



Office of the Director  
of Corporate Enforcement

*Oifig an Stiúrthóra um  
Fhorfheidhmiú Corparáideach*

*A Guide to Transactions  
Involving Directors*

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# 1.0 Introduction to the Guidance

## 1.1 Introduction

The Companies Acts contain extensive provisions detailing how the affairs of companies are to be conducted. These provisions describe how the various participants in companies are required to discharge their duties and obligations. In addition, participants are afforded substantial powers and rights in order to enable them to protect and defend their interests.

Company directors are in a special position as regards their relationship with the company of which they are a director. A director, or number of directors acting together, can exercise considerable power over the assets of a company - assets which ultimately belong to the company's shareholders and which may be required to discharge debts owed to the company's creditors. Because of this special position, company law contains a number of provisions designed to prevent directors from abusing their positions and thereby potentially, or actually, adversely affecting the interests of a company's shareholders and/or creditors.

The main provisions designed to protect shareholders and creditors in this regard are contained in Part III of the Companies Act, 1990 (as amended). The two main sets of provisions are those governing:

- substantial property transactions between directors and the companies of which they are directors, and
- the granting of loans, quasi-loans, guarantees and security for loans etc. by companies to, or in respect of, their directors.

## 1.2 Context in which this Guidance is published

During 2002, the Office of the Director of Corporate Enforcement (ODCE) received 27 reports from auditors in which the opinion was expressed that there were grounds for believing that indictable offences<sup>1</sup> had been committed in relation to companies' transactions with their directors. An analysis of those reports indicated that a significant proportion of the instances reported related to the

issue of unlawful loans to directors. This trend accelerated in 2003 with the reporting of approximately 200 cases to the ODCE.

## 1.3 Purpose of this Guidance

While there may be a number of reasons for the level of reports received to date, and for the historically high levels of non-compliance with Company Law in general, it is recognised that one of the contributory factors has been the lack of availability heretofore of accessible guidance material, particularly in relation to the more complex areas of the law, and a consequent lack of knowledge and understanding of the relevant legal provisions on the part of company directors and managers in particular.

While ignorance of the law is no defence, to the extent that non-compliance with company law has been caused by a lack of knowledge or understanding on the part of directors, the Director of Corporate Enforcement has sought to address the knowledge deficiency through the publication of this and other guidance.

The primary purpose of the guidance, which is aimed at company directors, managers and their advisors, is to encourage, assist and facilitate compliance with the relevant provisions of the Companies Acts by setting out:

- the key provisions of the Companies Acts relating to transactions between companies and the directors of those companies in a clear and readily understandable manner
- the criteria that must be adhered to in order to comply with the requirements regarding transactions with directors
- the criteria that must be complied with in order to avail of exceptions provided for by law
- details of the information that must be disclosed in companies' financial statements where such transactions are entered into, and
- the civil and criminal consequences of non-compliance.

<sup>1</sup> An indictable offence is an offence that is capable of being tried before a jury in the Circuit Court.

## 1.4 Importance of the Guidance

Given that the purpose of these legislative provisions is to protect shareholders and creditors, the Director of Corporate Enforcement takes breaches of these provisions very seriously. In light of the significant civil and criminal penalties provided for by law where these provisions are breached, company directors are strongly advised to study this guidance and, where necessary, to obtain appropriate professional legal and/or accountancy advice in advance of entering into such transactions.

In order to assist directors and other readers in their understanding of the provisions, the guidance is presented in two formats, namely

- a summary of the principal provisions, which is set out in Section 2.0. For ease of use, the summary guidance is fully cross referenced to the detailed guidance, and
- detailed guidance, which is set out from Section 3.0 onwards. The detailed guidance is fully cross referenced to the Companies Acts.

## 2.0 Summary of the Main Provisions Relating to Transactions Involving Directors

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This section provides a summary of the detailed guidance. To assist readers in their understanding of the law governing transactions involving directors, the summary is set out in the same format as, and is cross referenced to, the detailed guidance.

### Part 1

#### The Rules Governing Substantial Property Transactions With Directors (Section 3.0)

In order to protect shareholders from the abuse of power by directors, company law requires that where the directors of a company wish to purchase an asset from, or sell an asset to, the company, the transaction must first be approved by the shareholders. However, in order to minimise the administrative burden on companies, where the value of the asset in question is less than a certain amount, pre-approval is not required.

In the event that the directors enter into such a transaction without the required pre-approval of the shareholders, the company can choose to set the transaction aside i.e. render the transaction void.

Any director or other person who authorises a transaction without the shareholders' approval is liable to account to the company for any gain made by that person and reimburse the company for any loss suffered by it as a result.

#### Section 30 Companies Act, 1990 - Prohibition of Directors' Dealings in Options to Trade Certain Shares and Debentures (Section 4.0)

At the outset it should be noted that this topic is of no application to private companies. The effect of the prohibition is to make it an offence for company directors to deal in options to buy or sell relevant shares or debentures in a company, its subsidiary companies, its holding company or other subsidiaries of its holding company in respect of which dealing facilities are provided by a Stock Exchange.

## Part 2

### Loans and Similar Transactions Involving Directors (Section 5.0)

#### The General Prohibition (Section 5.1)

Section 31 of the Companies Act, 1990 introduced a general prohibition whereby companies are prohibited from granting loans to directors and from entering into certain other transactions with directors or persons connected with directors.

A person can be 'connected' to a director as a result of a number of different relationships. For the moment it will suffice to say that a person is connected with a director if that person is a near relative (including spouse) of the director, in business partnership with the director or is a company controlled by the director. Connected persons are dealt with in detail in section 5.2.

The types of transactions that are prohibited include:

- loans to directors or connected persons
- quasi-loans to directors or connected persons (a quasi-loan is a loan in all but name – readers should refer to **Appendix 11.1** for examples of quasi-loans)
- credit transactions where the company is a creditor for a director or connected person, and
- companies entering into guarantees or providing security in connection with any loan, quasi-loan or credit transaction to a director or person connected with a director.

However, while section 31 provides for a general prohibition of these transactions, the 1990 Act also contains a number of exceptions to the general prohibition whereby certain transactions can legally be entered into provided that certain criteria are satisfied.

#### The Exceptions

There are five exceptions to the general prohibition. They are:

- 1) Arrangements within 10% of Relevant Assets
- 2) Arrangements approved by a special resolution and accompanied by a statutory declaration
- 3) Arrangements between group companies
- 4) Directors' expenses, and
- 5) Business transactions.

However, as will be seen in the following sections and from the detailed guidance, the various exceptions do not all apply to the same categories of transactions. For example, certain of the exceptions do not apply to guarantees or the provision of security whereas other exceptions do not apply to loans, quasi-loans and credit transactions. For ease of reference, the applicability of each exception to the various relevant classes of transactions is summarised in **Appendix 11.2**.

#### *1. Arrangements within 10% of Relevant Assets (Section 5.4)*

This is the most commonly availed of exception to the general prohibition. It should be noted however that this exception applies only to loans, quasi-loans and credit transactions (defined in the legislation as 'arrangements'). It does not apply to guarantees or to the provision of security.

In order for this exception to be availed of, the aggregate of any loans, quasi-loans and credit transactions must not exceed 10% of the company's 'relevant assets'. If the directors of a company wish to avail of this exception it will be necessary for them to first ascertain the company's relevant assets. A company's relevant assets are:

- the net assets (i.e. total assets less total liabilities) of the company as per the most recent preceding balance sheet to have been laid before an annual general meeting (AGM) of the company, or
- where no preceding balance sheet has been laid before an AGM of the company, the company's called up share capital.

Once the relevant assets have been determined, the limit under this exception can be calculated by computing 10% of the relevant assets figure. For example, if a company's relevant assets are €250,000, this exception allows loans and similar arrangements with directors up to a limit of €25,000 (i.e. €250,000 x 10%).

Directors should note that in the event that they wish to avail of this exception, it will generally be essential to ensure that financial statements (which include a balance sheet) are regularly laid before an AGM of the company. This is because where a company has only a nominal called up share capital (e.g. €2), in the event that financial statements have not been laid before an AGM, 10% of the company's relevant assets will only be 20 cent.

It is possible that, while at the date the arrangement was entered into by the company the value of the arrangement (or aggregate arrangements) was less than 10% of the company's relevant assets, the value of the arrangement(s) can subsequently come to exceed 10% of the relevant assets for a variety of reasons including, for example, because the value of those assets has fallen.

Under such circumstances, the directors are required to amend the terms of the arrangement(s) thereby bringing the aggregate value of the arrangement(s) back to within the 10% limit within a period of two months of becoming aware, or when they ought reasonably have become aware, that such a situation exists. While failure to amend the terms within two months is not an offence, it does render the arrangement voidable at the instance of the company i.e. the company can choose to render the arrangement void. This is elaborated upon in Section 5.4.

### *2. Arrangements Approved by a Special Resolution and Accompanied by a Statutory Declaration (Section 5.5)*

This exception applies only to the provision by companies of guarantees and security in connection with loans, quasi-loans or credit transactions. It does not apply to the granting of loans, quasi-loans or credit transactions.

In order to avail of this exception, a company must satisfy a number of criteria, namely:

- the entering into the guarantee or security must be pre-approved by a special resolution of the company. In other words, 75% of the company's shareholders who vote must approve the transaction in advance.
- the special resolution must have been passed within 12 months of the entry into the transaction
- in advance of the shareholders' meeting at which the special resolution is to be considered, the directors must provide the shareholders with a statutory declaration which must, among other things, state:
  - the circumstances in which the guarantee or security is being entered into
  - the beneficiaries
  - the purpose of entering into the guarantee or security
  - the benefit that will accrue to the company, and

- that the directors are satisfied that, if the company enters into the proposed transaction, it will be able to pay its debts as they fall due, and
- the statutory declaration referred to above must be accompanied by a report (from an independent person who is qualified to act as the company's auditor) to the effect that, in that independent person's opinion, the statutory declaration is reasonable.

Where a company director makes a statutory declaration without having reasonable grounds for the opinion that the company will, having entered into the proposed transaction, be able to pay its debts as they fall due, that director may be held personally liable for the debts of the company.

### *3. Arrangements Between Group Companies (Section 5.6)*

Section 35 of the Companies Act, 1990 provides an exception to the general prohibition whereby a company is not prohibited from making a loan or quasi-loan to another company if that other company is its holding company, subsidiary or sister company<sup>2</sup> in circumstances where the transaction would otherwise be prohibited by virtue of the companies being connected. Similarly, a company is not prohibited from entering into a guarantee or providing security in connection with any loan or quasi-loan made to a company that is its holding company, subsidiary or sister company. Section 35 further provides an exception whereby credit transactions, and guarantees and securities in respect of credit transactions, can also be entered into with, and in respect of, other group companies.

However, before seeking to rely on this exception, it is important to ensure that the companies in question are in fact group companies. Section 5.6 and **Appendix 11.6** explain the requirements for a group in detail.

It should be noted that where two connected companies are not members of the same group, while they cannot avail of the exception set out above, they may be able to avail of another of the exceptions provided that the requisite criteria are satisfied e.g. it may be possible to avail of the 10% of relevant assets exception.

### *4. Directors' Expenses (Section 5.7)*

The general prohibition on loans and quasi-loans etc. does not prevent companies from providing company directors with funds to meet vouched

<sup>2</sup> Companies are sister companies if they are subsidiaries of the same holding company.

expenses provided that they have been, or are to be, properly incurred for the purposes of enabling the directors to discharge their duties as officers of the company.

However, where as a result of having received an advance of expenses, a director becomes indebted to the company i.e. where the expenses are not subsequently incurred, the director is required to reimburse the company within six months.

#### 5. Business Transactions (Section 5.8)

The general prohibition does not prevent a company from making a loan or quasi-loan or from entering into a credit transaction with a director (or person connected with a director) where the transaction is:

- in the ordinary course of the company's business, and
- the value of the transaction is not greater than that normally offered by the company.

It should be noted that this exception only applies to loans, quasi-loans and credit transactions. It does not apply to guarantees or securities.

#### The Consequences of Non-Compliance

While the purpose of this guidance is to assist directors and others to comply with their obligations under company law, the guidance would not present a complete picture were it not to deal with the consequences that can flow from non-compliance with the general prohibition contained in section 31 and related sections. This section provides a brief overview of the civil and criminal consequences that are provided for under the Companies Acts.

#### Civil Consequences of Breaches of the Prohibition (Section 6.0)

The following civil remedies are available where there is non-compliance with section 31 of the Companies Act, 1990

- Voidability and requirement to account for and indemnify (Section 6.1): Where a company enters into a transaction that is in breach of the prohibition, the company can render the transaction void i.e. the company can elect to cancel the transaction. Furthermore, any person who authorised the transaction is liable to account to the company for any gain made and reimburse the company for any loss suffered by it.
- Remedy orders (Section 6.2): If a company, or officer of a company (including a director), fails to comply with any requirement of the Companies Acts within 14 days of having been

served with a notice to comply, the High Court can make an order directing the company or officer to rectify the default.

- Imposition of personal liability (insolvent companies only) (Section 6.3): A person who benefits from a loan, quasi-loan or credit transaction can potentially be held personally liable for some or all of the company's debts if the company is being wound up and is unable to pay its debts and the court considers that the loan, quasi-loan or credit transaction has contributed materially to the company's inability to pay its debts.
- Restriction (insolvent companies only) (Section 6.4): The circumstances under which an individual may be restricted under the Companies Acts are dealt with in detail in Section 6.4. Where an individual is restricted, he or she may only act as director or secretary of a company during the following 5 years if that company meets certain minimum capitalisation requirements. These requirements are set out in Section 6.4.

#### Criminal Penalties for Breaches of Section 31 of the Companies Act, 1990 (Section 7.0)

Where a breach of the legal provisions of section 31 and related sections amounts to an offence, and that offence is prosecuted through the courts, the maximum penalties that can be imposed are as follows

- on summary conviction (i.e. in the District Court), a fine of €1,904 and/or 12 months imprisonment, and
- on conviction on indictment (i.e. in the Circuit Court), a fine of €12,697 and/or 5 years imprisonment.

## Part 3

### Auditors' Obligation to Report Suspected Indictable Offences (Section 8.0)

Company directors should be aware that auditors are required to report to the Office of the Director of Corporate Enforcement (ODCE) where they have formed the opinion that there are reasonable grounds for believing that the company, or an officer or agent of the company, has committed an indictable offence under the Companies Acts, including a suspected offence relating to a breach of the general prohibition on loans etc. to directors.

The detailed guidance sets out the circumstances in which auditors are required to report to the ODCE and details the type of information that may be sought from directors and auditors in the event that a report is required.

### Statutory and Other Disclosure Requirements

Companies' disclosure requirements are dealt with in the detailed guidance under the following headings

- Statutory disclosure requirements
- Special disclosure considerations relating to abridged financial statements
- Companies' disclosure requirements under accounting standards
- Auditors' obligations regarding companies' statutory disclosure requirements, and
- Directors' statutory disclosure requirements.

#### *1. Companies' Statutory Disclosure Requirements (Section 9.1)*

Directors are responsible under the Companies Acts for the preparation of their companies' financial statements (accounts). Companies that enter into transactions with directors, or persons connected with directors, are required by law to disclose certain information relating to those transactions in their financial statements. The information that must be disclosed is set out in the detailed guidance.

#### *2. Special Disclosure Considerations Relating to Abridged Financial Statements (Section 9.2)*

Every company, unless specifically exempted from doing so, is required to file certain information with the Companies Registration Office (CRO), including financial statements. When filing financial statements with the CRO, certain companies, dependent upon their size, can avail of exemptions whereby they can file abridged (i.e. summarised) rather than full financial statements.

Where a company is eligible to file abridged financial statements, the Companies Acts require a lesser degree of disclosure than would otherwise be the case. However, in certain circumstances, this reduced level of disclosure may not be sufficient for the financial statements to give a 'true and fair view' of the state of affairs of the company. Sections 9.1 and 9.2 deal with this matter in greater detail and provide guidance for directors as to when information above the minimum might require to be disclosed in a company's financial statements in order for them to give a true and fair view.

#### *3. Companies' Disclosure Requirements under Accounting Standards (Section 9.3 and Appendix 11.7)*

In addition to the financial statement disclosures required by law, directors are also required to prepare financial statements in accordance with accounting standards. Accounting standards represent best accountancy practice. Section 9.3, which should be read in conjunction with **Appendix 11.7**, sets out in detail the information relating to transactions with directors that must be disclosed under accounting standards.

#### *4. Auditors' Obligations Regarding Companies' Statutory Disclosure Requirements (Section 9.4)*

Where a company's financial statements do not provide all the disclosures required by law, auditors have certain obligations to include the required information in their audit reports.

#### *5. Directors' Statutory Disclosure Requirements (Section 9.5)*

In circumstances where a director has an interest (direct or indirect) in a contract (or proposed contract) with a company of which he/she is a director, that interest is required to be disclosed at a meeting of the directors of the company.

# Part 1

## SUBSTANTIAL PROPERTY TRANSACTIONS WITH DIRECTORS

## PART 1

### SUBSTANTIAL PROPERTY TRANSACTIONS WITH DIRECTORS

## 3.0 The Rules Governing Substantial Property Transactions with Directors

### 3.1 Section 29 Companies Act, 1990 - Requirement for Shareholders' Approval

Prior to February 1991, there was no mechanism whereby shareholders' approval was required in advance of substantial property transactions taking place between a company and its directors. In order to provide protection to shareholders against the abuse of power by a company's directors, section 29 of the Companies Act, 1990 provides that a company cannot enter into any arrangement with a director of the company, a director of the company's holding company, or a person connected<sup>3</sup> with such a director whereby

- a person referred to above acquires (or is to acquire) a non-cash asset<sup>4</sup> from the company, or
- the company acquires (or is to acquire) a non-cash asset from a person referred to above,

unless the arrangement is first approved by a resolution passed at a meeting of the company's shareholders. (If the director or connected person is a director of the company's holding company or a person connected with such a director, approval by a resolution in general meeting of the holding company is also required). However, the requirement for pre-approval only applies where the value of the asset(s) (as opposed to the actual purchase or selling price) is equal to or greater than €1,270 and exceeds the lesser of €63,487 or 10% of the company's relevant assets (the meaning of 'relevant assets' is explained in detail in section 5.4 of this guidance).

### 3.2 Civil Consequences of a Breach of Section 29

A transaction entered into in contravention of the above requirement is generally voidable at the instance of the company i.e. the company can cancel

the transaction (without any time limit), unless

- restitution of any money or any other asset which is the subject matter of the arrangement or transaction is no longer possible or the company has been indemnified by another person for the loss or damage suffered by it, or
- a person (other than the person for whom the transaction or arrangement was made) legitimately acquired rights which would be affected by voiding the transaction or arrangement, where they were acquired for value and without actual notice of the contravention, or
- the arrangement is, within a reasonable period, affirmed by the company in general meeting and, if it is an arrangement for the transfer of an asset to or by a director of its holding company or a person who is connected with such a director, is so affirmed with the approval of the holding company given by a resolution in a general meeting.<sup>5</sup>

Where an arrangement which breaches section 29 is entered into by a director or a person connected with a director, that director or connected person as well as any other director of the company who authorised the arrangement is liable to

- account to the company for any gain made directly or indirectly as a result of the arrangement, and
- indemnify (reimburse) the company for any loss or damage suffered as a result of the arrangement

unless

- the director can show that s/he took all reasonable steps to secure the company's compliance with the section, or
- the connected person can show that, at the time the arrangement was entered into, s/he did not know that the arrangement constituted a breach of the section<sup>6</sup>.

It should be noted that a director's liability as set out above continues to exist irrespective of whether or not the company has elected to void the transaction.

<sup>3</sup> The term 'connected person' is dealt with in detail in Section 5.2 of this guidance.

<sup>4</sup> A 'non-cash asset' is defined by section 29(9) Companies Act, 1990 as meaning any property or interest in property, other than cash. Any reference to the acquisition of a non-cash asset includes a reference to the creation or extinction of an estate or interest in, or right of way over, any property. Property in this context includes personal property such as, for example, shares.

<sup>5</sup> Section 29(3)(a),(b) and (c) Companies Act, 1990

<sup>6</sup> Section 29(5) Companies Act, 1990

## 4.0 Section 30 Companies Act, 1990 – Prohibition on Directors’ Dealings in Options to Trade Certain Shares and Debentures

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Section 30 of the Companies Act, 1990 makes it a criminal offence for directors (or persons acting on behalf of, or at the instigation of, directors) to deal in options to buy or sell ‘relevant’ shares or debentures<sup>7</sup>. The purpose of the section, which does not apply to private companies, is to ban speculative dealing in the shares of quoted companies by persons in possession of inside information.

An option to buy is a right to call for delivery of a specified number of shares or debentures at a specified price and within a specified time.

An option to sell is a right to make delivery of a specified number of shares or debentures at a specified price and within a specified time.

Relevant shares are defined as shares in the company, its subsidiaries, its holding company and its sister companies<sup>8</sup> and in respect of which dealing facilities are provided by a Stock Exchange (either in the State or elsewhere).

Relevant debentures are defined as debentures in the company, its subsidiaries, its holding company and its sister companies and in respect of which dealing facilities are provided by a Stock Exchange (either in the State or elsewhere).

The foregoing provision does not penalise a person who

- buys a right to subscribe for shares in, or debentures of, a company, or
- buys debentures that confer a right to subscribe for, or convert the debentures into, shares of the company<sup>9</sup>.

Section 30 was amended by section 102 of the Company Law Enforcement Act, 2001 to ensure that nothing in the foregoing will prevent a person from acquiring a right to shares in a company under a Revenue approved savings related share option scheme<sup>10</sup>.

The maximum penalty on summary conviction (i.e. in the District Court) is €1,904 and/or 12 months imprisonment. On conviction on indictment (i.e. in the Circuit Court), the maximum penalty is €12,697 and/or 5 years imprisonment<sup>11</sup>.

<sup>7</sup> Section 30(5) Companies Act, 1990

<sup>8</sup> The term sister companies refers to companies that are subsidiaries of the same holding company.

<sup>9</sup> Section 30(3) Companies Act, 1990

<sup>10</sup> Section 30(3A) Companies Act, 1990

<sup>11</sup> Section 240 Companies Act, 1990



# Part 2

## LOANS AND SIMILAR TRANSACTIONS INVOLVING DIRECTORS

## 5.0 Loans and Similar Transactions Involving Directors

### 5.1 The General Prohibition on Loans and Similar Transactions

Company directors occupy a special position *vis-à-vis* the companies of which they are directors. Without regulation, directors could potentially enter into transactions with their companies which would result in them placing their interests before those of the company, its shareholders and/or its creditors.

Prior to February 1991, there was no prohibition on companies extending loans to their directors<sup>12</sup>. As a result, directors could take loans from their companies (or, for example, have personal loans guaranteed by the company) to the potential detriment of the interests of companies' creditors.

Section 31 of the Companies Act, 1990 introduced a series of provisions designed to provide protection for creditors by prohibiting the making of loans by a company to that company's directors<sup>13</sup> (or directors of the company's holding company), or to persons connected<sup>14</sup> with the directors, subject to a number of exceptions.

In addition to the giving of loans, the general prohibition also extends to:

- companies making quasi-loans (i.e. loans in all but name) to directors (or persons connected with directors). The concept of a quasi-loan may be best explained by way of practical example. To that end, **Appendix 11.1** contains some examples of quasi-loans for illustrative purposes.
- companies entering into credit transactions as a creditor for directors (or persons connected with directors).<sup>15</sup>

<sup>12</sup> There was however, an obligation to disclose details of any such loans in the company's financial statements.

<sup>13</sup> The general prohibition set out in section 31 also applies to 'shadow directors'. A 'shadow director' is defined by section 27 of the Companies Act, 1990 as 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act'. For the purposes of transactions with directors, a shadow director is treated as though they are a director of the company (unless the directors are acting on advice given by that person in a professional capacity).

<sup>14</sup> The term 'connected persons' is dealt with in detail in Section 5.2 of this guidance.

<sup>15</sup> The term credit transaction is defined in section 25(3) of the Companies Act, 1990 as being 'a transaction under which one party ("the creditor"):

- (a) supplies any goods or sells any land under a hire-purchase agreement or conditional sale agreement;
- (b) leases or licenses the use of any land or hires goods in return for periodical payments;
- (c) otherwise disposes of land or supplies goods or services on the understanding that payment (whether in a lump-sum or instalments or by way of periodical payments or otherwise) is to be deferred.'

- companies entering into guarantees or providing any security in connection with any loan, quasi-loan or credit transaction made by another person to a director (or persons connected with directors)
- companies accepting the assignment to them of any rights, obligations or liabilities, which if they had been entered into by the company, would have been covered by the general prohibition, and
- situations where a person, in exchange for obtaining a benefit from the company, a subsidiary of the company, the holding company of the company or a sister company<sup>16</sup> of the company, enters into a transaction which, had it been entered into by the company, would have been covered by the general prohibition.

### 5.2 Connected Persons

The term 'connected person' is defined in section 26 of the Companies Act, 1990. In general, a person is connected with a director of a company if he or she is a near relative (including spouse) of the director, is in business partnership with the director or if he or she acts as trustee for a trust the principal beneficiaries of which are the director, near relatives (including spouse) of the director or any body corporate<sup>17</sup> which the director controls. A body corporate is also deemed to be connected with a director if it is controlled by that director<sup>18</sup>. Furthermore, it is presumed that the sole member of a single member company is connected with a director of that company<sup>19</sup>.

### 5.3 The Exceptions to the General Prohibition

As referred to above, there are a number of exceptions to the general prohibition and these are dealt with below. However, as will be seen in the following sections, the various exceptions do not all apply to the same categories of transactions. For example, certain of the exceptions do not apply to

Given that the definition specifically refers to situations where there is 'the understanding that payment...is to be deferred', trading balances arising in the ordinary course of business can constitute credit agreements where there is an understanding that payment will be deferred. In that context, readers should also refer to Section 5.8 for an elaboration on the term 'ordinary course of business' and the exception provided for in relation to same.

<sup>16</sup> The term 'sister' companies refers to companies that are subsidiaries of the same holding company.

<sup>17</sup> The term 'body corporate' is wider than a company as defined in the Companies Act and includes, for example, a company incorporated outside the State.

<sup>18</sup> A director of a company shall be deemed to control a body corporate where he or she, either alone or together with any other director or directors of the company, or any persons connected with the director or such other director or directors, are interested in 50% or more of the equity share capital of that body or are entitled to exercise or control the exercise of 50% or more of the voting power at any general meeting of that body.

<sup>19</sup> See ODCE Decision Notice D/2002/1 Information Book 1 for further information on single member private limited companies. Decision Notice D/2002/1 is available at [www.odce.ie/publications/decision.asp](http://www.odce.ie/publications/decision.asp).

guarantees or the provision of security whereas other exceptions do not apply to loans, quasi-loans and credit transactions. For ease of reference, the applicability of each exception to the various relevant classes of transactions is summarised in **Appendix 11.2**.

On a cautionary note, where a company is in a position to avail of one of the exceptions set out below, it will be prudent to ensure that the company has the legal capacity to enter into the proposed transaction or arrangement. Whether or not a company will have this capacity will be determined by the terms of its Memorandum and Articles of Association<sup>20</sup>.

While the legislation does provide a number of exceptions to the general prohibition, readers should note that failure to comply with the terms of an exception constitutes a breach of section 31 irrespective of the magnitude of the amount involved or the duration of the period during which the terms of the exception were not complied with.

## 5.4 Exception 1: Arrangements within 10% of 'Relevant Assets'

Notwithstanding the general prohibition, a company is permitted to enter into an arrangement (i.e. loan, quasi-loan or credit transaction as creditor)<sup>21</sup> with a director of the company, or a person connected with a director of the company provided that, at the time the arrangement is entered into, the aggregate value of the arrangement, together with any other such arrangements already in place, does not exceed 10% of the company's 'relevant assets'<sup>22</sup>. Readers should note that this exception does not apply to guarantees or to the giving of security. Moreover, the exception does not apply to loans, quasi-loans or credit transactions with a director of the company's holding company or with a person connected with a director of the company's holding company.

For the purposes of this exception, a company's 'relevant assets'<sup>23</sup> are calculated as follows:

- by reference to the net assets<sup>24</sup> of the company as shown in the last (if any) preceding financial statements to have been laid before an Annual General Meeting of the company, or
- in the event that no financial statements have been laid before an Annual General Meeting of the company in respect of a preceding year, the called up share capital of the company.

Directors should note that, in the event that they wish to avail of this exception, it will generally be essential to ensure that financial statements are regularly laid before an AGM of the company. This is because where a company has only a nominal called up share capital (e.g. €2), in the event that financial statements have not been laid before an AGM, 10% of the company's relevant assets will only be 20 cent (i.e. €2 x 10%). For illustrative purposes, examples of how a company's relevant assets are calculated are set out in **Appendix 11.3**.

Directors are advised that, where they wish to avail of this exception, they should ensure that they make themselves aware of the value of 10% of the company's relevant assets at the time the transaction is being considered. This is because any officer of a company who authorises or permits a company to enter into an arrangement knowing, or having reasonable cause to believe, that the company in entering into the arrangement is contravening the general prohibition is guilty of an offence<sup>25</sup>.

It is possible that, while at the date the arrangement was entered into by the company the value of the arrangement (or aggregate arrangements) was less than 10% of the company's relevant assets, the value of the arrangement(s) can subsequently come to exceed 10% of the relevant assets for a variety of reasons including, for example, because of a fall in the value of those assets.

Under such circumstances, the directors are required to amend the terms of the arrangement(s) thereby bringing the aggregate value of the arrangement(s) back to within the 10% limit within a period of two months of becoming aware, or when they ought reasonably have become aware, that such a situation exists<sup>26</sup>. While failure to amend the terms within two months is not an offence, it does render the arrangement voidable at the instance of the company i.e. the company can choose to render the arrangement void<sup>27</sup>. This point is illustrated by way of an example at **Appendix 11.4**.

In circumstances where the aggregate value of arrangements comes to exceed 10% of the company's relevant assets, it is recommended that directors should seek professional accountancy and/or legal advice in a prompt manner and prior to deciding on the most appropriate course of action to bring the aggregate of the arrangements back to within the 10% limit. This is because some of the methods by which the terms might be amended could potentially give rise to taxation or other implications.

20 The Memorandum and Articles of Association form the constitution of the company and are dealt with in more detail in ODCE Decision Notice D/2002/1 Information Book 1 - Companies.

21 The term 'arrangement' is defined in section 32(2) Companies Act, 1990.

22 Section 32 Companies Act, 1990.

23 The term 'relevant assets' is defined in section 29(2) Companies Act, 1990.

24 The value of a company's net assets is the aggregate of its assets less the aggregate of its liabilities (including any provisions for liabilities or charges).

25 Section 40, Companies Act, 1990.

26 Section 33(2) Companies Act, 1990.

27 Section 33(3) Companies Act, 1990.

## 5.5 Exception 2: Arrangements Approved by a Special Resolution and Accompanied by a Statutory Declaration<sup>28</sup>

A company is permitted to enter into a guarantee or to provide security in connection with a loan, quasi-loan or credit transaction<sup>29</sup> where

- the entering into the guarantee or the provision of the security has been approved by a special resolution<sup>30</sup> of the company, and
- the special resolution has been passed within the preceding 12 months, and
- the company has, with each notification of the meeting at which the special resolution is to be considered, provided each member with a copy of a statutory declaration satisfying all of the following criteria
  - the declaration must be made at a meeting of the directors
  - that abovementioned directors' meeting must take place within 24 days of the meeting at which the special resolution is to be considered by the members
  - the declaration must be made by the directors, or in the case of a company with more than two directors, a majority of the directors, and
  - the declaration must state<sup>31</sup>
    - the circumstances in which the guarantee is to be entered into or the security is to be provided
    - the nature of the guarantee or security
    - the person(s) to or for whom the loan, quasi-loan or credit transaction (in connection with which the guarantee is to be entered into or the security is to be provided) is to be made
    - the purpose for which the company is entering into the guarantee or providing the security
    - the benefit that will accrue to the company directly or indirectly

from entering into the guarantee or providing the security, and

- that the directors making the declaration have made a full inquiry into the affairs of the company and, having done so, have formed the opinion that the company, having entered into the guarantee or provided the security, will be able to pay its debts in full as they fall due, and
- within 21 days of entering into the guarantee or providing the security, a copy of the statutory declaration is furnished to the Registrar of Companies for registration (upon registration the statutory declaration becomes a public document).

It should however be noted that the statutory declaration referred to above has no effect unless it is accompanied by a report drawn up by an independent person who is qualified at the time of the report to act as the company's auditor. The independent report must state whether, in the opinion of the independent person, the statutory declaration is reasonable.<sup>32</sup> The report of the independent person must be in the form prescribed by Statutory Instrument (S.I.) 439 of 2001. The text of the S.I. is reproduced in **Appendix 11.5** for ease of reference<sup>33</sup>.

In the context of the foregoing, readers should note that the relevant accountancy bodies comprising the Consultative Committee of Accountancy Bodies – Ireland (CCAB-I)<sup>34</sup>, having sought legal advice on this matter, have advised their members not to sign these reports on the basis that the directors' opinion is in relation to all current and future debts and is without limitation in time. The CCAB-I considers that directors will be unable to substantiate such an opinion and, as a result, auditors will be unable to judge the reasonableness of that opinion. Consequently, directors seeking to avail of this exemption are advised to discuss the matter with their auditors in advance.

It should be noted that where a director makes a statutory declaration without having reasonable grounds for the opinion that the company, having entered into the guarantee or provided the security, will be able to pay its debts as they fall due, the High Court may declare that the director be held personally liable, without limitation of liability, for the debts and other liabilities of the company.

<sup>28</sup> Section 34 Companies Act, 1990.

<sup>29</sup> This exemption applies only to the provision of guarantees and securities. It does not apply to loans, quasi-loans or credit transactions.

<sup>30</sup> A special resolution requires a qualified majority of 75% to be passed. A qualified majority of 75% means 75% of the votes cast.

<sup>31</sup> Section 34(3) Companies Act, 1990

<sup>32</sup> Section 34(4) Companies Act, 1990

<sup>33</sup> Further copies of the S.I. can be obtained at [www.irishstatutebook.ie/ZZSI439Y2001.html](http://www.irishstatutebook.ie/ZZSI439Y2001.html)

<sup>34</sup> The member Bodies of CCAB-I whose members are eligible to act as auditors are the Institute of Chartered Accountants in Ireland (ICAI), the Association of Chartered Certified Accountants (ACCA) and the Institute of Certified Public Accountants in Ireland (ICPAI).

Moreover, if the company is wound up within 12 months of the making of the statutory declaration, and the company's debts have not been fully paid or provided for within 12 months of the commencement of the winding up, it is presumed, unless the contrary is shown, that the director did not have reasonable grounds for his/her opinion.

As indicated earlier, the passing of a special resolution<sup>35</sup> requires a majority of 75% of those members voting. However, unless all of the members entitled to vote at general meetings vote in favour of the resolution, the company must allow a period of 30 days to elapse before it can enter into the proposed guarantee or security.

In circumstances where not all of the members entitled to vote at general meetings voted for the approved special resolution, holders of not less than 10% of the nominal value of the company's issued share capital, or any class of issued share capital, can apply to the High Court to have the special resolution cancelled. Any such application must be made within 28 days of the date on which the special resolution was passed<sup>36</sup>.

## 5.6 Exception 3: Arrangements Between Group Companies<sup>37</sup>

Section 35 of the Companies Act, 1990, as originally enacted, provided that the general prohibition as set out in section 31 did not prohibit a company from making a loan or quasi-loan to its holding company or from entering into a credit transaction for its holding company or from providing any security or guarantee for its holding company i.e. in cases where this type of transaction would otherwise be prohibited by section 31 by virtue of the companies being connected through a director or person connected with a director. However, while the original section 35 allowed subsidiaries to make loans etc. to their holding companies, it did not permit the making of loans etc. by holding companies to their subsidiaries or by subsidiaries to other subsidiaries i.e. sister companies. This anomaly was addressed by section 79 of the Company Law Enforcement Act, 2001, which by amending section 35 of the 1990 Act, now also exempts loans etc. by holding companies to their subsidiaries and by subsidiaries to their sister companies from the general prohibition set down in section 31.

However, before seeking to rely on the exception provided for in the amended section 35, it is of vital importance that the 'group' as constituted actually qualifies as a group under the Companies Acts. To

that end, the terms 'subsidiary' and 'holding company' are defined in section 155 of the Companies Act, 1963.

Under section 155(1)(a), a company is a subsidiary of another company if, but only if, the holding company

- is a member of the subsidiary and controls the composition of its board of directors, or
- holds more than half, in nominal value, of the equity share capital of the subsidiary, or
- holds more than half, in nominal value, of those shares carrying voting rights (other than voting rights which arise in specified circumstances only).

A company is also a subsidiary of the holding company if it is a subsidiary of a subsidiary of the holding company i.e. a sub-subsidiary<sup>38</sup>.

Similarly, under section 155(4), a company shall be deemed to be another's holding company if, but only if, the other is its subsidiary.

It is also worth noting that, while the term company generally applies only to companies formed under the Companies Acts, section 155(5) provides that, for the purposes of that section, a company is 'any body corporate'. Accordingly, companies formed outside the State can also be holding companies and subsidiaries of companies formed under the Irish Companies Acts.

When determining whether a particular structure of companies is actually a 'group' for the purposes of section 155, it is important to appreciate the distinction between section 155 and the provisions of the European Communities (Companies: Group Accounts) Regulations, 1992 (referred to hereafter as the 'GAR').

The GAR set out the circumstances under which group (i.e. consolidated) financial statements (accounts) must be prepared. In that context, under the GAR the circumstances under which group accounts must be prepared extend beyond a group as constituted under section 155<sup>39</sup>. Therefore, under certain circumstances e.g. where a 'control contract'<sup>40</sup> is in existence, group accounts must be prepared notwithstanding the fact that the company structure in place does not qualify as a group under section 155. **Appendix 11.6** sets out an illustrative example of circumstances where a company, while required to prepare group accounts under the GAR, is not entitled

<sup>35</sup> A special resolution for this purposes can be passed in accordance with section 141(8) of the Companies Act, 1963 (as provided for by section 34(6) Companies Act, 1990). While a special resolution is ordinarily required to be passed at a duly convened and held general meeting of the company, under section 141(8) Companies Act, 1963, in any case in which a company is authorised by its Articles of Association, a resolution in writing signed by all of the members entitled to attend and vote on such a resolution at a general meeting shall be valid as if it had been passed at a duly convened and held general meeting of the company.

<sup>36</sup> Section 34(8)-(11) Companies Act, 1990

<sup>37</sup> Section 35 Companies Act, 1990 as amended by section 79 of the Company Law Enforcement Act, 2001

<sup>38</sup> Section 155(1)(b) Companies Act, 1963

<sup>39</sup> See also Financial Reporting Standard 2 (FRS 2) 'Accounting for Subsidiary Undertakings' as published by the Accounting Standards Board.

<sup>40</sup> See Appendix 11.6 for elaboration of what constitutes a 'group' for the purposes of the Companies Acts

to avail of group exemption from the general prohibition as provided for by section 35 as the criteria for a group under the Companies Acts are not satisfied.

### 5.7 Exception 4: Directors' Expenses<sup>41</sup>

The general prohibition as set out in section 31 does not preclude companies from doing anything to provide any of the directors with funds to meet vouched expenses properly incurred, or to be incurred, for the purposes of the company or for the purposes of enabling a director to perform his/her duties as an officer of the company.

However, where as a result of receiving an advance in respect of expenses to be incurred, a director becomes indebted to the company (e.g. where the aggregate of vouched expenses amounts to less than the amount advanced), any such debt must be repaid within 6 months. Failure to do so is an offence<sup>42</sup>.

The section grants an exemption in respect of situations where, for example, a company guarantees a director's credit card expenditure or loans a director funds to discharge his/her expenses and is only of application under such circumstances. Where the company pays for a director's expenses and no liability to repay arises (as would be normal commercial practice), this is not a loan and the general prohibition does not apply in the first instance.

### 5.8 Exception 5: Business Transactions

The general prohibition does not preclude a company from making a loan or quasi-loan or from entering into a credit transaction as a creditor if the company enters into the transaction in the ordinary course of its business and the value of the transaction is not greater (and the terms on which it is entered into are no more favourable) than that which the company normally offers (or is reasonable to expect the company to have offered) to an unconnected person of the same financial standing.<sup>43</sup>

The term 'ordinary course of its business' is not elaborated upon. However, it is generally accepted to apply to companies such as banks and financial institutions whose normal business includes the granting of loans. Similarly, a director of a company (or a person connected with such a director) might also be a trade debtor of the company in respect of credit sales of goods and services to that person by the company under normal trading conditions.

It should be noted however that in order to qualify for exemption under section 37, the value of the transactions would have to be no greater (and the terms on which they are entered into no more favourable e.g. the terms of credit) than that which the company normally offers.

It should be noted that this exception only applies to loans, quasi-loans and credit transactions. It does not apply to guarantees or securities.

<sup>41</sup> Section 36 Companies Act, 1990

<sup>42</sup> Section 36(3) Companies Act, 1990

<sup>43</sup> Section 37 Companies Act, 1990

## 6.0 Civil Consequences of Breaches of the Prohibition

### 6.1 Voidability and the Requirement to Account For and Indemnify<sup>44</sup>

Where a company enters into a transaction or arrangement that is in breach of the prohibition, the transaction or arrangement is voidable at the instance of the company i.e. the company can generally cancel the transaction or arrangement unless

- restitution of the money or any other asset which is the subject matter of the arrangement or transaction is no longer possible, or the company has been indemnified for the loss or damage suffered by it, or
- a person (other than the person for whom the transaction or arrangement was made) legitimately acquired rights which would be affected by voiding the transaction or arrangement, where they were acquired for value and without actual notice of the contravention.

Moreover, the director, the person connected with the director or any other director who authorised the transaction or arrangement is liable to

- account to the company for any gain made directly or indirectly as a result of the transaction or arrangement, and
- indemnify (reimburse) the company for any loss or damage suffered as a result of the transaction or arrangement,

unless

- the director can show that s/he took all reasonable steps to secure the company's compliance with the requirements, or
- a connected person or any other director involved can show that, at the time the transaction or arrangement was entered into, s/he did not know that the prohibition was being breached.

It should be noted that the question of whether the company is solvent or insolvent (i.e. unable to pay its debts as they fall due) is not relevant in this case – this civil consequence applies in either scenario.

### 6.2 Remedy Orders

Section 371 of the Companies Act, 1963 (as amended) provides that if a company or an officer of a company who has failed to comply with any provision of the Acts fails to rectify the default

within 14 days of having been served with a notice to comply, the High Court can, on the application of the Director of Corporate Enforcement (or the Registrar of Companies or any member of the company), make an order directing the company, or any officer of the company, to rectify the default.

In the context of the general prohibition, the Director of Corporate Enforcement can serve a notice on a company, or officer of a company, compelling the rectification of any breach of section 31. Failure to comply with such a notice within the prescribed 14 day period may result in the Director making an application to the High Court. It should be noted that where the High Court makes such an order it can provide that the costs of the application shall be borne by the company or any officer of the company responsible for the default.<sup>45</sup>

### 6.3 Insolvent Companies - Imposition of Personal Liability

An individual who benefits from an arrangement (i.e. a loan, quasi-loan or credit transaction) from a company can potentially be held personally liable for some or all of the company's debts and liabilities if

- the company is being wound up and is unable to pay its debts, and
- the Court considers that the arrangement has contributed materially to the company's inability to pay its debts or has substantially impeded the orderly winding up of the company<sup>46</sup>.

In deciding whether to make a declaration of personal liability, the Court must have regard to whether, and to what extent, any outstanding liabilities arising under the arrangement were discharged before the commencement of the winding up<sup>47</sup>. Moreover, in deciding the extent of any personal liability the Court must have particular regard to the extent to which the arrangement in question contributed materially to the company's inability to pay its debts or substantially impeded the orderly winding up of the company.<sup>48</sup>

### 6.4 Insolvent Companies - Restriction

Since the enactment of the Company Law Enforcement Act, 2001, liquidators appointed to insolvent<sup>49</sup> companies are required to report on certain matters to the Director of Corporate Enforcement<sup>50</sup>. In making their reports, liquidators are required, *inter alia*, to form an opinion as to whether the directors of the company acted honestly and responsibly in advance of the insolvency occurring. In forming their opinion, liquidators will have regard to all available information, including the presence of

44 Section 38 Companies Act, 1990  
45 Section 371(2) Companies Act, 1963  
46 Section 39(1) Companies Act, 1990  
47 Section 39(2) Companies Act, 1990

48 Section 39(3) Companies Act, 1990  
49 A company is insolvent if it cannot pay its debts as they fall due.  
50 Section 56, Company Law Enforcement Act, 2001

any unlawful loans or other arrangements to directors or persons connected to directors and whether or not those unlawful loans or other arrangements contributed to the company's inability to pay its debts.

Having reported to the Director of Corporate Enforcement, liquidators are required to apply to the High Court for the restriction of the company's directors unless the Director of Corporate Enforcement has specifically relieved the liquidator in question from doing so. The Director will only grant relief where he is satisfied, on the basis of the information available, that the director(s) acted honestly and responsibly. Where relief is not granted, the liquidator must make an application for restriction against the director(s) within the prescribed timeframe<sup>51</sup>.

Similarly, where a company is insolvent but is not in liquidation, the Director of Corporate Enforcement is empowered to examine the circumstances leading to the insolvency and, if he deems it to be appropriate, can seek the restriction of the company's directors<sup>52</sup>.

An individual restricted by the courts cannot, for a period of five years from the date of restriction, act as a company director or company secretary, or be concerned or take part in the promotion or formation of any company, unless the company in question satisfies certain minimum capitalisation requirements<sup>53</sup>. The Director has published a number of other documents that provide additional information on restriction and liquidators' duty to report<sup>54</sup>.

Dependent upon the liquidator's findings, together with any other information available, the Director may take the view that an application for restriction is insufficient given the behaviour of a particular director or directors. Under such circumstances, the Director may elect to pursue other enforcement options e.g. to apply to the High Court to have an individual disqualified from acting as a company director/secretary<sup>55</sup> or to initiate criminal proceedings. It should be noted that an order for disqualification can be granted in circumstances other than where the company is insolvent.

## 7.0 Criminal Penalties for Breaches of Section 31 of the Companies Act, 1990

An officer of a company who authorises or permits the company to enter into a transaction or arrangement knowing, or having reasonable cause to believe, that the company was thereby contravening the prohibition is guilty of an offence<sup>56</sup>. Similarly, a person who procures a company to enter into a transaction or arrangement knowing, or having reasonable cause to believe, that the company was thereby breaching the prohibition is also guilty of an offence<sup>57</sup>.

The maximum penalty on summary conviction (i.e. in the District Court) is €1,904 and/or 12 months imprisonment. On conviction on indictment (i.e. in the Circuit Court), the maximum penalty is €12,697 and/or 5 years imprisonment<sup>58</sup>.

In view of the civil and criminal penalties that apply to breaches of these provisions, company directors and secretaries are strongly advised to seek professional advice prior to entering, or authorising their companies to enter, into transactions of this nature.

51 The application must be made by the liquidator not earlier than three months and not later than five months after the liquidator has provided his report to the Director of Corporate Enforcement (section 56(2) Company Law Enforcement Act, 2001).

52 Section 251 Companies Act, 1990

53 In the case of a private company the minimum called up share capital must be €63,487 and in the case of a public limited company (plc) the minimum called up share capital must be €317,435. In both cases, the called up share capital must have been paid for in cash.

54 Company directors should refer to ODCE Decision Notice D/2002/1 Information Books 1 (Companies), 2 (Company Directors) and 7 (Liquidators, Receivers and Examiners) respectively. Liquidators wishing to obtain further information should refer to the aforementioned documents and also to ODCE Decision Notice D/2002/3 – 'The Liquidation-Related Functions of the Director of Corporate Enforcement' and ODCE Decision Notice D/2003/1 – 'The Liquidation-Related Functions of the Director of Corporate Enforcement –

Further Commencement of Section 56 of the Company Law Enforcement Act, 2001'. These documents are available free of charge from the ODCE and can also be downloaded from the ODCE website at [www.odce.ie/publications/decision.asp](http://www.odce.ie/publications/decision.asp).

55 Where an individual is disqualified, that person is precluded from acting as a company director, company secretary, auditor, liquidator or receiver for a period of 5 years (or for such other period as the Court sees fit). A disqualified person is also precluded from taking part in the formation or management of any company, whether directly or indirectly.

56 Section 40(1) Companies Act, 1990

57 Section 40(2) Companies Act, 1990

58 Section 240 Companies Act, 1990

# Part 3

**REPORTING, DISCLOSURE AND OTHER MATTERS**

## 8.0 Auditors' Obligation to Report Suspected Indictable Offences

### 8.1 Auditors' Reporting Obligations

Company directors and other officers should be aware that auditors who, in the course of their audit, form the opinion that there are reasonable grounds for believing that the company, or an officer or agent of the company, has committed an indictable offence under the Companies Acts are required to report that opinion to the Director of Corporate Enforcement<sup>59</sup>.

In the context of the general prohibition as set out in section 31, section 40 of the Companies Act, 1990 states that

- (1) *An officer of a company who authorises or permits the company to enter into a transaction or arrangement knowing or having reasonable cause to believe that the company was thereby contravening section 31 shall be guilty of an offence.*
- (2) *A person who procures a company to enter into a transaction or arrangement knowing or having reasonable cause to believe that the company was thereby contravening section 31 shall be guilty of an offence.*

The final determination as to whether

- an officer authorising or permitting a transaction or arrangement, or
- a person procuring a company to enter into a transaction or arrangement

knew, or had reasonable cause to believe, that the company was thereby contravening section 31 is a matter upon which only the Courts are competent to adjudicate. However, the auditor must, upon becoming aware that there has been a contravention of the general prohibition, form an opinion as to whether there exists an obligation to report to the ODCE i.e. whether there are reasonable grounds for believing that an indictable offence has been committed by the company, or an officer or an agent of the company.

As a prerequisite to forming that opinion, the auditor must first form an opinion as to whether there are reasonable grounds for believing that the criteria as set out in section 40 have been satisfied i.e. an opinion as to whether the

- officer(s) of the company who authorised or permitted the company to enter into the transaction or arrangement, or
- person(s) who procured the company to enter into the transaction or arrangement

knew or had reasonable cause to believe that the company was thereby contravening section 31.

In forming their opinion on this matter, auditors would be expected, *inter alia*, to

- discuss the matter with the directors and any other relevant persons
- review relevant correspondence and other documents that might pertain to the matter including, for example
  - previous management letters to the client and the client's replies thereto
  - previous letters of representation received from the client, and
  - any notes of previous discussions with the client on matters relating to the transaction or arrangement in question or to previous transactions or arrangements of a similar nature
- assess the directors' *bona fides* with regard to the matter, and
- exercise their professional judgement.

While there is no obligation to do so, auditors may also wish to seek legal advice, or the advice of their professional body, as part of the process of forming their opinion.

Where, having conducted the enquiries and performed the procedures deemed necessary, the auditor forms the opinion that the officer(s)/persons(s) did authorise, permit or procure the transaction knowing or having reasonable cause to believe that the company was thereby contravening section 31, the matter must be reported to the ODCE immediately. Under such

<sup>59</sup> Section 194(5) Companies Act, 1990 as amended by section 74 of the Company Law Enforcement Act, 2001.

circumstances, failure on the part of the auditor to report immediately is itself an indictable offence<sup>60</sup>. Moreover, in the event that an auditor's professional body detects a failure to report as a result of, for example, a subsequent monitoring visit, that body may be required to report the matter to the ODCE<sup>61</sup>.

Where, having conducted the enquiries and performed the procedures deemed necessary, the auditor forms the opinion that the officer(s)/persons(s) did not authorise, permit or procure the transaction knowing or having reasonable cause to believe that the company was thereby contravening section 31, there is no legal requirement to report to the ODCE. However, under such circumstances the auditor should ensure that the basis for forming that opinion is fully documented and capable of being justified should the need arise subsequently e.g. in the context of a professional body monitoring visit or where the ODCE challenges the decision not to report on the basis of other information available to it.

Where the opinion is formed that there is no legal requirement to report the matter to the ODCE, auditors should consider whether the matter is one that ought to be reported to a proper authority in the public interest and, where this is the case, they should discuss the matter with the board of directors.<sup>62</sup>

In circumstances where the auditor is unable to form an opinion as to whether the officer(s)/person(s) authorised, permitted or procured the transaction or arrangement knowing or having reasonable cause to believe that the company was thereby contravening section 31, the Director of Corporate Enforcement is of the view that auditors should, in the interests of prudence, report the matter to the ODCE.

Irrespective of whether or not the auditor forms the opinion that the officer(s)/person(s) authorised, permitted or procured the transaction knowing or having reasonable cause to believe that the company would thereby contravene section 31, upon first becoming aware of a suspected breach, certain of the auditor's obligations under Statement of Auditing Standards (SAS) 120 'Consideration of Law and Regulations' are activated<sup>63</sup>.

- SAS 120.6 requires 'When the auditors become aware of or suspect that there may be non-compliance with law or regulations, they should document their findings and, subject to any requirement to report to a third party, discuss them with the appropriate level of management.'

Obviously, given the nature of the subject matter i.e. directly involving directors or officers of the company, the appropriate level of management will usually be the board of directors.

- In the context of reporting non-compliance with law or regulations, SAS 120.8 goes on to require that 'The auditors should, as soon as practicable...either (a) communicate with management, the board or the audit committee, or (b) obtain evidence that they are appropriately informed, regarding any suspected or actual non-compliance with law or regulations that comes to auditors' attention.'
- SAS 120.9 further provides that 'If, in the auditors' judgement, the suspected or actual non-compliance is material or is believed to be intentional, the auditors should communicate the finding without delay'. Accordingly, in the case of a loan that exceeds 10% of a company's net assets, given that such a loan might ordinarily be considered material in the context of the financial statements, the matter will require immediate communication to the directors.

Clearly, any amounts drawn down by way of loan, or any other contraventions authorised or permitted subsequent to having been notified of the matter by the auditors pursuant to SAS 120 (or otherwise) are done so knowingly and therefore there is no question in such circumstances that they are reportable to the ODCE. It should be further noted that each additional drawdown or other contravention is potentially a separate offence.

Auditors are required to ensure that the provisions of SAS 120 are fully complied with as failure to adhere to auditing standards is a disciplinary matter, potentially having serious consequences.

In circumstances where existing arrangements, which at the time they were entered into were less than 10% of the company's relevant assets (and were therefore permitted by section 32), subsequently come to exceed that limit for any reason (e.g. because the value of the company's assets has fallen)<sup>64</sup>, the directors are required to amend the terms of the arrangements to bring them back to within the 10% limit within two months. Failure to do so is not an offence and is therefore not reportable to the ODCE by the auditor. However, as set out elsewhere in this guidance, failure to amend the terms of the arrangements does entitle the company to render the arrangement(s) void<sup>65</sup>.

60 Section 194(4) Companies Act, 1990

61 Section 192 Companies Act, 1990 as amended by section 73 Company Law Enforcement Act, 2001.

62 Auditors should refer to Statement of Auditing Standards (SAS) 120 'Consideration of Law and Regulations' as issued by the Auditing Practices Board and to the ODCE/APB joint guidance for more detailed guidance on the subject of public interest reporting. The joint guidance has been published as ODCE Decision Notice D/2002/2 'The Duty of Auditors to Report to the Director of Corporate Enforcement' and as APB Audit Bulletin 2002/01,

similarly titled. Decision Notice D/2002/2 can be obtained free of charge from the ODCE and can also be downloaded from the ODCE website ([www.odce.ie/publications/decision.asp](http://www.odce.ie/publications/decision.asp)).

63 Statements of Auditing Standards (SAS) are issued by the Auditing Practices Board (APB). The APB is the independent standard setter for auditors in the Republic of Ireland and the United Kingdom. Auditing standards contain basic principles and essential procedures with which auditors are required to comply when performing audits.

64 See the example of Unlucky Limited as set out in Appendix 11.4

65 See also Section 5.4 of this guidance.

## 8.2 Content of Auditors' Reports

On the basis of the ODCE's experience to date, the most common breach reported by auditors relevant to the subject matter of this guidance has been instances where the value of loans to directors has exceeded 10% of companies' relevant assets.

Where auditors are required to make a report to the ODCE, they are required to provide details of the grounds for their opinion in a form and manner which will '*facilitate appropriate action by the Director*'<sup>66</sup>. For example, where the subject matter of an auditor's report is a loan exceeding 10% of the company's relevant assets, the auditor will be expected to provide the following information to the ODCE in order to facilitate appropriate action

- where practicable, the date(s) on which the loan(s) was/were advanced
- the identity of each individual to whom the loan(s) was/were given
- the value of the loan(s)
- whether the company's relevant assets were calculated by reference to the company's net assets as shown in the last preceding financial statements laid before an AGM or by reference to the company's called up share capital, and
- the extent to which 10% of the company's relevant assets was exceeded by the loan(s).

## 8.3 ODCE Follow-Up to Auditors' Reports

Where, on receipt of an auditor's report, all of the information specified in the preceding paragraphs, or such other information as is required, has not been provided, the ODCE will request that the relevant information be furnished.

Where the ODCE is informed that a breach of section 31 has been voluntarily rectified, information may be sought from the directors of the company and/or the auditor. Such details might typically include, for example

- confirmation by the directors of the rectification together with supporting documentary evidence to substantiate rectification, and
- confirmation by the auditor of the accuracy of any matters of fact provided by the directors relating to the rectification of the breach.

Where the Director is satisfied with the information and assurances received, he *may* consider taking no further action – depending on the specific circumstances of each case. Any such decisions will be made on a case by case basis.

Where the Director has not been advised that the reported breach has been rectified and where enforcement action is being contemplated, the ODCE will make further enquiries which may include, *inter alia*, the taking of statements from the directors (and/or persons connected with directors where applicable) and the auditor.

Enforcement action may include, but is not limited to, the following

- the commencement of action under section 371 of the Companies Act, 1963, requiring the rectification of the particular breach(es)<sup>67</sup>
- in the case of insolvent companies, application for the restriction of one or more directors of the company, and/or
- the initiation of criminal proceedings.

<sup>66</sup> Auditors should refer to the ODCE/APB (Auditing Practices Board) joint guidance for more detailed guidance on their reporting obligations. The joint guidance has been published as ODCE Decision Notice D/2002/2 'The Duty of Auditors to Report to the Director of Corporate Enforcement' and APB Audit Bulletin 2002/01, similarly titled. Decision Notice

D/2002/2 can be obtained free of charge from the ODCE and can also be downloaded from the ODCE website ([www.odce.ie/publications/decision.asp](http://www.odce.ie/publications/decision.asp)).

<sup>67</sup> See also section 6.2

## 9.0 Statutory and Other Disclosure Requirements

### 9.1 Companies' Statutory Disclosure Requirements

Under the Companies Acts, a company's financial statements (accounts) are required to give a 'true and fair view' of the state of the company's affairs and of its profit (or loss) for the period in question<sup>68</sup>. The term 'true and fair view' is not defined in legislation. However, where financial statements prepared in accordance with the provisions of the Companies (Amendment) Act, 1986 and accounting principles do not provide sufficient information to give a true and fair view, the 1986 Act<sup>69</sup> requires that any additional information necessary for the purposes of giving a true and fair view shall be provided in the financial statements or in a note thereto. In exceptional circumstances where compliance with the provisions of the 1986 Act would prevent the giving of a true and fair view, section 3(1)(d) of that Act requires directors to depart from the requirements of the Act insofar as is necessary in order for the financial statements to give a true and fair view. In practice, such departures are, however, rarely merited or necessary.

In addition to the foregoing, with regard to transactions with directors, the Companies Act, 1990 requires that certain information be disclosed in companies' financial statements. Any transaction or arrangement of a kind described in section 31 of the Companies Act, 1990 (whether or not it is prohibited by section 31<sup>70</sup>) must be disclosed in the company's financial statements (by way of note disclosure<sup>71</sup>). Similarly, any agreement by the company to enter into such a transaction or arrangement must also be disclosed<sup>72</sup>. Furthermore, any other transaction with the company in which a person who, at any time during the period covered by the financial statements, was a director of the company (or its holding company) had a material interest, either directly or indirectly, must be disclosed in the financial statements<sup>73</sup>.

In disclosing the principal terms of the transaction or arrangement, the following information is required to be included in the notes to the financial statements<sup>74</sup>

- a statement of the fact either that the transaction, arrangement or agreement was made, or continued to exist, during the period covered by the financial statements
- the name of the person(s) benefiting from the arrangement and, where that person is connected with a director, the name of the director
- where relevant, the name of the director with the material interest and the nature of that interest
- in the case of a loan or an agreement for a loan
  - the amount owed by the person to whom the loan or agreement was made in respect of principal and interest at the beginning and end of the period covered by the financial statements
  - the maximum amount of the liability during the period
  - the amount of any unpaid interest, and
  - the amount of any provision that has been made in respect of any failure, or anticipated failure, to repay all or part of the loan.
- in the case of a guarantee or security
  - the amount for which the company was liable under the guarantee or in respect of the security at the beginning and end of the period covered by the financial statements
  - the maximum amount for which the company may become liable, and
  - any amount paid and any liability incurred by the company or its subsidiary for the purpose of fulfilling the guarantee or discharging the security (including any loss incurred as a result of the enforcement of the guarantee or security).
- in the case of any other transaction, arrangement or agreement, the value of the transaction or the value of the transaction or arrangement to which the agreement relates
- in the case of arrangements to which the exemption limit of 10% of relevant assets applies (section 5.4 refers), the aggregate value of such arrangements at the end of the period covered by the financial statements in relation

68 Section 149 of the Companies Act, 1963 and section 3 of the Companies (Amendment) Act, 1986.

69 Section 3(1)(d)

70 Section 41(8)(a) Companies Act, 1990

71 Section 41(2)(a) (individual company financial statements), section 41(1)(a) (group financial statements) and 41(3) Companies Act, 1990

72 Section 41(2)(b) Companies Act, 1990 (individual company financial statements), section 41(1)(b) (group financial statements) and section 41(3) Companies Act, 1990

73 Section 41(2)(c) (individual company financial statements), section 41(1)(c) (group financial statements) and section 41(3) Companies Act, 1990. For the purposes of sections 41(1)(c) and 41(2)(c), a transaction or arrangement between a company or its holding company and a director (or a person connected with a director) shall be treated as a transaction in which that director is interested. An interest in such a transaction is not material if in the opinion of the majority of the directors (other than the director in question) of the company which is preparing the accounts it is not material (section 41(5) Companies Act, 1990).

74 Section 42 Companies Act, 1990

to each person concerned (and also expressed as a percentage of the company's relevant assets at that time), and

- in relation to arrangements referred to in the preceding bullet, details of any amendment to the terms of those arrangements by virtue of the directors having become aware during the period that the limit of 10% of relevant assets had been exceeded.

Companies (other than licensed banks) are also required to include in the notes to their financial statements a statement of the amount(s) outstanding at the end of the period covered by the financial statements in relation to transactions, arrangements and agreements made by the company for persons who at any time during the period covered by the financial statements were officers of the company (but not directors) and the number of officers for whom such arrangements etc. were made<sup>75</sup>. This requirement does not extend to cases where the amount outstanding from the officer at the period end does not exceed €3,175<sup>76</sup>.

As the non-disclosure of any material unlawful transaction or arrangement to which a company has been a party could potentially impair the true and fair view, details of any material breach(es) of section 31 should be disclosed by the directors in the notes to the financial statements. In deciding whether an unlawful transaction or arrangement is material in the context of the financial statements, directors should have regard to the Accounting Standards Board's 'Statement of Principles', which states:

*'An item of information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users of those financial statements, including their assessment of management's stewardship. Whether information is material will depend on the size and nature of the item in question judged in the particular circumstances of the case'.*

Directors should also be aware that the company's auditors will, pursuant to their professional obligations as set out in Statement of Auditing Standards (SAS) 120<sup>77</sup>, consider the adequacy of the disclosures contained in the financial statements when considering the implications of any unlawful transactions or arrangements for their audit report. In that context, SAS 120 states:

*'When determining whether a suspected or actual instance of non-compliance with law or regulations requires disclosure in the financial statements, auditors have regard to whether shareholders require the information to enable them to assess the performance of the company and any potential implications for its future operations or standing. Where a suspected or actual instance of non-compliance needs to be reflected in the financial statements, a true and fair view will require that sufficient particulars are provided to enable users of the financial statements to appreciate the significance of the information disclosed. This would usually require the full potential consequences to be disclosed and, in some cases, it may be necessary for this purpose that the financial statements indicate that non-compliance with law or regulations is or may be involved'*<sup>78</sup>.

## 9.2 Special Disclosure Considerations Relating to Abridged Financial Statements

A company can avail of 'small company' exemptions if two of the following criteria are satisfied in respect of the financial year in question<sup>79</sup>

- the balance sheet total does not exceed €1,904,607
- the turnover does not exceed €3,809,214
- the average number of employees does not exceed 50.

Where a company can avail of the small company exemption, it is only required to file an abridged (summarised) balance sheet and selected notes to the financial statements with the Registrar of Companies<sup>80</sup>.

A company can avail of 'medium company' exemptions if two of the following criteria are satisfied in respect of the financial year in question<sup>81</sup>

- the balance sheet total does not exceed €7,618,428
- the turnover does not exceed €15,236,856
- the average number of employees does not exceed 250.

Where a company can avail of the medium company exemption, it is only required to file an abridged (summarised) profit and loss account, abridged balance sheet, selected notes to the financial statements and the directors' report with the Registrar of Companies<sup>82</sup>.

<sup>75</sup> Section 43(2) Companies Act, 1990

<sup>76</sup> Section 43(3) Companies Act, 1990

<sup>77</sup> Statements of Auditing Standards (SASs) are issued by the Auditing Practices Board, the independent standard setter for the Republic of Ireland and the United Kingdom.

<sup>78</sup> SAS 120, paragraph 54.

<sup>79</sup> Section 8(2) Companies (Amendment) Act, 1986

<sup>80</sup> Section 10(1), 10(2) and section 12(1) Companies (Amendment) Act, 1986

<sup>81</sup> Section 8(3) Companies (Amendment) Act, 1986

<sup>82</sup> Section 11(1), 11(2) and section 12(2) Companies (Amendment) Act, 1986

Where a company, by virtue of the exemptions set out above, elects to file abridged financial statements with the Companies Registration Office, the information required to be disclosed in the notes to those abridged financial statements is prescribed in section 12 of the Companies (Amendment) Act, 1986. However, notwithstanding the provisions of section 12, the overriding consideration above all others is that the abridged financial statements are required to give a ‘true and fair view’<sup>83</sup> of the state of the company’s affairs<sup>84</sup>. Accordingly, in order to ensure that the financial statements give a true and fair view of the state of the company’s affairs, it will, under certain circumstances, be necessary for companies to provide disclosure over and above that required by section 12 in the notes to their abridged financial statements.

As the non-disclosure of any material unlawful transaction or arrangement to which a company has been a party could potentially impair the true and fair view, details of any material breach(es) of section 31 should be disclosed by the directors in the notes to the abridged financial statements. In deciding whether an unlawful transaction or arrangement is material in the context of the abridged financial statements, directors should have regard to the Accounting Standards Board’s ‘*Statement of Principles*’, which states:

*‘An item of information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users of those financial statements, including their assessment of management’s stewardship. Whether information is material will depend on the size and nature of the item in question judged in the particular circumstances of the case.’*

Directors should also be aware that the company’s auditors will, pursuant to their professional obligations as set out in Statement of Auditing Standards (SAS) 120<sup>85</sup>, consider the adequacy of the disclosures contained in the financial statements when considering the implications of any unlawful transactions or arrangements for their audit report. In that context, SAS 120 states:

*‘When determining whether a suspected or actual instance of non-compliance with law or regulations requires disclosure in the financial statements, auditors have regard to whether shareholders require the information to enable them to assess the performance of*

*the company and any potential implications for its future operations or standing. Where a suspected or actual instance of non-compliance needs to be reflected in the financial statements, a true and fair view will require that sufficient particulars are provided to enable users of the financial statements to appreciate the significance of the information disclosed. This would usually require the full potential consequences to be disclosed and, in some cases, it may be necessary for this purpose that the financial statements indicate that non-compliance with law or regulations is or may be involved.’*

In circumstances where

- the company has legitimately availed of exceptions to the general prohibition, or
- the company has agreed to enter into transactions or arrangements that come within the general prohibition and the exceptions thereto (or which breach the general prohibition), or
- the company is party to a transaction in which a person who, at any time during the period covered by the financial statements was a director of the company (or its holding company), had a material interest,

details should be disclosed in the notes to the financial statements if the non-disclosure of same would result in the abridged financial statements not giving a true and fair view.

### 9.3 Companies’ Disclosure Requirements under Accounting Standards

In addition to satisfying statutory disclosure requirements under the Companies Acts, under *accounting rules* companies’ financial statements must also comply with accounting standards in order for those financial statements to give a ‘true and fair view’. Accounting standards contain guidance as to how certain matters should be dealt with in a company’s financial statements<sup>86</sup>. Companies’ disclosure requirements under accounting standards relevant to the subject matter of this guidance are dealt with in detail in **Appendix 11.7**.

In the context of compliance with accounting standards, readers may be interested to note that the

83 See section 9.1 for elaboration on the concept of ‘true and fair view’.

84 Section 3 Companies (Amendment) Act, 1986

85 Statements of Auditing Standards (SAS) are issued by the Auditing Practices Board, the independent standard setter for the Republic of Ireland and the United Kingdom.

86 ‘Accounting Standards are authoritative statements of how particular types of transaction and other events should be reflected in financial statements and, accordingly, compliance with accounting standards will normally be necessary for financial statements to give a true and fair view. The requirement to give a true and fair view may in special circumstances require a departure from

accounting standards. However, because accounting standards are formulated with the objective of ensuring that the information resulting from their application faithfully represents the underlying commercial activity, the [Accounting Standards] Board envisages that only in exceptional circumstances will departure from the requirements of an accounting standard be necessary in order for financial statements to give a true and fair view.’ (Extract from the ‘Foreword to Accounting Standards’ as published by the Accounting Standards Board in June 1993).

Companies (Auditing and Accounting) Bill, 2003<sup>87</sup>, which at the time of writing has not been enacted, proposes to introduce a provision whereby companies will be required to

- include a statement in their annual financial statements as to whether those financial statements have been prepared in accordance with accounting standards, and
- ensure that any material departure(s) from applicable accounting standards and the reasons for any such departure(s) are noted in the financial statements.

It is further proposed that failure to comply with these requirements will constitute an offence.

## 9.4 Auditors' Obligations Regarding Companies' Statutory Disclosure Requirements

Where any of the statutory disclosure requirements referred to above regarding transactions with directors are not complied with in a company's financial statements, the company's auditors must, as far as they are reasonably able to do so, include the required information in their audit report<sup>88</sup>.

## 9.5 Directors' Statutory Disclosure Requirements

A company director who is in any way, whether directly or indirectly, interested in a contract (or proposed contract) with the company is required to declare the nature of that interest at a meeting of the directors of the company<sup>89</sup>.

## 10.0 Further Information

A number of other publications are available from the ODCE. These are available free of charge upon request and can also be downloaded from the ODCE website at [www.odce.ie/publications](http://www.odce.ie/publications). Publications available include:

**Decision Notice D/2002/1:** This provides guidance to the public on the principal duties, powers and rights of

- companies
- company directors
- company secretaries
- members and shareholders
- auditors
- creditors
- liquidators, receivers and examiners.

This guidance, which has been published in the form of seven Information Books, is written in clear, non-technical language.


**Decision Notice D/2002/2:** This document, which was published in conjunction with the Auditing Practices Board (APB) and the Consultative Committee of Accountancy Bodies – Ireland (CCAB-I), provides guidance to auditors on their obligation to report suspected indictable offences under the Companies Acts.


**Decision Notice D/2002/3:** This document provides, *inter alia*, guidance to the liquidators of insolvent companies on their obligation to report to the ODCE under section 56 of the Company Law Enforcement Act, 2001.


**Decision Notice D/2002/4:** This document sets out the ODCE's approach to the problem of unliquidated insolvent companies.

**Decision Notice D/2003/1:** This document sets out the Director of Corporate Enforcement's approach to the further commencement of section 56 of the Company Law Enforcement Act, 2001.

Copies of these documents can be obtained free of charge from the following contact points:

 Office of the Director of  
Corporate Enforcement,  
16 Parnell Square,  
Dublin 1.

 01 – 858 5800  
Lo call 1890 315 015

 01 – 858 5801

 [info@odce.ie](mailto:info@odce.ie)

 [www.odce.ie](http://www.odce.ie)

<sup>87</sup> Section 39 Companies (Auditing and Accounting) Bill, 2003

<sup>88</sup> Section 46 Companies Act, 1990

<sup>89</sup> Section 194(1) Companies Act, 1963

# 11.0 Appendices

- Appendix 11.1      Examples of Quasi-Loans
- Appendix 11.2      Summary of the Applicability of the Exceptions to the General Prohibition to Relevant Classes of Transactions
- Appendix 11.3      Calculation of a Company's 'Relevant Assets'
- Appendix 11.4      Illustrative Example re Section 33 - Unlucky Limited
- Appendix 11.5      Statutory Instrument (S.I.) No. 439 of 2001  
Companies Act, 1990 (Section 34) Regulations, 2001
- Appendix 11.6      Definition of a 'Group'
- Appendix 11.7      Companies' Disclosure Requirements under Accounting Standards

## Appendix 11.1

### Examples of Quasi-Loans

A quasi-loan is defined<sup>90</sup> as a transaction under which one party (the creditor) agrees to pay, or pays otherwise than in pursuance of an agreement, a sum for another person (the borrower) or agrees to reimburse, or reimburses otherwise than in pursuance of an agreement, expenditure incurred by a third party for the borrower

- on terms that the borrower (or a person on his/her behalf) will reimburse the creditor, or
- in circumstances giving rise to a liability on the borrower to reimburse the creditor.

These definitions are probably best illustrated by way of example.

#### Example 1 – Repayment of a Loan on Behalf of the Borrower

Some time ago Tom received a loan of €10,000 from Jerry. Quasi Ltd, a company of which Tom's brother is a director, has now agreed to discharge Tom's debt to Jerry on the understanding that Tom will reimburse the company as soon as he has available funds.

As Tom is connected to Quasi Ltd. (through his brother who is a director of the company), this is a quasi-loan under the definition as set out in section 25(3) of the Companies Act, 1990. As a result, this type of transaction is covered by the general prohibition contained in section 31 of the Companies Act, 1990.

#### Example 2 – Reimbursement of Expenditure Incurred by a Third Party

Butch engaged Sundance to carry out some work to his house. In doing the work, Sundance incurred expenditure on materials to the value of €15,000. As Butch is experiencing cashflow difficulties, Quasi Ltd., a company of which Butch's sister is a director, has agreed to reimburse Sundance, with Butch reimbursing the company when his cashflow position improves.

As Butch and Quasi Ltd. are connected (through Butch's sister), this transaction constitutes a quasi-loan as defined by section 25(3) of the Companies Act, 1990. As a result, this type of transaction is covered by the general prohibition contained in section 31 of the Companies Act, 1990.

While quasi-loans are prohibited by section 31, sections 32, 35, 36 and 37 permit such transactions in certain circumstances provided that certain criteria are met. See section 5.3 *et seq* for further information on the exceptions to the general prohibition.

<sup>90</sup> Section 25(2)(a) Companies Act, 1990

## Appendix 11.2

### Summary of the Applicability of the Exceptions to the General Prohibition to Relevant Classes of Transactions

Exception	Applies to Loans, Quasi-Loans and Credit Transactions	Applies to Guarantees and to the Provision of Security in Connection with Loans, Quasi-Loans and Credit Transactions
Section 32 – 10% of Relevant Assets	✓	X
Section 34 – Arrangements Approved by Special Resolution and Accompanied by a Statutory Declaration.	X	✓
Section 35 – Arrangements between Group Companies	✓	✓
Section 36 – Directors' Expenses	✓	✓
Section 37 – Business Transactions	✓	X

## Appendix 11.3

### Calculation of a Company's 'Relevant Assets'

#### Example 1 – PQR Limited

PQR Limited ('the company') has four directors. At a directors' meeting on 15 June 2002, loans of €30,000 and €20,000 respectively were approved for two of the directors. The loans were advanced by way of company cheques dated 1 July 2002.

On 1 July 2002, the company's financial statements for the year ended 31 December 2001 had been prepared and audited, but they had not at that time been laid before an AGM of the company. The audited financial statements for the year ended 31 December 2000 had however been laid before an AGM on 15 August 2001. Set out below is the balance sheet of the company as at 31 December, 2000.

#### PQR Ltd. - Balance Sheet as at 31 December 2000

	€	€
Fixed Assets		250,000
Current Assets	340,000	
Less: Current Liabilities	<u>(110,000)</u>	
Net Current Assets		230,000
Less: Term Loan		<u>(100,000)</u>
Net Assets		<u><u>380,000</u></u>
<b>Financed by:</b>		
Called Up Ordinary Share Capital		100
Profit & Loss Account		<u>379,900</u>
Shareholders' Funds		<u><u>380,000</u></u>

In order to determine whether the loans made to the two directors are in breach of the general prohibition or whether they come within the exception provided for under section 32 (whereby the aggregate of loans are less than 10% of the company's 'relevant assets'), it is necessary first to ascertain what the value of the relevant assets of the company is.

In this case, the most recent preceding set of financial statements to have been laid before an AGM of the company are those relating to the year ended 31 December, 2000. Accordingly, these financial statements are used for the purposes of calculating the company's relevant assets – which in this case are the net assets i.e. €380,000. As 10% of the relevant

assets is €38,000 (i.e. €380,000 x 10%) the aggregate loan amount of €50,000 exceeds 10% of the company's relevant assets by €12,000 and section 31 has therefore been breached.

If no preceding set of financial statements had been laid before an AGM of the company, the calculation would be based on 10% of the called up share capital. This value would be €10 (i.e. €100 x 10%). Again, the loan of €50,000 would contravene the prohibition, with the loan exceeding the permitted limit by €49,990.

#### Example 2 – DEF Limited

DEF limited is a company with three directors, Tom, Dick and Harry. The company operates in the construction industry.

Dick is a carpenter by trade and, in addition to being a director of DEF Limited, also operates an unincorporated carpentry business that trades under the business name Windows & Co. From time to time DEF Limited supplies goods and services on credit to Dick's business. Where goods and services are supplied to Windows & Co., the selling price and credit terms are the same as those offered to DEF Limited's other customers. At present, Windows & Co. owes DEF Limited €65,000.

Some time ago Tom's brother experienced personal cashflow difficulties and, while Tom was unable to provide assistance from his personal resources, Dick and Harry – who have known Tom's brother for many years - agreed to advance a repayable loan of €50,000 to Tom's brother from DEF Limited's bank account.

Three months ago, Harry was due to travel to South Africa on company related business. To cover his expenses the company advanced Harry a cheque for €5,000. The trip was subsequently cancelled and Harry has not to date repaid the €5,000.

Dick recently received notification of his family's private health insurance premium renewal. As he didn't have the amount to hand at the time, he wrote a company cheque in the amount of €2,500, which he hasn't repaid at this time.

DEF Limited's last annual general meeting was held in March 2003 and the company's audited financial statements for the year ended 31 December, 2002 were laid before that meeting. The company's balance sheet as at 31 December, 2002 is set out opposite.

### DEF Limited – Balance Sheet as at 31 December 2002

	€	€
Fixed Assets		250,000
<u>Current Assets:</u>		
Stocks	200,000	
Trade Debtors (incl. Windows & Co. and Dick)	150,000	
Harry (travel expenses)	5,000	
Other Debtors (loan to Tom's brother)	50,000	
Cash	<u>10,000</u>	
	415,000	
<u>Less: Current Liabilities</u>		
Trade Creditors	50,000	
VAT & PAYE	<u>15,000</u>	
	(65,000)	
Net Current Assets		350,000
Less: Term Loan		<u>(100,000)</u>
<b>Net Assets</b>		<u><b>500,000</b></u>
Financed by:		
Called Up Share Capital		3,000
Profit & Loss Account		<u>497,000</u>
<b>Shareholders' Funds</b>		<u><b>500,000</b></u>

Tom has recently learned of the fact that companies' transactions with directors, and persons connected with directors, are regulated by the Companies Acts and wishes to know whether the transactions referred to above are permitted by law.

#### Credit Sales to Windows & Co.

The company's sales of goods and services on credit to an unincorporated business run by a director of the company represent credit transactions with a director of the company. Accordingly, unless these transactions fall into one of the exceptions from the general prohibition, they will be unlawful under section 31.

Under section 37 of the Companies Act, 1990, the general prohibition on loans, quasi-loans and credit transactions to directors does not apply to transactions entered into in the ordinary course of the company's business. As credit sales to Windows & Co. are credit transactions on normal commercial terms and relate to the ordinary business of DEF Limited (i.e. the sale of construction related materials), these transactions are permitted and therefore do not contravene the general prohibition contained in section 31.

#### Company loan to Tom's brother

Tom's brother is a person connected to a director of the company. Accordingly, unless this transaction comes within one of the exceptions to the general prohibition, it is in breach of the general prohibition.

In this case, one exception to the general prohibition that it may be possible to avail of is that relating to the limit of 10% of relevant assets. However, in determining whether the 10% exception can be availed of, it is necessary to determine whether there are any other transactions that need to be taken into account for the purposes of this calculation. This will be revisited later.

#### Harry's travel expenses

Section 36 of the Companies Act, 1990 provides an exception to the general prohibition in respect of directors' expenses provided that any amounts paid by the company to the director are for the purposes of meeting vouched expenditure properly incurred, or to be incurred, by the director for the purposes of carrying out his duties as a director.

Accordingly, section 36 would ordinarily permit the payment of an amount in advance to Harry for the purposes of covering his expenses. However, in this case Harry's trip has been cancelled and, accordingly, he will not be incurring any expenses. Under such circumstances, section 36 provides that Harry has six months to repay the amount to the company and that failure to do so is an offence. In this case, only three months have elapsed since the amount was paid to Harry and therefore the amount advanced is currently covered by the exception to the general prohibition provided by section 36.

#### Dick's private health insurance premium

The payment of Dick's personal expenses by the company constitutes a quasi-loan and, accordingly, is prohibited by section 31 unless a specific exception can be availed of.

In this case, the only exception to the general prohibition that may be relevant is that relating to the limit of 10% of relevant assets. However, in determining whether the 10% exception can be availed of, it is necessary to determine whether there are any other transactions that need to be taken into account for the purposes of this calculation. This is considered further below.

#### Calculation of 10% of the company's relevant assets

Given that the company has laid a preceding set of financial statements before an AGM, the company's relevant assets must be calculated by reference to the net assets as shown in the balance sheet.

From the balance sheet above, it can be seen that the company's net assets (i.e. assets less liabilities) are €500,000. Therefore the limit of 10% of relevant assets is €50,000. As the aggregate of the arrangements relating to the loan to Tom's brother and Dick's private health insurance premium (€52,500) exceeds the 10% limit, the company is in breach of section 31.

Readers should note that:

- the capacity of the company to discharge its debts as they fall due is irrelevant to the operation of this provision.
- in advance of entering into such transactions, directors should establish the value of the company's relevant assets and should thereafter continue to monitor their value. Directors should also review all similar transactions to which their companies are currently party and remedy any breaches of the permitted limit. Under such circumstances it is advisable that appropriate legal and/or accountancy advice should be sought.
- it is a criminal offence for any director or other officer to authorise or permit a company to enter into such a transaction knowing, or having reasonable cause to believe, that the company in so doing would be in contravention of section 31.

## Appendix 11.4

### Illustrative Example re Section 33 - Unlucky Limited

On 1 July, 2002 the directors of Unlucky Limited approved and advanced a loan of €50,000 to one of the directors, Mr. Hapless. At that time the last set of financial statements to have been laid before an AGM of the company were those relating to the year ended 31 December, 2001 (which were laid before an AGM held on 31 March, 2002). The company's relevant assets at the date the loan was approved and advanced were therefore its net assets per the balance sheet dated 31 December, 2001 (in this case €1,000,000). As 10% of relevant assets was €100,000 (i.e. €1,000,000 x 10%), at the date of granting the loan, the loan amount was less than the 10% limit and therefore fell within the exception provided by section 32.

On 1 December, 2002 the company's single largest asset, its premises, was completely destroyed by fire. Unfortunately, the company's other director, Mr. Gormless, had forgotten to renew the insurance premium shortly beforehand and as a result the building was uninsured at the date of the fire. As a consequence, it was necessary to write the value of the premises down from €600,000 to nil in the financial statements for the year ended 31 December, 2002.

The result of the writedown has been to reduce the company's net assets (which in turn will become the new relevant assets at the next AGM) from €1,000,000 to €400,000. As the loan of €50,000 now exceeds 10% of the company's net assets (which equal €40,000 (i.e. €400,000 x 10%)), under section 33(2), the directors have a duty on becoming aware, or when they ought reasonably have become aware, of the reduction to amend the terms of the loan within two months in order to bring it back to within the 10% limit. While failure to do so is not an offence, it does render the loan voidable at the instance of the company i.e. the company can elect to render the loan void.

## Appendix 11.5

### Statutory Instrument (S.I.) No. 439 of 2001: Companies Act, 1990 (Section 34) Regulations, 2001

I, Noel Treacy, Minister of State at the Department of Enterprise, Trade and Employment, in exercise of the powers conferred on me by section 3(3) of the Companies Act, 1990 (No. 33 of 1990), as adapted by the Enterprise and Employment (Alteration of Name of Department and Title of Minister) Order, 1997 (S.I. No. 305 of 1997), and the Enterprise, Trade and Employment (Delegation of Ministerial Functions) Order, 1998 (S.I. No. 265 of 1998), make the following Regulations:

- 1 These Regulations may be cited as the Companies Act, 1990 (Section 34) Regulations, 2001.
- 2 These Regulations come into operation on the 1st day of October, 2001.
- 3 The form of report of an independent person set out in the Schedule to these Regulations is prescribed for the purposes of section 34(4) of the Companies Act, 1990 (No. 33 of 1990) (inserted by section 78 of the Company Law Enforcement Act, 2001(No. 28 of 2001)).

#### *Schedule*

Form of report of independent person for the purposes of section 34 of the Companies Act, 1990

1. \*I am/\_\_\_\_\_ [name of firm] is an independent person who, at the time of this report, is qualified to be appointed the auditor of \_\_\_\_\_ [name of company].

\* *delete as appropriate*

1. \*I am/\_\_\_\_\_ [name of firm] is an independent person who, at the time of this report, is the auditor of [name of company] and is qualified to continue to be such auditor.

\* *delete as appropriate*

2. I/We have examined the statutory declaration made for the purposes of section 34 of the Companies Act, 1990, on \_\_\_\_\_, 20\_\_, by \_\_\_\_\_, being the directors/a majority of the directors of \_\_\_\_\_ [name of company], a copy of which is appended to this report.

3. The directors aforesaid are responsible under the said section 34 for the making of the statutory declaration.
4. It is my/our responsibility, as an independent person, to form an opinion, based on my/our examination of the statutory declaration, accounting records of \_\_\_\_\_ [name of company] and explanations provided to me/us by directors and officers of the company, as to whether the statutory declaration is reasonable.
5. I/We also examined the evidence available to support the statutory declaration that I/we consider appropriate and I/we have ascertained from the directors the steps taken by them to ensure that the declaration complies with the said section 34 and that the statement contained in it pursuant to subsection (3)(f) of the said section 34 is reasonable.
6. In my/our opinion the statutory declaration is reasonable.

Signature(s) \_\_\_\_\_

\_\_\_\_\_

Date \_\_\_\_\_

GIVEN under my Official Seal

25th September, 2001

NOEL TREACY

Minister of State at the Department of Enterprise, Trade and Employment.

#### **Explanatory Note**

*(This note is not part of the Instrument and does not purport to be a legal interpretation).*

These Regulations set out the form of the report of the independent person which is required under section 34(4) of the Companies Act, 1990, as amended, to accompany a statutory declaration under section 34 of the Companies Act, 1990, as amended.

## Appendix 11.6

### Definition of a ‘Group’

Jack and Jill are the directors and sole shareholders of two companies (Company A and Company B). They have signed a contract as directors of Company A giving to Company B

- the sole right to appoint all of the directors of Company A, and
- authority to manage all of the affairs of Company A.

On the basis of the foregoing, Jack and Jill have been given to understand that they have formed a ‘group’ under the Group Accounts Regulations, which state, *inter alia*, that ‘*an undertaking shall be deemed to be a subsidiary of another if one company has the right to exercise a dominant influence over another company by virtue of a control contract*’. They now propose to provide a loan from one company to the other and wish to know whether this is permissible under the Companies Acts.

If we refer back to the definition of a subsidiary under section 155 of the Companies Act, 1963, it can be seen that a company is a subsidiary of another company if, but only if, the holding company

- is a member of the subsidiary and controls the composition of its board of directors, or
- holds more than half, in nominal value, of the equity share capital of the subsidiary, or
- holds more than half, in nominal value, of those shares carrying voting rights (other than voting rights which arise in specified circumstances only).

A company is also a subsidiary of the holding company if it is a subsidiary of a subsidiary of the holding company i.e. a sub-sub-subsidiary<sup>91</sup>.

If we look at the specifics of this example, it is clear that the companies in question are not a group under section 155 – (ii) and (iii) above are not applicable in that neither company has a majority shareholding in the other. In the case of (i) above, while Company B controls the composition of the Board of Company A, it is not a member of Company A and therefore a group does not exist.

As a consequence, the group exemption provided for under section 35 of the Companies Act, 1990 cannot be availed of in this instance. It is worth noting however that, notwithstanding the fact that a group does not exist, there are other exceptions to the general prohibition that it may be possible to avail of, for example, section 32 of the Companies Act, 1990 allows the granting of a loan to a director, or person connected with a director, provided that the aggregate of any such loans does not exceed 10% of the relevant assets of the lending company.

If the above example is taken a little further, on the assumption that Company A and Company B are both €2 companies (with one share in each being held by Jack and Jill respectively), in the event that Jack and Jill were to sell their two shares in Company A to Company B, Company A would become a wholly owned subsidiary of Company B. Under these circumstances, the structure would qualify as a group under section 155 and, accordingly, inter-company loans would be permissible under section 35 despite the two companies being connected through a director or person connected with a director.

Similarly, under the specific circumstances of this example, in the event that either Jack or Jill was to sell their one share in Company A to Company B, the resulting structure would also qualify as a group under section 155. This is due to the fact that Company B

- would be a member of Company A (holding 50% of its issued ordinary share capital), and
- would control the composition of the Board (by virtue of the contract signed by the directors giving Company B the sole right to appoint all of the directors of Company A).

Accordingly, inter-company loans would be permissible under section 35 despite the two companies being connected through a director or person connected with a director<sup>92</sup>.

<sup>91</sup> Section 155(1)(b) Companies Act, 1963

<sup>92</sup> The potential taxation implications of such share transfers, which are outside the scope of this guidance, would require consideration and professional accountancy and/or legal advice should be sought in advance of such a course of action.

## Appendix 11.7

### Companies' Disclosure Requirements Under Accounting Standards

In addition to satisfying statutory disclosure requirements under the Companies Acts, under accounting rules company financial statements (accounts) must also comply with accounting standards in order for those financial statements to give a 'true and fair view'. Accounting standards contain guidance as to how certain matters should be dealt with in a company's financial statements<sup>93</sup>. Companies' disclosure requirements under accounting standards relevant to the subject matter of this guidance are detailed in this appendix.

The accounting standard of most relevance to the subject matter of this guidance is Financial Reporting Standard 8 (FRS 8) '*Related Party Disclosures*'<sup>94</sup>. FRS 8 requires the disclosure of information on related party transactions. For the purposes of FRS 8, parties related to a company include, *inter alia*

- its directors and the directors of any of its parent undertakings i.e. holding company
- its holding company and its subsidiaries, and
- members of the close family of the directors and directors of any parent undertakings.

The information required to be disclosed in company financial statements by FRS 8 is as follows

- the names of the transacting related parties
- a description of the relationship between the parties
- a description of the transactions
- the amounts involved
- any other elements of the transaction necessary for an understanding of the financial statements
- the amounts due to or from related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date, and
- amounts written off in the period in respect of debts due to or from related parties.

The foregoing is only a summary of the provisions of FRS 8 and company directors should seek professional accountancy advice in order to ensure that company financial statements are fully in compliance with the requirements of the FRS and that its disclosure requirements are fully satisfied.

While FRS 8 ordinarily applies to all companies, 'small companies' (as defined in section 9.2 above) can exempt themselves from the requirements of FRS 8 if they choose to apply the provisions of the 'Financial Reporting Standard for Smaller Entities' (FRSSE)<sup>95</sup>. Where a small company elects to apply the provisions of the FRSSE, less onerous disclosure requirements apply. Section 15 of the FRSSE sets out the disclosures required in respect of related party transactions. Where the reporting entity (i.e. the company)

- purchases, sells or transfers goods and other assets or liabilities, or
- renders or receives services, or
- provides or receives financial support

to, from or on behalf of a related party, then such material transactions should be disclosed<sup>96</sup>, including

- the names of the transacting related parties
- a description of the relationship between the parties
- a description of the transactions
- the amounts involved
- any other elements of the transactions necessary for an understanding of the financial statements
- the amounts due to or from related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date, and
- amounts written off in the period in respect of debts due to or from related parties.

The FRSSE states that transactions with related parties may be disclosed on an aggregated basis (aggregation of similar transactions by type or related party) unless disclosure of an individual transaction, or connected transactions, is necessary for an understanding of the impact of the transactions on the financial statements of the reporting entity or is required by law.

<sup>93</sup> 'Accounting Standards are authoritative statements of how particular types of transaction and other events should be reflected in financial statements and, accordingly, compliance with accounting standards will normally be necessary for financial statements to give a true and fair view. The requirement to give a true and fair view may in special circumstances require a departure from accounting standards. However, because accounting standards are formulated with the objective of ensuring that the information resulting from their application faithfully represents the underlying commercial activity, the [Accounting Standards] Board envisages that only in exceptional circumstances will departure from the requirements of an accounting standard be necessary in order for financial statements to give a true and fair view.' (Extract

from the 'Foreword to Accounting Standards' as published by the Accounting Standards Board in June 1993).

<sup>94</sup> FRS 8, while extant at the time of writing, may be replaced in the future. Readers should refer to Financial Reporting Exposure Draft 25 (FRED 25) as published by the Accounting Standards Board for further detail.

<sup>95</sup> The FRSSE is issued by the Accounting Standards Board (ASB), the independent body charged with setting accounting standards for Ireland and the UK.

<sup>96</sup> With regard to the term 'material', the FRSSE states that '*The materiality of a related party transaction should be judged in terms of its significance to the reporting entity*'.

The foregoing is only a summary of the provisions of the FRSSE. Where directors are eligible and elect to apply the provisions of the FRSSE, they should seek professional accountancy advice in order to ensure that company financial statements are fully in compliance with the requirements of the FRSSE and that its disclosure requirements are fully satisfied.

#### **Special Accounting Standard-Related Disclosure Considerations for Abridged Financial Statements**

In addition to the legal requirement that abridged financial statements give a true and fair view of the state of the company's affairs, abridged financial statements must also comply with the provisions of accounting standards. Unless a company filing abridged financial statements is eligible, and has elected, to apply the FRSSE, the abridged financial statements must also comply with the provisions of FRS 8.