at least regularly, (3) the director can delegate the duties of the company to the management provided it is normal business practice and there are no suspicious circumstances, although the director still has a duty to supervise the discharge of the delegated function, as per *Re Barings Plc (No5) (2000)*. The test to determine liability is a subjective standard test and the court will examine what is reasonable for that particular director – the more qualified the director, the higher the standard will be expected from him, as established in *Dorchester Finance Co Ltd v Stebbing (1977)* (0-5 marks).

Sanctions: In accordance with Section 232 where a director breaches his duty of care and skill he is liable to account to the company for any gain made directly or indirectly from the breach of duty, or indemnify the company for any loss or damage resulting from that breach (0-2 marks).

- (c) (1) **Content of a Directors Report:** In accordance with Section 325-326 CA 2014 the directors report should include the following: (1) the names of the persons who, at any time during the financial year, were directors of the company, (2) a general review of the principal activities and the business of the company during the year, (3) a statement of the measures taken to ensure compliance with the books and records requirements of the legislation, (4) the amount of any interim dividends paid by the directors during the year and the amount, if any, that the directors recommend should be paid by way of final dividend, (5) particulars of any important events affecting the company which have occurred since the end of that year, (6) an indication of the activities, if any, of the company in the field of research and development, (7) an indication of the existence of branches of the company outside the State and the country in which each such branch is located, (8) any political donations made during the year that are required to be disclosed by the Electoral Act 1997, (9) a description of any risks and uncertainties facing the company, (10) information on the acquisition or disposal of own shares, (11) information on directors interests in shares or debentures, and (12) a statement that the directors have taken appropriate steps to make themselves aware of relevant audit information and to ensure that the auditors are aware of this information (any 6 = 0-6 marks).

(2) **Companies Required to File a Compliance Statement:** In accordance with Section 225 CA 2014: (1) all public limited companies, and (2) private limited companies limited by shares or by guarantee, and (3) designated activity companies where the balance sheet total of the Ltd or DAC exceeding €12.5 million and turnover exceeding €25 million are obliged to complete compliance statements – this obligation does not apply to unlimited companies (0-3 marks)

(3) **Content of the Compliance Statement:** This statement must: (1) acknowledge their responsibilities for ensuring corporate compliance, (2) confirm that a compliance policy statement is in place, and (3) confirm that arrangements and structures are in place to secure compliance, and (4) confirm a review of these arrangements and structures (any 3 = 0-3 marks)

- (d) **Acting while Restricted:** Pursuant to Section 825 CA 2014 for a restricted person to act as a company officer they must serve notice in writing to the company that they are a restricted person within 14 days prior to the date that they accept the appointment. In addition, the company must be highly capitalised, with €500,000 issued share capital in a public company and €100,000 issued share capital in any other company (0-3 marks).

SOLUTION 3

- (a) **Audit Committee:** Section 167 introduces a requirement for the directors of a company over a particular size to either establish an audit committee or to explain in the directors' report why they have not decided to establish an audit committee – in respect of a LTD company these size requirements are: (1) a balance sheet total exceeding €25m, and (2) a turnover exceeding €50m – in their most recent financial year and the year immediately preceding that year – this obligation also applies to parent companies where the combined balance sheet total of the company and its subsidiaries meets these thresholds (0-2 marks).

Role of an Audit Committee: In accordance with Section 167(6) 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).

- (b) **Proxies:** In accordance with Section 183 CA 2014 this is both a document appointing and the appointment of a person to attend, vote, and speak on behalf of another shareholder at a meeting (0-1 mark) – the rules regarding the appointment of a proxy are as follows: (1) unless the company's Constitution provides otherwise, a member of a company will not be entitled to appoint more than one proxy to attend on the same occasion, (2) a member must serve notice in writing in a prescribe format (Section 184) to the company of their intention to appoint a proxy, (3) this notice must be delivered to the company's registered office or may be sent electronically, (4) this notice must be received by the company at least 48 hours prior to the meeting, and (5) a proxy can vote on a show of hands or a poll (any 2 = 0-2 marks).

- (c) **The Effect of the Constitution/Section 31 Contracts:** The effect of Section 31 is that it binds the company and the members, the members and the company, the members with/against each other, to the same extent as if the Constitution had been signed and sealed by each member. A member's right to enforce these provisions is a personal right, therefore any action for violation of Section 31 only applies to rights and obligations affecting members in their capacity as members. In *Hickman v Kent* (1915) the company successfully invoked Section 31 to prevent a member issuing proceedings in breach of an arbitration clause in the company's Constitution. Consequently company officers and creditors cannot rely on provisions in the Constitution because they are also members. In *Eley v Positive Government Life Assurance Co* (1876) the plaintiff was unsuccessful in his Section 31 action, as it was his rights as the company solicitor (as stated in the Constitution) that were breached and not his shareholder rights. However, in exceptional circumstances an outsider may rely on the Constitution to infer a term/condition into a separate contract. In *Re New British Iron Company* (1989) the Constitution stated that the directors were entitled to an annual remuneration of £1,000, but the company was placed in liquidation before the payment was made. The Court held that the salary was an implied term in his employment contract, and although he could not rely on Section 31 per se he could use the Constitution to show that the right to the £1,000 salary was an implied term in his employment contract (0-6 marks).

Conclusion: (1) Bronte can claim a breach of her Section 31 rights with respect to the failure to allow her to appoint a proxy to attend the meeting (unless this right is precluded by the company's Constitution), but (2) Hayes cannot claim for breach of his rights under Section 31, as the term in the Constitution relates to his rights as the company accountant and not his shareholder rights – although he could use the Constitution to demonstrate the existence of a separate employment contract between himself and Damson Delights Handmade Chocolates Ltd to act as the company accountant – and sue for breach of that contract (0-2 marks).

- (d) **Shareholders Rights:** These are dependent upon the class and type of shares held and are usually stated in the company's Constitution, but generally include the following: (1) the right to receive a declared dividend, (2) the right to participate in the liquidation of the company and to receive any surplus assets once all other creditors have been repaid, (3) the right to receive and inspect the annual return and accounts of the company – as well as the minutes of meetings, (4) the right to inspect the statutory registers and Constitutional documents of the company, (5) the right to statutory notices and information regarding the company, (6) a general right to transfer their shares, and (7) the right of access to the Courts to vindicate their rights (any 4 = 0-4 marks).

SOLUTION 4

- (a) **Fraudulent Trading:** This offence is governed by Section 610 CA 2014 and arises where any person was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company, or creditors of any other person or for any fraudulent purpose. The offence is not confined to company officers and can be committed by anyone – including shareholders, creditors and third parties. In *Re Kelly's Carpetdrome Ltd (1983)* the company's officers and owner were deemed guilty of fraudulent trading where the company kept no proper books of accounts and it appeared that financial documentation had been deliberately destroyed. The assets of the company had also been transferred to a connected company to avoid the payment of revenue debts. In *Re Hunting Lodges Ltd (1985)* a third party purchaser was also held liable for fraudulent trading. In addition, the fraudulent act may be either a one-off or a continuous action to complete the offence.

In order to be actionable the alleged wrongdoer must be aware of the fraudulent act and must have acted with an intention to defraud. In *Re Aluminium Fabricators Ltd (1983)* the concealment of cash payments in a secret account was held to be fraudulent. In *Re Synnott (1996)* the company traded while insolvent for 14 years and accumulated debts of €2.5m. One of the directors who solicited investments from customer when he knew that the company was insolvent was found liable for fraudulent trading. The offence is still actionable if certain matters occurred outside the State (0-5 marks).

In accordance with Section 722 fraudulent trading is classed as a Category 1 offence and where a person is found guilty of this offence the criminal penalties are as follows: (1) on summary conviction, a term of imprisonment not exceeding 12 months and/or a class A fine, or (2) on indictment, a term of imprisonment not exceeding 10 years and/or a fine not exceeding €500,000. The offence also attracts the civil sanction of personal liability for the debts of the business arising from the fraudulent act (0-3 marks).

Conclusion: That Nolan and Brayden are unlikely to be found guilty of this offence as they did not act dishonestly or with an intention to defraud, whereas Adeline is likely to be guilty as she satisfies both elements of the offence in relation to the sale of the vintage cars and the sale of the business undervalue (0-2 marks).

- (b) **Agreement entered into by Adeline with the Fuel Supplier:** This transaction is likely to be classed as an unfair preference. Section 604 CA 2014 defines this as any act relating to property done by an insolvent company, in favour of a creditor, with a view to giving that creditor preference over other creditors in the event of liquidation. Any unfair preference created within 6 months of the liquidation of the company is automatically invalid and void, where the company was insolvent at the point the charge was created. This period extends to two years if it is in favour of a director or a connected person. The burden of proving an unfair preference is on the liquidator. As per *Re M K Kushler (1943)* this intention must exist at the time the transaction occurred. In *Re O'Connors Nenagh Shopping Centre Ltd; Fitzpatrick v O'Connor (2011)* Justice Gilligan in the High Court refused an application by a liquidator to have a mortgage declared an unfair preference on the basis that there was no taint of dishonesty and there was "... no evidence that [the company's] dominant intention in signing up to the charge, which they had previously in any event agreed to do, was for the purpose of giving a preference to the Bank of Ireland" (0-4 marks).

Conclusion: In our scenario if this transaction is classed as an unfair preference then the fuel supplier will have to return the secured payment he received from the company (0-1 mark).

- (c) **Agreement entered into by Adeline and her father's hotel in respect of the sale of the vintage cars:** This transaction is likely to be classified as an improper transfer of assets – as defined in Section 608 CA 2014. In this situation where an application is made by a liquidator, creditor or contributory of a company which is being liquidated, and it can be shown to the satisfaction of the court that there was an improper transfer of assets for the purpose of perpetrating a fraud on the company, its creditors or members, the Court has power to order that the property or the proceeds of sale or transfer of the property is delivered to the company or to the liquidator on such terms or conditions as the Court thinks fit. In deciding whether it is just and equitable to make an order the Court will have regard to the rights of persons who have bona fide and for value acquired an interest in the property the subject of the application. For the purpose of Section 608 a transfer includes a conveyance, mortgage, security or a loan. In *Le Chatelaine Thudichum (LCT) v Conway (2008)* the defendant had fraudulently transferred stock and cash from the plaintiff company which reduced the pool of assets available to the creditors upon the liquidation of the company. The defendant was ordered to repay the company for the property fraudulently acquired (0-4 marks).

Conclusion: That it is likely that the Court will order Adeline to deliver the proceeds of the sale of these vintage cars to the Court for disbursement to the unpaid creditors of the company (0-1 mark).

SOLUTION 5

(a) Office of the Director of Corporate Enforcement

The objective of the ODCE is to improve the compliance environment in the Irish economy by encouraging the adherence to the requirements of the Companies Acts and secure convictions of those who disregard the law, encourage high legal standards of corporate practice and support sustainable economic and social development. Areas of activities include:

Compliance

- Education and public awareness
- Influencing policy development and raising standards of compliance
- Improving stakeholder relations
- Consultations with professional bodies and other interested bodies

Enforcement

- Identifying misconduct and enforcing serious breaches of the companies acts
- Restrictions and disqualification of directors and other company officers
- Providing support to external organisations

General information services.

(10 marks)

(b) Role of the audit committee:

The Cadbury report recommended that all companies establish audit committees. The Smith report emphasised the essential role the audit committee should play in ensuring independence and objectivity of the external auditor and monitoring management. The Audit committee should be proactive, raising issues of concern with management and spearheading openness and cultivating a questioning environment. As independent non-executive directors, the members of the audit committee should enhance the accountability and transparency of the operations. The annual report should disclose detailed information on the role and responsibility of the audit committee and include information on actions taken by the committee in discharging their responsibilities.

(8 marks)

Responsibilities of the audit committee

- Monitor the integrity of companies' financial statements
- Review companies' internal financial control systems
- Monitor and review the effectiveness of companies' internal audit function
- Make recommendations to the board in relation to the appointment, remuneration and terms of engagement of the external auditor.
- Monitor and review the independence, effectiveness and liaise with external auditors
- Review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters
- Develop and implement the policy of engagement for non-audit services.

(10 marks)

(professional marks 2)

[Total: 30 marks]

SOLUTION 6

(a) Principles based

The Code is a guide to a number of key components of effective board practice. It is based on the underlying principles of all good governance: accountability, transparency, probity and focus on the sustainable success of an entity over the longer term. Good corporate governance has in-built flexibility for companies to adapt their practices to take into account their particular circumstances.

The “comply or explain” approach is the trademark of corporate governance in the UK. It has been in operation since the Code’s beginnings and is the foundation of its flexibility.

The Code is not a rigid set of rules. It consists of principles (main and supporting) and provisions. The Listing Rules require companies to apply the Main Principles and report to shareholders on how they have done so. The principles are the core of the Code and the way in which they are applied should be the central question for a board as it determines how it is to operate according to the Code.

It is recognised that an alternative to following a provision may be justified in particular circumstances if good governance can be achieved by other means. A condition of doing so is that the reasons for it should be explained clearly and carefully to shareholders.

They should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches. Shareholders should be careful to respond to the statements from companies in a manner that supports the “comply or explain” process and bearing in mind the purpose of good corporate governance. Refer to Corporate Governance Code 2014.

Rules based

Post Enron, the US authorities passed the Sarbanes-Oxley Act which established a rules based approach to corporate governance. The act made substantial changes to the financial reporting process. The aim of the new legislation was to encourage directors to act ethically and monitor their company’s financial accounting practices more carefully.

Since the start of 2004 all US companies are required to submit an annual assessment of the effectiveness of their internal control systems to the Security Exchange Council. The Act requires companies’ independent auditors to audit and report on the internal control reports produced by management in the same way as they audit the accounts.

All listed companies must have a disclosure committee responsible for overseeing the process by which disclosures are made. The act represented a turning point for directors as it specified personal liability and prison if found guilty of corporate crime. The company’s principle executive officer and principle financial officer are required to sign certificates making them personally responsible for the correctness of the financial statements.

This has led to increased audit fees, expected to be 1/3 higher, due to increased audit work and assurances required and a reluctance by some to assume the role of non-executive directors.

This prescriptive and hard-line approach of utilizing company law and forcing companies to act accordingly contrasts sharply with a softer and more explanatory approach of the UK system. An appreciation of a framework which allows the individual and the board to consider the issues and decide on the treatment to be adopted is perceived by many as a superior approach.

(16 marks)

- (b)** Directors are required, in fulfilling their stewardship responsibilities, to establish a system of controls, financial and non-financial, to ensure effective operations, efficient use of resources and compliance with rules and regulations. The need for enhanced transparency and disclosure is a key requirement of the updated Combined Code.

The directors should:

- consider the risks facing the organisation, at all levels, i.e., business risk, operational risks etc.
- prioritize the risks
- assess the likelihood of the risk affecting the business, determine how these risks can be managed or eliminated. (risk management strategy)
- design, implement and monitor the internal control system.
- explain, in the annual report, how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.
- describe the main features of the internal control and risk management systems in relation to the financial reporting process
- report on the review of the effectiveness of the internal control system in the annual report.

Refer to Turnbull report, Corporate Governance Code, updates

(12 marks)
(2 professional marks)

[Total: 30 marks]