

## Goal 2: Uncovering Suspected Breaches of Company Law

### Introduction

In its assessment of suspected company law breaches, the ODCE is anxious to improve corporate conduct and foster a culture of compliance with the Companies Acts. The Office is particularly motivated to secure the correction of unlawful behaviour where that results in those who are culpable for the defaults actually or potentially deriving an unfair competitive or other advantage over other company stakeholders. On occasion of course, the conduct in question may merit legal action in which case a formal investigation is undertaken.

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

In 2008, the Office again received a large number of auditor reports and public complaints alleging breaches to the Companies Acts. However, a feature of 2008 was the incidence of financial statement defaults which were detected following the ODCE's decision to focus some attention on the financial statements of companies limited by guarantee in particular.

The cases which emerged in 2008 derived from the following main business sectors.

Complaints/Reports by Business Sector in 2008	% of Complaints/Reports
Real Estate, Renting and Associated Business Activities	26%
Community and Personal Services	17%
Construction	9%
Wholesale, Retail and Motor Trades	7%
Transport and Communications	6%
Manufacturing	6%
Financial Intermediation	3%
Hotels and Restaurants	3%
Other Business Sector	9%
Unknown Business Sector	9%
Not a company	5%
<b>Total</b>	<b>100%</b>

### Number/Sources of Issues Examined

In all, some 627 cases were opened in 2008, a 7% decline on the 674 cases for 2007. **Appendix 2.1.1** contains further details on these figures.

Most of this reduction was attributable to an 11% decline in public complaints which dropped to 295 cases from 331 in 2007. However, an 8% rise from 204 in 2007 to 221 in 2008 was also evident in the number of reports received from auditors, recognised accountancy bodies and others who are required to report suspected breaches of the Companies Acts to the ODCE. This increase in cases was primarily due to auditor reports which grew by 11%.

Much of the balance was due to an ODCE 'campaign item' which in 2008 focused attention on the detection of deficiencies in the financial statements of companies limited by guarantee in particular. The corresponding 'campaign item' in late 2007 was an examination of compliance with new disclosure obligations in the European Communities (Companies) (Amendment) Regulations 2007.

### Cooperation between Regulatory Authorities

In the face of limited company document and premises inspection powers, the Office must rely to a large extent on public information and on third parties to identify possible misconduct. It is important therefore that its information sources for possible company law breaches should be wide-ranging, and that is why the Office seeks on an ongoing basis to encourage other regulators to report possible non-compliance with the Companies Acts. These mutually supportive information-sharing arrangements are sometimes formalised in bilateral Memoranda of Understanding (MOUs).

### ODCE/Accountancy Body Contacts

The ODCE enjoys a constructive relationship with the professional accountancy bodies, and there were regular meetings in 2008 at plenary and technical levels to review the reporting arrangements from auditors and the bodies themselves to the ODCE and from the ODCE to the bodies in turn. Work commenced on developing revised guidance for auditors to assist them in reporting suspected indictable offences under the Companies Acts. The Director has expressed his concern on a number of occasions at the relatively narrow range of offences that are typically reported by auditors, and it is hoped that the guidance, when finalised, will lead to a wider variety of detected defaults from the profession.

In November 2008, new protocols were also put in place regarding the referral of issues from the ODCE to the bodies relating to individual members of the accountancy profession. The spur for these protocols was a sequence of referrals made by the ODCE to the bodies and to the Irish Auditing and Accounting Supervisory Authority (IAASA) arising from the ODCE's detection of financial statement defaults primarily in companies limited by guarantee in particular. The ODCE welcomes the fact that the bodies in question have reminded their members that companies limited by guarantee are ineligible for audit exemption. Hopefully, this will serve to improve compliance with this statutory obligation in the future.

Work was also undertaken during the year in reviewing the wording of the obligation in Section 202 of the Companies Act 1990 under which companies and directors must keep proper books of account. The purpose of this review is to clarify the intent and scope of the obligation in the current commercial environment. It is intended that any revised wording will be forwarded for consideration as part of the proposed Companies Consolidation and Reform Bill in due course.

#### **ODCE/IAASA Contacts**

Regular contacts took place at staff level between both bodies in 2008. In addition to the financial statement default issues identified above, cases involving unqualified persons acting as auditors was also a cause of regular contact.

#### **ODCE/Revenue Contacts**

There were extensive contacts during the year with the Revenue Commissioners on company law related issues. The contacts focused in particular with respect to the Office's work in addressing the area of unliquidated insolvent companies where Revenue would often be a substantial creditor. In all, information on some 80 companies and former companies was shared.

#### **ODCE/Financial Regulator Contacts**

The relationship between the ODCE and the Financial Regulator developed during the year as contacts became more frequent. Late in 2008, the Director and the Chief Executive of the Financial Regulator met to agree revisions to their existing Memorandum of Understanding (MOU), and a revised MOU was signed.

#### **ODCE/Pensions Board Contacts**

A preliminary meeting took place between the ODCE and the Chief Executive of the Pensions Board to formalise cooperation with respect to cases involving insolvent

companies which had deducted pension contributions from employees but had failed to remit them to the pensions provider. The ODCE forwarded a draft MOU to the Pensions Board for consideration, and its finalisation will be pursued in 2009.

#### **ODCE/Garda Bureau of Fraud Investigation (GBFI) Contacts**

Regular contacts also took place between in particular the Garda members seconded to the ODCE and their colleagues in GBFI and elsewhere in the Force.

At the invitation of GBFI, the Director attended in late 2008 a presentation given in Dublin by members of the Federal Bureau of Investigation from the United States of America. Other regulators and financial entities were also represented.

#### **ODCE/Companies Registration Office (CRO) Contacts**

The staff of the CRO again provided valuable assistance to the Office in 2008, particularly in retrieving and certifying filed original documentation for use by the ODCE in Court enforcement proceedings.

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

In general, it was readily apparent from auditor reports and from the Office's own detection work what were the issues of detected non-compliance. Where it was necessary to establish if the issues raised actually concerned breaches of company law, ODCE staff engaged with the relevant complainants.

### **Nature of Issues identified in Auditor and Other Mandatory Reports**

The 221 mandatory reports received in 2008 contained seven main suspected offences. **Appendix 2.2.1** to this Report identifies the types of offences reported.

Consistent with previous years, the following two issues represented 87% of the reported defaults:

- 161 cases involved excessive directors' transactions where directors used company funds contrary to the restrictions in Section 31 of the Companies Act 1990. This figure represented a 17% increase on the 138 reports received in 2007;
- 32 instances of a suspected failure to keep proper books of account contrary to Section 202 of the Companies Act 1990 were received in 2008. This was a welcome decrease on the 40 reports received in 2007.

## Directors' Loans

Previous ODCE Annual Reports have highlighted the phenomenon of directors' transactions, and unfortunately, events in 2008 kept this issue in the public eye.

With regard to 161 reported cases of excessive directors' transactions, the associated loan amounts grew to €134 million in 2008, a fourfold increase on the €33.7 million reported by auditors in 2007. A particular feature was the incidence of loans taken by directors from companies in the construction and property development sectors where some 47 auditor reports were received involving about €98 million in loans. This figure represents approximately 73% of all transactions reported by auditors in 2008.

Having regard to the high burden of proof required for the prosecution of these defaults, the Office continued in 2008 with its established policy of encouraging directors to return the loans in question to the company and warning them of the future consequences of repeating this default. In all, company directors repaid some €164 million, and the Office cautioned 423 directors during the year, the vast bulk of which were cases notified to us by auditors. At year-end, 43 cases including one quite significant case remained on hands.

A new feature to emerge in late 2008 was an apparent failure to make adequate disclosure of the amount of directors' transactions in company financial statements. This issue particularly surfaced in Anglo Irish Bank Corporation plc ("Anglo") and directly led to the resignation of its chairman and another director who had been beneficiaries of these loans. This issue was the subject of detailed scrutiny by ODCE staff at year-end.

Sections 41 to 46 of the Companies Act 1990 set down the disclosure obligations which were the subject of previous ODCE Guidance<sup>19</sup>. In essence, information involving transactions between companies and their directors or between companies and other parties connected to the directors must be disclosed in the notes to company financial statements. Special disclosure provisions in Sections 43 and 44 in particular apply to licensed banks. Having regard to the developments in Anglo, the ODCE decided in late December to write to some 40 licensed banks in the State to assess the extent to which they were compliant with their obligations under Sections 43 and 44.

## Nature of Issues Identified in Voluntary Reports and Other Detections

Appendix 2.2.2 outlines in summary form the character of the various public complaints and other detected issues which came to attention in 2008.

## Property Management Companies

A further 61 complaints about management companies were made to the ODCE in 2008. As in previous years, some of these complaints dealt with issues which fell outside the remit of the Office (such as the level of service charges and the non-assignment of the common areas to the management company). The relevant company law issues in these complaints primarily related to failures to:

- convene annual general meetings (AGMs);
- inform members in good time of the holding of these meetings;
- disclose to members the companies' latest financial accounts and
- permit the inspection of company registers.

Illustration 2.2.1 provides an example of a management company case in an apartment block in Dublin City which was the subject of recurring problems but which was satisfactorily resolved by the Office on an administrative basis.

### Illustration 2.2.1: Residential Property Management Company Case

In 2008, the ODCE received a number of complaints from the members of a property management company whose concerns centred on the failure to convene its AGM and to supply members with unabridged audited company accounts. The complainants satisfied the Office that they were indeed members of the company and that they had engaged in extensive correspondence with the company secretary over some time seeking to have their concerns addressed. The company secretary had apparently promised on more than one occasion to rectify the identified deficiencies.

The ODCE proceeded to write to the company's directors seeking certain information with respect to the fulfilment of their statutory duties, and it transpired that the directors had entrusted the running of the company to the company secretary and the managing agents. In response to the ODCE's intervention, the directors then:

- convened an AGM in accordance with the Companies Acts;
- confirmed that the company's auditor was in place and
- undertook to grant the members access to the company's books and records.

The members subsequently participated at the AGM and received copies of the company's audited financial statements in advance.

<sup>19</sup> The Guide to Transactions Involving Directors (November 2003) is available at [www.odce.ie](http://www.odce.ie). Section 9 of the Guide deals with the applicable disclosure obligations.

## Financial Statement Defaults

In its investigations of complaints in recent years, the ODCE had occasionally detected in its examination of the financial statements of companies limited by guarantee incorrect claims for filing and audit exemption and other financial statement defaults. Companies limited by guarantee are usually 'not-for-profit' companies that are formed for some charitable, community or social purpose. By virtue of their character, the law requires that the assets managed by them must be subject to the assurance of an independent audit.

In a focused campaign in 2008, the ODCE examined the financial statements of 264 companies. In 68 cases (some 25% of the companies examined), it was evident from the company financial statements that there was non-compliance with the Companies Acts to a greater or lesser extent. In all, over 100 deficiencies were detected, and the primary defaults were the following:

- on 64 occasions, the auditors certified that they were satisfied that the directors were entitled to lodge abridged accounts and the companies then filed abridged accounts, notwithstanding the fact that companies limited by guarantee are not entitled to file abridged accounts<sup>20</sup>;
- in 30 cases, the auditors reported a deficiency of capital notwithstanding the fact that companies limited by guarantee have no issued share capital<sup>21</sup>;
- on eight occasions, the auditors failed to provide a complete audit opinion in accordance with the statutory requirement<sup>22</sup>, and
- in a small number of other cases, no audit was undertaken.

Following ODCE contact with the company auditors and/or directors concerned, all of the defaults in question were rectified. As indicated earlier, the auditors' professional bodies and IAASA were advised of the professional lapses in question so that they could take appropriate remedial action. **Illustration 2.2.2** provides an example of a company which had improperly claimed audit exemption for many years.

### Illustration 2.2.2: West of Ireland Community-Based Company

A community-based company had owned and managed property for many years. It had been inappropriately claiming audit exemption for some time. Having recently disposed of assets, it had received substantial funds as a result.

Following ODCE contact with the company, the directors took steps to appoint an auditor, to prepare audited financial statements and to file them in the CRO.

## Outstanding Debts

In 2008, a significant number of complaints alleged a failure on the part of companies to pay outstanding debts was also received. In the absence of any evident breach of company law, the ODCE suggested to the complainants that they explore their own legal remedies to recover any monies due to them.

## Throughput of Cases

**Appendix 2.2.3** provides details of case throughput. Of the 950 or so cases on hands in 2008, some 584 cases were closed. This represents a 15% increase on the 507 cases closed in 2007. This result was due in part to a concerted effort on the part of Office staff in 2008 to clear a large number of the Office's outstanding cases.

**Appendix 2.2.4** provides information on the manner of disposal of these 584 cases:

- 56% of the cases were closed having secured a remedy of the company law default and/or having adopted a compliance approach to the default. In many cases, the ODCE issued a caution to the relevant persons warning of the consequences of a repetition of the detected default. Over half of these cases involved excessive directors' transactions;
- 25% of them were concluded on the basis that there was insufficient evidence of default under the Companies Acts to warrant further action. As a general rule, the allegations were considered to be irrelevant or peripheral to the Companies Acts and/or the remit of the ODCE. A typical case type would be a complaint about service charges in a property management company;

<sup>20</sup> Only private companies are entitled to file abridged accounts under the Companies (Amendment) Act 1986 (as amended).

<sup>21</sup> The requirement on auditors to make such a report under Section 40 of the Companies (Amendment) Act 1983 is only relevant to companies which have a share capital.

<sup>22</sup> As required by Section 193 of the Companies Act 1990 (as amended).



- 12% were closed on the basis that it was more appropriate that the complainants pursued their own legal or other remedies to advance their interests. The accompanying **Illustration 2.2.3** involves a case in which a prominent company asked the ODCE in 2008 to consider taking disqualification or restriction proceedings against two of its former directors;
- the remaining cases were generally considered to be a matter for primary evaluation by other authorities, e.g., the Pensions Board in respect of a failure to remit pension contributions to the pensions provider.

#### **Illustration 2.2.3: Request to the ODCE to consider Disqualification Proceedings**

On the instruction of his Board of Directors, a Company Secretary complained to the ODCE in 2008 that there had been a gross dereliction of duty by two former directors. The Company had taken emergency legal action in the form of injunctive relief to protect its interests, and it was said to be considering further unspecified legal action against the former directors and related parties. Acting on legal advice, the Board had formed the opinion that both former directors were not fit persons to be directors of any limited liability company and that they ought to be disqualified or restricted. The ODCE was asked to consider taking appropriate action on foot of the complaint.

In reply, the ODCE sought all relevant documents evidencing the Board's contentions and further information in relation to the legal action already taken and now being contemplated and the timescale for making that decision. The reply also asked the Company to address the following issue:

*"The legal advice made available to your Company will no doubt have pointed out that under Section 160(4) of the Companies Act [1990], it is open to any member or officer of your Company to apply to the High Court for the disqualification of any of its former officers in the indicated circumstances of this case. Accordingly, I have to ask why your Company should be asking this Office to consider exercising its right to make a disqualification application when the same right of action is available to you."*

The Company did not avail of the opportunity to pursue its complaint with the Office, and no information is available to suggest that it launched its own disqualification proceedings against the former directors in question.

In addition to the 584 closed cases, a further 78 cases were deemed appropriate for more detailed investigation. This included a number of auditor reports where the Office considered that legal action may be warranted if relevant evidence of misconduct were obtained and certain property management company cases where the directors had failed to respond positively to ODCE attempts to secure rectification of the identified defaults.

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

On occasion, it is necessary for the ODCE to consider undertaking a thorough fact-finding investigation of a company's activities in order to identify if misconduct has occurred. 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.

#### **High Court Inspection**

On foot of an application by the ODCE, the High Court appointed Mr Bill Shipsey SC in July 2008 as Inspector to DCC plc, S&L Investments Ltd and Lotus Green Ltd to investigate aspects of various purchases and sales of the shares of Fyffes plc in 1995 and 2000. This was the first occasion in which the Office had applied to the High Court for the appointment of an inspector to a company.

The ODCE's successful petition to the Court followed:

- the Office's examination of the High Court and Supreme Court Judgments in the civil proceedings with respect to alleged insider dealing in 2000 which were initiated by Fyffes plc against DCC plc, S&L Investments Ltd, Lotus Green Ltd and James Flavin and
- its own investigations which raised questions about the legal validity of certain related share transactions in 1995.

The Inspector commenced work in Autumn 2008, and the known cost of the Inspection was some €180,000 up to the end of 2008.

#### **Ongoing Investigations**

At the start of 2008, the Office had four ongoing examinations of company books and documents in hand. One of these related to DCC plc and related companies, and it concluded following the High Court's decision in July to appoint an Inspector to the companies.

Previous Annual Reports have referred to the ODCE's examination of the books and documents of Cologne Reinsurance Ltd. It is understood that some related legal proceedings in the USA involving a number of parties may have concluded in 2008, and the Office was awaiting confirmation of the details from the US authorities at year-end prior to considering what ODCE action, if any, may be appropriate.

Two further company examinations which had been initiated prior to 2008 remained ongoing at year-end.

### **New Company Investigations**

Other than the Inspection of DCC plc, S&L Investments Ltd and Lotus Green Ltd, no new fact-finding examination of a company's books and documents was initiated in 2008.

### **Departmental Company Examinations**

In 2008, the Department of Enterprise Trade and Employment kept the Director informed of developments in relation to the examinations of the books and documents of College Trustees Limited, Guinness and Mahon (Ireland) Limited and Hamilton Ross Company Limited.

## **Conclusion**

Having regard to the volume of cases examined and closed, 2008 was a very busy year for the Office in evaluating possible company law defaults. As the year ends however, it is clear that the events disclosed at Anglo will dominate Office attention in 2009. This will place a considerable strain on its available resources and will inevitably pose challenges in managing the normal throughput of detection work in parallel. In those circumstances, it is unlikely that a similarly large number of cases will be dealt with in 2009.

The large volume of directors' loans which emerged in the property and construction industry in 2008 in the face of a sharp decline in the sector's performance suggests that creditors may find it difficult to recover some or all of these sums in 2009. If this eventuality arises, then the directors of those property and construction companies will be at risk of sanction from the courts. Every effort should be made by those directors to repay all of the outstanding monies due to their companies so as to minimise the liabilities of creditors, and the ODCE will continue to encourage this.