

# Technical Factsheet 50

## Section 202

### Companies Act 1990

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This guidance has been prepared to advise members regarding the extent to which auditors are bound to disclose information to the Gardai and the Court during prosecutions under Section 202 of the Companies Act, 1990.

Members may also wish to refer to previous guidance distributed by the Consultative Committee of Accountancy Bodies – Ireland (CCAB-I) in August 1991 entitled 'Companies Acts, 1990'. That guidance is reproduced as an appendix to this guidance.

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#### **BACKGROUND**

- 1 Companies are required to keep proper books of account, whether in document format or otherwise, (such as, for example, computerised records). Section 202 of the Companies Act, 1990, requires that:
  - a The entries in the company's books and records are made in a timely and consistent manner;
  - b The company's books and records correctly record and explain the transactions of the company;
  - c At all times the company's books and records will enable the financial position of the company to be determined with reasonable accuracy;
  - d The company's books and records will enable the directors to ensure that the annual accounts comply with the Companies Acts; and
  - e The company's books and records will enable those annual accounts to be readily and properly audited.
- 2 Proper books of account shall be deemed to be kept if they comply with these requirements and give a true and fair view of the state of affairs of the company and explain its transactions.
- 3 Section 194 of the Companies Act, 1990, obliges auditors of a company to notify the company as soon as they are of the opinion that proper books of account are not being kept or have not been kept. The Act exempts immaterial contraventions from this

notification requirement but obliges the auditors to notify the Registrar of Companies in writing where the directors of the company have not taken the necessary steps within 7 days to ensure that proper books of account are kept.

- 4 Detailed guidance on the implications of Sections 194 and 202, published in August 1991, is reproduced in the attached Appendix.
- 5 Prosecution proceedings against companies and their directors, where auditors have issued a "Section 194" report, are being actively pursued by the Company Law Division, Department of Enterprise, Trade and Employment. As part of that process, Gardai have met with the auditor to take a formal statement and, in one case, the auditor was subpoenaed to appear as a witness in the District Court.

#### **SPECIFIC ISSUES**

Legal advice was obtained as to particular responsibilities of the auditor in such cases. This advice is outlined below.

#### **Is the auditor (or former auditor) required to co-operate with the Gardai?**

Once the auditor has discharged his obligation under Section 194 of the Companies Act, 1990, to notify the company and the Registrar of Companies that he believes that proper books of account are not being kept, there is no express obligation on the auditor under the legislation to assist in any subsequent prosecution. An auditor cannot be required to give an interview/written statement to the Gardai prior to the trial, but, like any other witness, he can be subpoenaed. This would require the auditor to attend and give evidence at trial and, if required, to produce relevant documents. (In giving evidence at trial

an auditor would not be entitled to refuse to answer on the basis of client confidentiality). The disadvantage to the Gardai of having to formally subpoena an auditor is that they will not know details of the auditor's evidence in advance of the trial, or whether such evidence will help or hinder the prosecution.

One of the auditor's key concerns will be to protect challenges to his reputation and integrity and for this reason he may wish to voluntarily co-operate with the Gardai, but in doing so he would need to take account of the duty of confidentiality owed to the client.

#### **Can evidence be taken by affidavit?**

No, as affidavit evidence is not permissible in criminal prosecutions.

If there is a "guilty" plea, the auditor's testimony will not be required (except in the unlikely event of it being relevant to sentencing).

If there is a "not guilty" plea, then a full trial will be necessary to resolve the merits. Oral testimony will be required in these circumstances. Therefore, where the defendant pleads "not guilty", an auditor will be required to attend court and give oral evidence, whether he chooses to co-operate voluntarily or is subpoenaed by either party.

#### **How extensive are the questions which the auditor is obliged to answer when giving evidence?**

The auditor can be asked any relevant question. He cannot refuse to answer questions at trial on the basis of auditor/client confidentiality. However, all of the auditor's own communications with his legal advisers will be privileged and the auditor will not be required to disclose the nature of those communications which have been created for the purpose of any

litigation or to obtain confidential legal advice. The judge in the trial will ultimately decide whether or not an auditor is obliged to answer any questions put to him.

What documents must be ‘discovered’?

There is no statutory obligation on the auditor to provide the prosecution or defence with the audit file or other documents as a matter of course. If the auditor is served with a subpoena duces tecum it will set out the documents which the Gardai or indeed the defendant (i.e. the company or the accused director) require him to produce at the trial of the action. Subject to any questions of legal privilege or of relevance, the auditor would have to produce the documents referred to in the subpoena to the court. As with answering questions in court, the judge would ultimately decide whether documents are relevant or privileged.

It is possible that the police or the defendant could seek “non-party” discovery, from the auditor under the Rules of the Superior Courts, but this would be unusual in criminal proceedings. If successful, the auditor would have to list and produce relevant documents. Privileged documents would not have to be produced.

**Must working papers be made available – which ones?**

The comments in relation to previous issues apply equally to working papers. In short, an auditor can be compelled by subpoena to produce them at trial, or (but this is unusual in criminal proceedings) to give discovery on affidavit of such documents.

**When giving a Section 194 Notice to the company and the Registrar, should the auditor warn his client of possible prosecution and that the auditor may have to give evidence?**

There is no duty on the auditor to give such a warning, but it would seem prudent and appropriate for him to notify his client, if nothing else, in the interests of good client relations.

**Should the auditor resign due to conflict of interest?**

There is no express statutory duty to do so, however, the auditor is under a professional duty to do so if he perceives a conflict of interest. While in some cases it may be impossible for an auditor to continue in the event of a Section 202 prosecution, it would go too far to suggest as a blanket rule that an auditor should resign in all such prosecutions. The mere fact of a subpoena or prosecution of the directors need not, of itself, require an auditor to resign. The precise facts of each case would need to be considered.

Obviously in many such cases, by definition, there may well have been a breakdown in relations (since the company has failed or refused to take remedial steps “to ensure that proper books of account are being kept” and hence avoid the auditor having to report the matter to the Registrar of Companies within seven days of notifying the company). If an auditor feels that there is a conflict, or feels unable to discharge his duties, then he should certainly resign, but otherwise it may not be appropriate to do so.

## **APPENDIX**

### **Companies Act, 1990**

This Memorandum has been prepared by the Consultative Committee of Accountancy Bodies – Ireland (CCAB-I) to highlight for the members of its constituent bodies the implications of certain detailed provisions of Part X – Accounts and Audit – of the Companies Act, 1990. The Memorandum has been prepared following consultation with Senior Counsel.

CCAB-I issued an earlier Memorandum in March 1991 highlighting for the members of its constituent bodies those provisions of the Companies Act, 1990, which substantially change detailed provisions of previous companies legislation, or which introduced significant new statutory requirements for companies and/or officers. Certain provisions of this Act, brought into force by Commencement Order prior to March 1991, were listed as an Appendix to that earlier memorandum. The Companies (Commencement) (No. 2) Order, 1991, brings into force almost all the remaining provisions of this Act. Details of that Order, together with the commencement dates for the provisions of the Act, are set out in the Appendix hereto.

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## **RECORDS AND AUDITORS – PART X**

### **Books of account requirements**

- 1 Companies are required to keep proper books of account, whether in document format or otherwise, (such as, for example, computerised records). This Act expands on the existing requirements of the 1963 Act to require that:
  - a The entries in the company's books and records are made in a timely and consistent manner;
  - b The company's books and records correctly record and explain the transactions of the company;
  - c At all times the company's books and records will enable the financial position of the company to be determined with reasonable accuracy;
  - d The company's books and records will enable the directors to ensure that the annual accounts comply with the Companies Acts; and
  - e The company's books and records will enable those annual accounts to be readily and properly audited.
- 2 Proper books of account shall be deemed to be kept if they comply with these requirements and give a true and fair view of the state of affairs of the company and explain its transactions.
- 3 Furthermore, auditors of a company have now a statutory duty to notify the company as soon as they are of the opinion that proper books of account are not being kept or have not been kept. The Act exempts immaterial contraventions from this notification requirement but obliges the auditors to notify the Registrar of Companies in writing where the directors of the company have not taken the necessary steps within 7 days to ensure that proper books of account are kept.

- 4 Under this new statutory framework, where the Court considers that a company's failure to keep proper books of account has either:
- a Contributed to its inability to pay its debt; or
  - b Has resulted in substantial uncertainty as to the assets and liabilities of the company; or
  - c Has substantially impeded the orderly winding-up of the company;

The Court may, on the application of the liquidator or any creditor of the company, declare that one or more of the officers (or former officers) of that company are to be personally liable for all or part of the debts and other liabilities of the company. Such personal liability could extend to the company's auditor if he has failed, having formed the relevant opinion, to notify the company that proper books of account were not being kept.

#### **Accounting periods covered**

- 5 Section 205 provides that Section 202 to 204 – which set out the obligations of a company to keep proper books of account and the related penalties that may arise where proper books are not kept – apply “... as respects the accounts of a company for each financial year of the company beginning or ending after such date after the commencement of the provision as may be specified by the Minister by order.” Under the Commencement Order S.I. 117 of 1991 the Minister for Industry and Commerce has specified 2nd July 1991 as the relevant date.

Legal advice received by CCAB-I is, having regard to the nature of the obligation imposed by Section 202, the criminal offences created by Sections 202 and 203, together with the civil liability that arises

under Section 204, that the relevant provisions only apply to:

- 1 Financial periods of a company commencing on or after 2nd July 1991; and
- 2 Where a company's financial period straddles 2nd July 1991 the portion of that period falling after 2nd July 1991.

#### **Auditors' reporting obligations**

- 6 As noted in 3. Above, the auditors of a company are obliged to notify the company when they are of the opinion that proper books of account are not being kept or have not been kept. Section 194(1) of the Act uses the term “If, at any time, the auditors of a company form the opinion ...” in setting out this obligation.

Legal advice received by CCAB-I is that this term of reference means any time that the auditor is discharging his functions as an auditor – in other words when the auditors are carrying out an exercise which impinges upon the books of account, whether as part of the interim audit, the year end audit or a particular assignment such as attendance at a stock take – and information is acquired which suggests a contravention of Section 202. The auditor is then under an obligation to form an opinion at that time whether or not there has been a contravention.

- 7 Auditors should, however, ensure that they are made aware of any other relationships between any department of their firm and the company which could affect their work. They should ensure that they are informed of potential “Section 194” matters by all of the departments within their firm which have relationships with the company. It would, therefore, be prudent for such firms to establish adequate systems of inter-departmental communication so that any

such matters are brought to the attention of the appropriate partner responsible for the audit.

8 Auditors are not obliged to make a report under Section 194 where, in their opinion, the contraventions of Section 202 “ ... are minor or otherwise immaterial in nature.” In determining whether contraventions uncovered can be so described the auditor must assess the quantum in financial terms that is involved as a result of the failure and the impact of those contraventions upon the accounting system.

9 Where the auditors form the opinion that the company’s directors “ ... have taken the necessary steps to ensure that proper books of account are kept ...” they are not obliged to notify the Registrar of Companies of the contravention of Section 202 – which they would otherwise be obliged to do within 7 days of so notifying the company. It is theoretically possible for the company’s directors, up to the 7th day following the receipt of the notice from the auditors of such contravention, to take those necessary steps. Although it may frequently be possible to do so, this does not mean that the proper books of account have to be put in place but merely that the necessary steps have been taken within 7 days. For example, the nature of the contravention may be such that the company is obliged to advertise for and engage new competent staff to deal with its accounting records, while in the meantime arranging for some other party to maintain proper books of account. In determining whether the appropriate steps have been taken by the company’s directors, the auditors will have to assess the competence of the directors and the bona fides and extent of their actions within this 7 day period.

10 It should be remembered that the auditors’ duty to comply with the provisions of this Act is personal to them and, accordingly it is recommended that they obtain independent legal advice when in doubt or where deemed necessary in particular circumstances.

#### **Interpretation of detailed provisions**

11 Legal advice received by CCAB-I as to the nature of the obligations imposed by certain detailed requirements of Section 202(1) – in relation to the obligation to keep proper books of account – would indicate that:

1 The phrase “correctly record and explain” means that the recording and explanation of the company’s transactions must be correctly done and should not be misleading.

2 The requirement that the proper books of account “will at any time enable the financial position of the company to be determined with reasonable accuracy” does not imply instantaneous derivation but rather that, at any particular time, those books and records are such that without undue delay, having regard to the size and complexity of the company concerned, the financial position can be determined with reasonable accuracy. It is considered that the financial position of a company cannot be known unless a statement of assets, liabilities and reserves of a company is available, such as will enable its overall financial position to be assessed.

3 The proper books of account are to be such as will enable the directors to ensure that any balance sheet and profit and loss account “ .... Complies with the requirement of the Companies Acts ...”.

This compliance obligation is not restricted to the documents maintained in accordance with the record keeping requirements of Section 202(3) but would also extend to other subsidiary documents which may have an impact upon the balance sheet, profit and loss account, or disclosure notes to those statements.

- 12 Section 202(2) requires that the books of a company shall be kept “... on a continuous and consistent basis ...”. It is considered that this requires entries in the books of account to be made without undue delay and on a regular basis appropriate to the level of activity of a company, while meeting the requirements of Section 202(1). The further requirement that the entries into the books of account “... be consistent from one year to the next”, does not preclude changes in sub-analysis of the underlying records, nor variations arising from changes in accounting policies or as a result of new legislation.
- 13 In regard to the obligation in Section 202(3), that entries be made “from day to day”, such entries would not necessarily have to be made on a daily basis provided that they did record for each day the monies received and expended by the company. Furthermore, the analysis and disclosure given by documents in a particular company could be such that the “... record of all goods purchased and of all goods sold ...” and the “... record of all of the invoices relating to such purchases or sales” will be the same document.
- 14 Section 202(4) requires proper books of account to be such as will “... give a true and fair view of the state of affairs of the

company and explain its transactions”. The effect of this subsection is that there should be records kept, in the same manner as is required of the more formal books of account covered by Section 202, relating to matters that impact upon the state of affairs of the company e.g. contingent liabilities, litigation in progress, etc. These further records, though perhaps not directly dealt with by the accounting function of the company concerned, and probably maintained in correspondence file format, must be regarded as part of the books of account in the context of this subsection.

#### **Returns from branches**

- 15 Section 193(4)(c) requires the auditors’ report to include the expression of their opinion as to whether proper returns adequate for their audit have been received from branches of the company not visited by them. Obviously, if a particular company has no branches, this reporting requirement does not arise. Furthermore, since the returns from branches are qualified in terms of “... adequate for their audit ...” this statement need not be made in circumstances where:
- a A branch (or branches) is properly considered by the auditor as immaterial in the overall context of forming the opinion as to the true and fair view disclosed by the company’s financial statements;
  - b The auditor becomes aware that proper returns may not have been made by some or all of a company’s branches, but those branches’ activities are immaterial in the context of the company’s branches, but those branches’ activities are immaterial in the context of the company’s annual accounts.