

The draft Companies Decree 2013 - the Impact on Auditors and Officers of Companies

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Generally

- ✦ To regulate or not to regulate companies?
- ✦ Common law shows a tension between control by courts and shareholders
- ✦ Shift in governance theory from agency to trusteeship means that companies now owe legal duties to stakeholders, not just shareholders
- ✦ That has reflected in statute law
- ✦ English Companies Act
- ✦ Australian Corporations Act

Result

- ◆ More prosecution powers given to company enforcers
- ◆ More investigation powers
- ◆ Companies now have a greater criminal liability
- ◆ Companies now have greater definition in relation to directors' and officers' duties

Common law duties

- ✦ a duty to protect the interests of creditors as well as shareholders when a company became insolvent
- ✦ to exercise the reasonable care and skill expected of a reasonable director when carrying out their duties
- ✦ not to obtain personal gain from the company
- ✦ not to sell the assets of the company to save jobs unless it is an honest attempt to save the business
- ✦ not to exceed the powers given to them by the Articles of Association
- ✦ and not to steal or convert company assets, even if he or she is the principal shareholder

But what is the test of a reasonable director?

- ✦ ***"It may be that in January, or even earlier, a dispassionate mind would have reached the conclusion that the company was doomed. But directors immersed in the day to day task of trying to keep their businesses afloat cannot be expected to have totally dispassionate minds. They tend to cling to hope."***
- ✦ **(Re CU Fittings Ltd - Lord Hoffman)**

Statute now codifies the duty of care in other countries

- ✦ (Australia) Corporations Act
- ✦ **Commonwealth Bank of Australia v Friedreich**
- ✦ ***" As the complexities of commerce has gradually intensified (for better or for worse) the community has of necessity come to expect more than formerly from directors whose task it is to govern the affairs of companies, to which large sums of money are committed by equity or by loan. In response, the parliaments and the courts have found it necessary in legislation and litigation, to refer to the demands made on directors in more exacting terms than formerly and the standard of capability required of them has correspondingly increased."***

Statutory duties in the UK

- ✦ **1. Duty to act within your powers**
- ✦ **2. Duty to promote the success of the company**
- ✦ **3. Duty to exercise independent judgment**
- ✦ **4. Duty to exercise reasonable care, skill and diligence**
- ✦ **5. Avoiding a 'situational' conflict of interest**
- ✦ **6. Disclosing a 'transactional' conflict**
- ✦ **7. Not accepting benefits from third parties**

Duties under the Fijian Companies Act

- ◆ Directors must not trade when a company is insolvent
- ◆ Directors must disclose conflicts of interest (section 201)
- ◆ No other real guidance

Proposed Companies Decree

- ✦ Note there may be further changes
- ✦ Three regulators
- ✦ The Ministry of Justice for the regulation of auditors and receivers
- ✦ The Reserve Bank for the for the administration of takeovers, regulation of securities exchanges and central depository, regulation of securities industry licences, capital raisings, managing investment schemes, insider trading, offences (in conjunction with the Registrar) and investigations, and information-gathering,
- ✦ The Registrar of Companies, for administering the remainder of the Decree as well as for offences, investigations and information-gathering in conjunction with the RBF.

Directors' Duties

- ✦ Sections 91 to 127
- ✦ 1. Duty to act within powers of law and articles of association section 103
- ✦ 2. Duty to promote the success of the company Section 104
- ✦ 3. Duty to exercise independent judgment Section 105
- ✦ 4. Duty to exercise reasonable care, skill and diligence Section 106
- ✦ 5. Duty to avoid conflicts of interest Section 107
- ✦ 6. Duty not to accept benefits from third parties Section 108
- ✦ 7. Duty to declare interest in transaction (including proposed transaction) Section 109

Criminal offences

- ✦ **115.– Good faith, use of position and use of information – criminal offences**
(1) A Director or other Officer of a Company commits an offence if they breach their duties under section 104, 105, 107, 108 or 109 and the Director or other Officer of a Company was reckless or intentionally dishonest and failed to exercise their powers and discharge their duties in good faith in the best interests of the Company or for a proper purpose.

Criminal Offences

- ✦ ***(2) A Director, Officer or employee of a Company commits an offence if they dishonestly use their position or any information they have obtained because they are or have been a Director, Officer or employee of a Company–***
- ✦ ***(a) with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the Company; or***
- ✦ ***(b) recklessly as to whether the use may result in themselves or someone else directly or indirectly gaining an advantage, or in causing detriment to the Company.”***

Test for directors

- ✦ ***(1) A Director or other Officer of a Company must exercise reasonable care and diligence.***
- ✦ ***(2) This means the care and diligence that would be exercised by a reasonably diligent person with–***
 - ✦ ***(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the Director or other Officer in relation to the Company, and***
 - ✦ ***(b) the general knowledge, skill and experience that the Director or other Officer has.***

Defence – of business judgement

- ✦ ***(a) make the judgment in good faith for a proper purpose; and***
- ✦ ***(b) do not have a material personal interest in the subject matter of the judgment; and***
- ✦ ***(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and***
- ✦ ***(d) rationally believe that the judgment is in the best interests of the Company.***
- ✦ ***The Director or Officer's belief that the judgment is in the best interests of the Company is a rational one unless the belief is one that no reasonable person in their position would hold.***

A criticism

✦ ***"In recognition of the risky nature of most business, courts are reluctant to intrude into the boardroom and second-guess directors' decisions. Providing the directors have performed their duties without personal interests being served, have informed themselves, and have acted in what they believe are the company's best interests, the courts will not interfere, unless the decisions are really very foolish. Only then will honest directors have to face actions for negligence. Certainly, they can make bad decisions and not be pursued. This notion or principle, which shields directors from all but the most egregious carelessness, is called the business judgment principle."***

✦ (Mathew Hooper, Bond University)

Financial Reporting

- ✦ Sections 386-389
- ✦ Mandatory reporting by auditors of Decree breaches-
- ✦ **"398.– Reporting to the Registrar**
- ✦ **An Auditor conducting an Audit contravenes this section if the Auditor is aware of circumstances that give the Auditor reasonable grounds to suspect–**
 - ✦ **(a) a contravention of this Decree;**
 - ✦ **(b) an attempt, in relation to the Audit, by any person to unduly influence, coerce, manipulate or mislead a person involved in the conduct of the Audit; or**
 - ✦ **(c) an attempt, by any person, to otherwise interfere with the proper conduct of the Audit, and the Auditor does not notify the Registrar in writing of those circumstances as soon as practicable, and in any case within 28 days, after the Auditor becomes aware of those circumstances".**

Registration of Auditors and liquidators section 410

- ***"An applicant for registration as an Auditor must–***
- ***(a) ordinarily reside in Fiji;***
- ***(b) hold a degree, diploma or certificate from a university acceptable to the Ministry of Justice or another institution in Fiji or outside of Fiji acceptable to the Ministry of Justice;***
- ***(c) have, in the course of obtaining that degree, diploma or certificate, passed examinations in such subjects, under whatever name, as the appropriate authority of the university or other institution certifies to the Ministry of Justice to represent a course of study–***
- ***(A) in accountancy (including auditing) of not less than three years duration; and***
- ***(B) in commercial law (including company law) of not less than two years duration;***
- ***(d) is a chartered accountant with a current Certificate of Public Practice issued by the Fiji Institute of Accountants in accordance with the Fiji Institute of Accountants Act (Cap. 259); and***
- ***(e) in the case of a liquidator–***
- ***(A) satisfy the Ministry of Justice as to the experience of the applicant in connection with Companies to which a Receiver or Manager have been appointed, or are being wound up; and***
- ***(B) satisfy the Ministry of Justice that the applicant is capable of performing the duties of a liquidator and is otherwise a fit and proper person to be registered as a liquidator."***

Section 414 – register of auditors

- ✦ ***(a) the name of the person;***
- ✦ ***(b) the day on which the application by that person for registration as an Auditor was granted;***
- ✦ ***(c) the address of the principal place where the person practises as an Auditor and the address of the other places (if any) at which he or she so practises; and***
- ✦ ***(d) if the person practises as an Auditor as a member of a firm, employee of a Company or under a name other than his or her own name – the name and address of that firm, Company or other name under which he or she so practises; and***
- ✦ ***(e) particulars of any suspension of the person's registration and may cause to be entered in the Register in relation to a person who is registered as an Auditor such other particulars as the Ministry of Justice considers appropriate.***

Audit Independence

- **"430.– General requirement for Auditor independence**
- **(1) An Auditor contravenes this subsection if–**
- **(a) the Auditor engages in audit activity in relation to an audited Company or Managed Investment Scheme at a particular time;**
- **(b) a conflict of interest situation exists in relation to the audited Company or Managed Investment Scheme at that time;**
- **(c) at that time the individual Auditor is aware that the conflict of interest situation exists; and**
- **(d) the Auditor does not, as soon as possible after the Auditor becomes aware that the conflict of interest situation exists–**
- **(A) notify the Ministry of Justice of the conflict of interest within 21 days; and**
- **(B) take all reasonable steps to ensure that the conflict of interest situation ceases to exist.**
- **(2) Within 21 days of becoming aware of the conflict of interest, an Auditor must notify the Ministry of Justice and Company or Managed Investment Scheme being audited as to whether the conflict of interest continues to exist or has been resolved.**
- **(3) The obligations imposed by this section are in addition to, and do not derogate from, any obligation imposed by–**
- **(a) another provision of this Decree;**
- **(b) Auditing Standards; or**
- **(c) a code of professional conduct."**

When is audit independence absent? Section 431

- ✦ ***When the Auditor is not capable of exercising objective and impartial judgment in relation to the conduct of the audit of the audited Company or Managed Investment Scheme; or***
- ✦ ***a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the Auditor is not capable of exercising objective and impartial judgment in relation to the conduct of the audit of the audited Company or Managed Investment Scheme."***

To be done after the Decree is passed

- ✦ Regulations for registration of auditors
- ✦ Agreement on minimum qualifications for auditors
- ✦ Prescribed forms for applying and for reporting breaches of the Decree to the Registrar
- ✦ Ensure all auditors have professional indemnity insurance and fidelity insurance

Conclusion

- ✦ Greater accountability of directors and officers subject to the business judgement rule
- ✦ Registration of auditors and liquidators and procedures for removal
- ✦ Insurance will be mandatory
- ✦ Mandatory reporting of breaches of Decree by auditors
- ✦ Need for efficiency of regulators