

## Goal 2: Uncovering Suspected Breaches of Company Law

### Introduction

The provisions contained in the Companies Acts are designed to facilitate the creation of sound business and social enterprises and to secure in that context an equitable balance in the duties of company stakeholders (company directors, shareholders, creditors, etc.) to one another. Where one or more company stakeholders are dissatisfied with the performance of the company or other stakeholders, they may use the law to call the stakeholders in question to account. Where a breach of law is at issue and a complaint or report is made to this Office, it is important that the alleged default is investigated and if appropriate, rectified or sanctioned in order to maintain public confidence and credibility in the existing framework of rights and obligations.

### Sub-Goal 2.1: Developing Detection and Reporting Arrangements for Suspected Breaches of the Companies Acts

Public complaints and reports from auditors and liquidators continued to be the main source of information with respect to potential defaults vis-à-vis the Companies Acts. This section of the Report deals with all alleged and detected misconduct, other than that contained in regular liquidator reports which are part of the later Goal 4 chapter.

#### Number/Sources of Suspected Breaches

As will be apparent from the breakdown of detected non-compliance by source which is outlined in **Appendix 2.1.1** to the Report, the number of reports in 2007 declined marginally by about 4% on the 2006 outturn. The primary reason for this reduction was the 30% drop from 268 to 186 in the number of auditor reports received.

On the other hand, the number of public complaints and other detections increased by 16% from 406 to 470 cases. Much of this increase was the result of the ODCE's own efforts in 2007 in monitoring compliance with the new legal requirements for the disclosure by limited companies of certain particulars on their websites. See the previous Goal 1 chapter for details of these requirements.

### Cooperation between Regulatory Authorities

Like other regulators, the ODCE is required by law to keep confidential commercially sensitive information which it receives as part of its work. However generally speaking, the law also permits one regulator to share information of relevance to the remit of another. In recent years, the ODCE has developed Memoranda of Understanding (MOUs) with a number of other regulators to help define the standards of mutual cooperation which should operate with respect to information-sharing.

Pursuant to the cooperation which is permitted by law, the Director and his staff had formal meetings during the year with the Revenue Commissioners, the Financial Regulator, the Irish Auditing and Accounting Supervisory Authority, the Garda Bureau of Fraud Investigation (GBFI) and the recognised accountancy bodies. Given a mutual interest in property management companies, the ODCE also met with the Chief Executive Designate of the National Property Services Regulatory Authority in 2007.

There were extensive contacts with the Revenue Commissioners in particular with respect to the Office's work in addressing the area of unliquidated insolvent companies where Revenue would often be a significant creditor. Regular contacts also took place between the Garda members of the ODCE and their counterparts in GBFI and in other areas of the force on specific case issues.

As part of their continuing co-operation, the ODCE and the recognised accountancy bodies decided in 2007 to establish a technical liaison group to address issues of interpretation with respect to particular accounting and auditing obligations in the Companies Acts. It is envisaged that this technical liaison group will meet quarterly, and its work will be kept under review by the Director and Chief Executives of the accountancy bodies who will continue to meet every six months or so.

The staff of the Companies Registration Office (CRO) also continued to be of substantial assistance to the work of the Office, especially in retrieving and certifying filed original documentation for use by the ODCE in Court proceedings.

The ODCE developed in 2007 a draft MOU on information-sharing with the Private Security Authority, and progress in finalising its terms was well advanced at year-end.

A small number of contacts on individual case issues also took place during the year with a variety of Government Departments and regulatory and other agencies.

## Sub-Goal 2.2: Identifying Suspected Breaches of the Companies Acts

The ODCE continued in 2007 to evaluate issues of suspected default reported to or detected by it in order to identify relevant breaches of company law. It is in the nature of many public complaints in particular that alleged misconduct may be quite general, and when examined, some will be found not to be relevant to the Office's remit.

The following main business sectors were the subject of the 674 complaints and reports received in 2007:

Complaints/Reports by Business Sector in 2007	% of Complaints/Reports
Real estate, renting and associated business activities	32.0%
Construction	11.5%
Wholesale, retail and motor trades	8.5%
Manufacturing	7.0%
Community and personal services	6.7%
Financial intermediation	5.0%
Transport and communications	4.5%
Hotels and restaurants	2.8%
Other Business Sector	1.7%
Unknown Business Sector	11.0%
Not a company	9.3%
<b>Total</b>	<b>100.0%</b>

### Nature of Issues identified in Mandatory Reports

The 204 mandatory reports which were primarily received from auditors in 2007 disclosed six main suspected offences under the Companies Acts. **Appendix 2.2.1** to this Report outlines the nature of the main offences reported to the Office in 2007 relative to the previous year's outturn.

The following two offences represented almost 87% of those reports:

- 138 instances of infringements of the directors' transactions provisions contained in Part III of the Companies Act 1990 were reported. This suspected default was contained in about 68% of auditor reports. The associated loan amounts were valued at €33.7 million;

- 40 instances of a suspected failure to keep proper books of account in companies as required by Section 202 of the Companies Act 1990 were received. This default was apparent in about 19% of auditor reports. This failure can denote serious misconduct on the part of a company and/or its directors.

The 138 instances of directors' transactions infringements constituted about half the reported 268 infringements of 2006, and this reduction was the most notable feature of the mandatory reports received in 2007. This decreasing trend which has been evident since 2005 is partially explained by the success of the ODCE's efforts since 2003 in informing company directors in particular of the legal limitations which apply to the personal use of company assets. However, it may also be the case that part of this decrease is attributable to a differing interpretation now being placed by some auditors on their reporting obligation in this area.

At the 'Meet the Regulators' Conference in November 2007 which was organised by the Institute of Chartered Accountants in Ireland, the Director reiterated his disappointment that so few indictable offences under the Companies Acts were coming to the attention of auditors during their audit. Arising from these comments, the ODCE and representatives of the recognised accountancy bodies have agreed to discuss in 2008 at technical level the extent to which this constitutes an underreporting of company law offences by auditors and if this were found to be the case, the means by which better reporting might take place in the future.

At the Conference, the Director also adverted to the occasional enquiries which his Office's accountants have had to make of auditors in respect of the validity of audit reports attached to the financial statements of companies. The following **Illustration 2.2.1** identifies one such instance in 2007 where the relevant audit firm felt it necessary to alter its audit opinion following contact from the ODCE. The company in question was one where the financial statements had been prepared on a going concern basis but where the auditor had not been able to verify the valuation of over €150,000 which the company's directors had placed on its stock. It is the view of the ODCE that the absence of adequate stock records is a clear breach of Section 202(3)(c) of the Companies Act 1990 where, as in this case, the related provision was material in the context of that company's financial statements.

**Illustration 2.2.1: Original and Revised Audit Opinions filed with the CRO**  
**(Differences in text between the two Reports are underlined below)**

Original Auditors' Report	Revised Auditor's Report
<p><b>"Basis of Opinion</b></p> <p>We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board.</p> <p>...</p> <p>We planned <u>and performed</u> our audit so as to obtain all of the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error.</p> <p><u>We did not observe a stock count at the year end and there were no other satisfactory audit procedures that we could adopt to confirm that the stock was properly counted and valued.</u></p> <p>...</p>	<p><b>"Basis of Opinion</b></p> <p>We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board, <u>except that our scope was limited as explained below.</u></p> <p>...</p> <p>We planned our audit so as to obtain all of the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error.</p> <p>However, the evidence available to us was limited as <u>we were unable to observe the counting of physical stock which the directors have valued at €157,560 due to limitations placed on the scope of our work by the company. As a result of this we have been unable to obtain sufficient appropriate audit evidence concerning stock.</u> Because of the significance of this item, we have been unable to form a view on the financial statements.</p> <p>...</p>
<p><b><u>Qualified opinion arising from limitation of scope</u></b></p> <p><u>Except for any adjustments that might have been found necessary had we been able to obtain sufficient evidence concerning stock, in our opinion the financial statements give a true and fair view of the state of the Company's affairs as at the 31 October 2005 and of its results for the year then ended and have been properly prepared in accordance with the Companies Acts 1963 to 2005.</u></p> <p>In respect <u>alone</u> of the limitation on our work relating to stock:</p> <ul style="list-style-type: none"> <li>■ we have not obtained all the information and explanations that we consider necessary for the purpose of our audit; and</li> <li>■ <u>we were unable to determine whether proper accounting records have been maintained.</u></li> </ul> <p><u>With the exception of the above, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at the 31 October 2005 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Acts 1963 to 2005.</u></p> <p><u>We have obtained all other information and explanations we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the company.</u> The financial statements are in agreement with the books of account.</p> <p>..."</p>	<p><b><u>Opinion: disclaimer on view given by financial statements</u></b></p> <p><u>Because of the possible effect of the limitation in evidence available to us, we are unable to form an opinion as to whether the financial statements give a true and fair view, in accordance with Generally Accepted Accounting Practice in Ireland, of the state of the Company's affairs as at and of its results for the year then ended.</u></p> <p>In respect <u>solely</u> of the limitation of our work relating to stock, we have not obtained all the information and explanations that we consider necessary for the purpose of our audit <u>and proper accounting records were not maintained.</u></p> <p><u>In October 2006, we issued a special report expressing our opinion that the Company had failed to maintain proper books of account in respect of stock. The directors since the Balance Sheet date have taken the necessary steps to ensure proper books of account are kept by the Company.</u></p> <p>The financial statements are in agreement with the books of account.</p> <p>..."</p>

## Nature of Issues identified in Voluntary and Other Reports

The character of non-compliance denoted in the 470 public complaints and other cases detected in 2007 is outlined in **Appendix 2.2.2** to this Report. Relative to 2006, there were two notable features of the year's cases.

Firstly, the number of complaints received in 2007 in respect of property management companies was 64 cases, a 146% increase on the previous year's figure of 26. The company law issues which provoked the complaints in 2007 in respect of apartment owners' management companies (AOMCs) primarily related to the non-convening of annual general meetings, the failure to inform members in good time of the holding of these meetings, the failure to disclose to members the company's latest financial accounts and the dissolution of a number of these companies.

This increase is likely to have been prompted by the publication of the ODCE's Consultation Paper on the Governance of AOMCs in December 2006 and the attendant publicity giving rise to an awareness that the ODCE may be in a position to offer some relief to the grievances felt by many apartment owners.

The second notable difference vis-à-vis the 2006 outturn arose from the ODCE's decision to monitor in mid-2007 compliance with the new obligations in the European Communities (Companies) (Amendment) Regulations 2007 which came into effect from the preceding 1 April. As indicated earlier, these Regulations require the disclosure by limited liability companies of certain particulars in their electronic communications and on their websites. A specimen list of 100 Irish companies, based on size and website usage, were examined, and 80 were found to be companies which were required to have websites which were subject to the Regulations. Initially, only one of the 80 companies was found to be fully compliant necessitating contact by the Office with the remaining 79 companies. The accompanying **Illustration 2.2.2** discusses the most frequent instances of non-compliance which were detected.

## Throughput of Cases

Some highlights of concluded cases by case type in 2007 are as follows:

- with respect to complaints about AOMCs, the ODCE successfully rectified difficulties in 43 of these cases by contacting the directors in question. Legal action is being considered in two cases at the end of the year following the failure of the directors involved to act to remedy the defaults administratively. 19 other cases are continuing to be assessed at year-end;
- in dealing with detected non-compliance vis-à-vis the disclosure of company particulars on websites, 73 companies achieved compliance by the end of year following ODCE contact with them. The Office was continuing to engage with six defaulting companies at year-end;
- in relation to excessive directors' transactions, 179 cases involving amounts to the value of €63 million were examined in detail. Some 122 cases were successfully resolved. Of those, seven cases involved loan amounts in excess of €1 million in each case, and over €10 million of company assets was repaid by directors to their companies. In all, some 368 directors were cautioned. At the end of the year, 57 cases remained on hand.

### Illustration 2.2.2: Issues arising from ODCE Monitoring of Compliance with the European Communities (Companies) (Amendment) Regulations 2007

A typically compliant website and any electronic or written correspondence emanating from a limited liability company should have at least the following:

*XY Limited a private company limited by shares registered in the Republic of Ireland No. 99990900 with a registered office at 16 Parnell Square, Dublin 1.*

The Regulations are aimed at consumer protection insofar as they require disclosure of the identity of the vendor of the goods or the provider of the services. It was therefore a concern that the primary failure to disclose the relevant details was evident on retail trade websites which were selling to consumers.

Some Irish-registered trading companies operate multiple websites (i.e. one for each commercial premises), and frequently, each of these websites was found not to be compliant with the Regulations. Companies should disclose the required details on each and every website which it operates; it is not sufficient that one company website has the required particulars.

Another detected problem was the failure by groups of companies to comply with the provisions. Certain Irish-registered companies have a web presence as part of a parent or sister company website, but the required details were not disclosed on the website.

If any group company registered in an EU Member State is operating through a website, the details of that company, together with the details of any other sister companies registered in EU Member States which are operating through the same site, must be included on the website.



As will be apparent from **Appendix 2.2.3**, over 500 cases were disposed of in 2007 compared with more than 900 in 2006. The latter result was exceptional in that the cases in question predominantly involved excessive directors' transactions which were capable of being dealt with on a relatively expeditious basis. Although the issue of directors' transactions continued to form a part, albeit a reducing part, of the overall caseload, many other case types addressed in 2007 were more complex which militated against an early resolution of the matters at issue.

An example of case complexity is provided in the accompanying **Illustration 2.2.3** where the ODCE had to review extensive documentation relating to an AOMC and engage in a series of contacts with the complainant, the management company, the auditor of the company and representatives of the developer in question. The case confirms the need for the development of the ODCE Governance Handbook which is in preparation as it illustrates the confusion which is present in this area among both professionals and less qualified persons. It also indicates that the Office cannot always successfully resolve a complainant's problems even where, as here, significant non-compliance was detected and rectified.

### Illustration 2.2.3: Evidence of Confusion in regard to AOMC Governance and Financial Statements

In 2007, an apartment owner complained that she and other members of the associated management company had been denied representation at its annual general meeting (AGM).

As a result, the ODCE wrote to the company secretary requesting clarification of a number of matters, including the attendees at the last AGM and the legal ownership of the common areas of the apartment development. The ODCE letter also drew attention to the fact that as it was a company limited by guarantee, the management company was not entitled under Section 18 of the Companies (Amendment) Act 1986 to file abridged accounts with the CRO. The associated opinion from the company's auditors stating that the company was so entitled was not therefore correct.

The solicitors to the management company responded in June 2007 indicating that the common areas had not been vested by the developer in the management company, that abridged accounts had been lodged and that insufficient notification of the holding of the company's 2006 AGM had been provided to the subscriber shareholders resulting in the Meeting being inquorate. The solicitors also stated that arrangements would be made to properly reconvene the company's 2006 AGM.

Having considered this response, the ODCE engaged with the auditors to the company. It transpired that:

- they were auditors to both the developer and the management company;
- the income derived from the apartment owners' service charges (which is used to meet the costs of maintaining the development as a whole) constituted income of the developer and not the management company pending the transfer of the common areas from the developer to the management company;
- this income had been incorrectly included as income of the management company in the company's financial statements;
- they had incorrectly filed abridged accounts for the management company.

The auditors subsequently took steps to file with the CRO revised unabridged accounts on behalf of their clients which constituted the developer, the management company in question and all other relevant management companies where the common areas had not yet been transferred to the ownership of the companies.

The ODCE advised the complainant that as the common areas of the apartment development remained in the legal ownership of the developer, it was the developer, not the management company, who was responsible for the maintenance of the development, and it was he who should be called to account for the use of service charge monies collected from her and her fellow apartment owners. Although the management company would be relatively inactive pending transfer of the common areas, she was advised to consult her apartment purchase contract to ascertain her entitlement to membership of the company and to attendance at the company's rescheduled AGM.

### Manner of Disposal

**Appendix 2.2.4** to the Report summarises how the 507 cases were concluded in 2007 distinguishing between mandatory and voluntary and other reports. A further 111 cases were referred for consideration of possible enforcement or insolvency action.

Of the 507 cases concluded, almost 50% were closed having secured a remedy of the default and/or issued a caution to the relevant persons. Most of these related to cases involving excessive directors' transactions. The following **Illustration 2.2.4** deals with another case type where the detected default of non-registration was remedied in 2007 following ODCE intervention.

### Illustration 2.2.4: Rectification of the Non-Registration of an External Company

Separate complaints were received in 2006 and 2007 in relation to a trading entity which represented itself as a company. Both complainants drew attention to the fact that the entity was not registered in the State.

On investigation, it transpired that the entity had two business premises in Dublin and Galway and had been operating in the State for some years. While it had been incorporated in the UK in 2003, the entity was not registered with the CRO as an Irish company nor was it registered as a branch or as an external company under the European Communities (Branch Disclosures) Regulations 1993 (S.I. 395 of 1993) or Part XI of the Companies Act 1963 (as amended) respectively.

The ODCE requested the entity to comply with the relevant legislation. Initial contacts did not secure the necessary remedial action. After some months, the Office was poised to take legal action when arrangements were made in 2007 to register the entity as an external company.

In another 32% of cases, no action was warranted following assessment by the Office because of the absence of (or insufficient evidence of) any obvious company law default. Typically, the complainant will have a concern about possible misconduct which is not directly relevant to the requirements of the Companies Acts.

In about 11% of cases, the ODCE decided not to intervene as the complainant had available legal remedies to address his or her concerns. Generally, there will be debts owing to a complainant, and in this situation, the ODCE will decline to involve itself in a pure inter-party commercial dispute.

The small balance of cases included complaints which were found, on examination, to be clearly a matter for investigation by another authority.

### Sub-Goal 2.3: Commissioning/ Supporting Formal Company Investigations

In circumstances suggesting fraud, illegality or prejudicial conduct, the Companies Acts permit the ODCE to require the production of specified books and documents of a company for examination. To date, the Office has used these powers infrequently.

### Ongoing Investigations

The ODCE Annual Reports for 2005 and 2006 previously dealt with the investigation of Cologne Reinsurance (Dublin) Limited. During 2007, the Office monitored developments with respect to the related legal proceedings taking place against a number of parties in the USA. The Director will consider in due course what action, if any, is called for in the State as a result of these ongoing developments.

At the start of 2007, there were two further investigations on hands where the ODCE had used its legal powers under Section 19 of the Companies Act 1990 (as amended). Further documentation relating to these companies was acquired during the year, and both investigations remained open at year-end.

### New Company Investigation

The Director initiated a new examination of a company's books and documents in 2007 and acquired relevant materials for evaluation. This examination was also ongoing at the end of the year.

### Departmental Company Examinations

In 2007, the Department of Enterprise Trade and Employment kept the Director informed of developments in relation to its outstanding examinations of the books and documents of College Trustees Limited, Guinness and Mahon (Ireland) Limited and Hamilton Ross Company Limited.

### Conclusion

The Office continued in 2007 to tackle as effectively as possible the issues of apparent misconduct which were brought to its attention. It is clear that a large number of individual instances of company law non-compliance were rectified or otherwise addressed as a result of the ODCE's work and that this was of public benefit.

The decline in auditor reports experienced in 2007 is expected to continue further in 2008 as a result of the introduction of the more generous criteria for audit exemption which became available in late 2006 following the commencement of Section 9 of the Investment Funds, Companies and Miscellaneous Provisions Act 2006.

However, the ODCE expects the level of public complaints to be maintained at current levels, and the Office intends to continue in 2008 to identify instances of default through its own efforts and in cooperation with other regulatory authorities.