LESSON 6

ACCOUNTS AND AUDIT

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STUDY TEXT

6.1 Books of Account

By s.147(1) every company shall cause to be kept in the English language "proper books of account" with respect to -

(a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;

(b) all sales and purchases of goods by the company;

(c) the assets and liabilities of the company.

S.147(2) provides that "proper books of account" shall be deemed not to have been kept with respect to the matters aforesaid if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

By s.147(3) (a) the books of account are to be kept at the registered office of the company or, with the consent of the registrar and subject to such conditions as he may impose, at such other place as the directors think fit, and shall at all times be open to inspection by the directors.

6.2 Profit and Loss Account

By s.148(1) the directors of every company shall, at some date not later than eighteen months after the incorporation of the company and subsequently once at least in every calendar year, lay before the company in general meeting a profit and loss account for the period, in the case of the first

account, since the incorporation of the company, and, in any other case, since the preceding account. The account shall be made up to a date not earlier than the date of the meeting by more than nine months or, in the case of a company carrying on business or having interests abroad, by more than twelve months.

A company which does not trade for profit is required to lay an income and expenditure account instead of a profit and loss account. The period during which the accounts are to be laid before the general meeting may be extended by the registrar for any special reasons.

6.3 Contents and Form of Accounts

By s.149(1), every balance sheet shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account shall give a true and fair view of the profit or loss of the company for the financial year.

By s.149(2), a company's balance sheet and profit and loss account shall comply with the requirements of the Sixth Schedule to the Act, (subject to such modifications as the registrar may, on the application or with the consent of the company's directors, allow).

6.4 Group Accounts

S.150(1) provides that if, at the end of its financial year, a company has subsidiaries, then it must include in its annual accounts "group accounts" dealing with the affairs of the subsidiaries as well.

By s.150(2)(b) group accounts need not deal with a subsidiary of the company if the company's directors are of opinion that -

i. it is impracticable, or would be of no real value to the members of the company, in view of the insignificant amounts involved, or would involve expense or delay out of proportion to the value to members of the company; or

ii. the result would be misleading; or

iii. the result would be harmful to the business of the company or any of its subsidiaries; or

iv. the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

The approval of the registrar shall be required for not dealing in group accounts with a subsidiary on grounds (iii) or (iv).

By s.150(2)(a), a company is exempt from the obligation to prepare group accounts if it is a wholly owned subsidiary of another body corporate incorporated in Kenya.

6.5 Form of Group Accounts

S.151(1) provides that the group accounts laid before a holding company shall be **consolidated accounts** comprising

(a) a consolidated balance sheet dealing with the state of affairs of the company and all the subsidiaries to be dealt with in group accounts;

(b) a consolidated profit and loss account dealing with the profit or loss of the company and those subsidiaries.

However, the group accounts need not be prepared in this form if the directors are of the view

that they could be prepared in another form which would be readily appreciated by the company's members (s.15(1)).

6.6 Contents of Group Accounts

By s.152(1), the group accounts laid before a company shall give a true and fair view of the state of affairs and profit or loss of the company and the subsidiaries dealt with thereby as a whole, so far as concerns members of the company.

S.153(1) further provides that the group accounts, if prepared as consolidated accounts, shall comply with the requirements of the Sixth Schedule to the Act, so far as applicable thereto, and if not so prepared, shall give the same or equivalent information.

6.7 Financial Year of Holding Company and Subsidiary

S.153(1) provides that a holding company's directors shall ensure that, except where in their opinion there are good reasons against it, the financial year of each of its subsidiaries shall coincide with the company's own financial year.

By s.153(2) the registrar is empowered to postpone the submission of a company's accounts to a general meeting from one calendar year to the next for purposes of enabling the company's financial year to end with that of the holding company.

6.8 Balance sheet

S.148(2) requires the directors to prepare and lay before the company in general meeting a balance sheet as at the date to which the profit and loss account, or the income and expenditure account, is made up.

By s.155(1) the balance sheet shall be signed on behalf of the board by two of the directors of the company, or if there is only one director, by that director.

By s.155(4) if any balance sheet is not signed as required but a copy is issued, circulated or published, the company and every officer who is in default shall be liable to a fine not exceeding one thousand shillings.

6.9 Accounts to be Annexed to Balance Sheet

By S.156 (1) the profit and loss account, and, so far as not incorporated in the balance sheet or profit and loss account, any group accounts laid before the company in general meeting, shall be annexed to the balance sheet. however, S.156 (2) requires the accounts so annexed to be approved by the board of directors before the balance sheet is signed on their behalf.

By S.156 (3), if any copy of the balance sheet is issued, circulated or published without having annexed thereto a copy of the profit and loss to be annexed, the company and every officer of the company who is in default shall be liable to a fine not exceeding one thousand shillings.

6.10 Directors Report

By S.157 (1) the balance sheet must have attached to it a directors' report on the company's affairs, including the amount, if any, which they recommend should be paid by way of dividend, and the amount, if any, which they propose to carry to reserves within the meaning of the Sixth Schedule to the Act.

6.11 AUDITORS

6.11.1 **APPOINTMENT**:

S.159 (1) provides that "every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that, until the conclusion of the next, annual general meeting".

6.11.2 **REAPPOINTMENT**:

By S.159 (2) a retiring auditor shall be deemed to be reappointed without any resolution being passed unless:-

a) he is not qualified for reappointment; or

b) a resolution has been passed at that meeting (i.e. annual general meeting) appointing somebody instead of him or providing expressly that he shall not be appointed; or

c) he has given the company notice in writing of his unwillingness to be reappointed.

6.11.3 **APPOINTMENT BY REGISTRAR:**

"Where at an annual general meeting no auditors are appointed or are deemed to be reappointed, the Registrar may appoint a person to fill the vacancy" (S.159 (3).

6.11.4 **APPOINTMENT BY DIRECTORS**:

The first auditors of a company may be appointed by the directors at any time before the first annual general meeting, and auditors so appointed shall hold office until the conclusion of that meeting.

In default of appointment of the first auditors by directors the company may do so. Where the directors have appointed the first auditors, the company may "at a general meeting remove such auditors and appoint in their place any other persons who have been nominated for appointment by any member of the company. Notice of nomination to be given to the members at least FOURTEEN DAYS before the date of the meeting.

6.11.5 **CASUAL VACANCIES**:

By S.159 (6) "The directors may fill any casual vacancy in th office of auditor, but while any such vacancy continues the surviving or continuing auditor or auditors, if any, may act".

6.11.6 **QUALIFICATIONS**:

By S.161 (1) "A person or firm shall not be qualified for appointment as auditor of a company unless he or, in the case of a firm, every partner in the firm is the holder of a practising certificate issued pursuant to s.21 of the Accountants Act

6.11.7 **PERSONS WHO CANNOT BE APPOINTED**:

Under S.161 (2) none of the following persons shall be qualified for appointment as auditor of a company

a) an officer or servant of the company;
b) a person who is a partner of or in the employment of an officer or servant of the company (unless the company is a private company);

c) a body corporate, and
d) persons who are disqualified for appointment as auditor of the company's subsidiary or holding company or subsidiary of the company's holding company.

6.11.8 **PENALTY FOR IMPROPER APPOINTMENT**:

S.161 (4) provides that if any unqualified person is appointed as auditor, the person appointed, the company and every officer in default, shall be liable to a fine not exceeding Shs.4,000/-.

6.11.9 **DUTIES OF AUDITORS**

The duties of auditors are explained in the following cases.

1. RE: KINGSTON COTTON MILL CO. (1896)(CHANCERY)

For some years before a company was wound up, balance sheets signed by the auditors were published by the directors to the shareholders in which the value of the company's stock-in-trade at the end of each year was **grossly overstated**. The auditors relied on certificates, **willfully false**, given by J., one of the directors who was also manager, as to the value of the stock-in-trade. Dividends were paid for some years on the footing that the balance sheets were correct but if the stock-in-trade had been stated at its true value it would have appeared that **there were no profits out of which a dividend could be paid**.

NOTE:

i) In each case the amount of stock-in-trade at the end of the year was entered in the balance sheet "as per manager's certificate".

ii) The manager was a man of great business ability and of high repute , and up to the stoppage of the company was trusted by everyone; but he had designedly exaggerated the value of the stock-in-trade in order to make the company appear prosperous.

QUESTION:

Was it the duty of the auditors to **test** the accuracy of the manager's certificate by a comparison of the **figures in the books**, and were they liable for the dividends which had been paid in consequence of the erroneous balance sheets?

HELD:

It being **not part of the duty of the auditors to take stock**, they were justified in relying on the certificates of the manager, a person of acknowledged competence and high reputation, and they were **not bound to check his certificates** in the absence of anything to raise suspicion. They were not liable for the dividends wrongfully paid.

NOTE:

i) An auditor is not bound to be suspicious where there are no circumstances to arouse suspicion; he is only bound to **exercise a reasonable amount of care and skill**.

ii) Where an officer of a company has committed a breach of his duty to the company, the direct consequence of which has been a misapplication of its assets, for which he could be made responsible in an action, such breach of duty is a "misfeasance' for which he may be **summarily** proceeded against under the Companies Act, and it is not necessary that an action should be brought.

The object of the section is to facilitate the recovery by the liquidator of assets of a company **improperly dealt with** by its promoters, directors and other officers. The section applies to **breaches** of trust and to **misfeasances** by such persons, but is inapplicable to cases of breach of contract, trespass, negligence, etc.

LINDLEY, LJ stated:

...To decide this question, it is necessary to consider -

1) what their duty was;
2) how they performed it, and in what respects (if any) they failed to perform it.

The duty of an auditor generally was very carefully considered by this court in RE: LONDON AND GENERAL BANK (1895) and I cannot usefully add anything to what will be found there. It was there pointed out that an auditor`s duty is to examine the books, ascertain that they are right, and to prepare a balance sheet showing the true financial position of the company at the time to which the balance sheet refers. But it was also pointed out that **an auditor is not an insurer**, and that **in the discharge of his duty he is only bound to exercise a reasonable amount of care and skill**. It was further pointed out that what in any particular case is a reasonable amount of care and skill depends on the circumstances of the case; that if there is nothing which ought to excite suspicion, less care may or ought to have been aroused. These are **the general principles which have to be applied to cases of this description**.

I protest, however, against the notion that an auditor is **bound to be suspicious** as distinguished from **reasonably careful**. To substitute the one expression for the other may easily lead to serious error..... Auditors are, however, in my opinion bound to see what **exceptional duties**, if any, **are cast upon them by the articles of the company whose accounts they are called upon to audit. Ignorance of the articles and of exceptional duties imposed by them would not afford any legal justification for not observing them**..... (such as taking stock). The complaints made against the auditors in this particular case... is that they failed to detect certain frauds. There is no charge of dishonesty on the part of the auditors. They did not certify or pass anything which they did not **honestly believe to be true**. It is said, however, that they were culpably careless..... frauds were committed by the manager, who in order to bolster up the company and to make it appear flourishing when it was the reverse, deliberately exaggerated both the quantities and values of the cotton and yarn in the company`s mills.... I confess I cannot see that their omission to check his (i.e. manager`s) returns was a breach of their duty to the company. **It is no part of an auditor`s duty to take stock**..... He must rely on other people for details of the stock in trade **on hand**. In the case of a cotton mill he must rely on **some skilled person** for the materials necessary to enable him to enter the stock-in-trade at its **proper value** in the balance sheet. In this case the auditors relied on the manager. He was a man of high character and of unquestionable competence. He was trusted by every one who knew him.... the directors are not to be blamed for trusting him. The auditors had no suspicion that he was not to be trusted to give accurate information as to the stock-in-trade **in hand**, and they trusted him accordingly in that matter. But it is said that they ought not to have done so, and for this reason. The stock journal showed the quantities that is, the weight in pounds of the cotton and yarn **at the end of each year**. **Other books** showed the quantities of cotton **bought during the year** and the quantities of yarn **sold during the year**. If these books had been compared by the auditors they would have found that the quantity of cotton and yarn in hand **at the end of the year** ought to be **much less** than the quantity shown in the stock journal, and so **much less** that the value of the cotton and yarn entered in the stock journal could not be right, or at all events was so abnormally large as to **excite suspicion** and demand **further inquiry**..... But although it is no doubt true that such a

process might have been gone through, and that, if gone through, the fraud would have been discovered, can it be truly said that the auditors were **wanting in reasonable care not thinking it necessary to test the managing director`s return**? I cannot bring myself to think they were, nor do I think that any jury of businessmen would take a different view. It is not sufficient to say that the frauds must have been detected if the entries in the books had been put together in a way which never occurred to any one **before** suspicion was aroused. The question is whether, no suspicion of anything wrong being entertained, there was a want of reasonable care on the part of the auditors in relying on the returns made by a competent and trusted expert relating to **matters on which information from such a person was essential**. I cannot think there was. The manager had no apparent conflict between his interest and his duty. His position was not similar to that of a cashier who was to account for the cash which he receives, and whose own account of his receipts and payments could not reasonably be taken by an auditor without further inquiry.

LOPES,LJ.:" ... (1) What is a misfeasance within the meaning of S.324(1)?

Have the auditors in the circumstances of this case committed a misfeasance? It has been held that an auditor is an officer within the meaning of the Section:- In RE LONDON AND GENERAL BANK. But has there been any misfeasance by the auditors? This depends upon what meaning is to be assigned to the word "misfeasance" as used in this section. The learned judge in the court below held that misfeasance covered any misconduct by an officer of the company as such for which such officer might have been sued apart from the section. In my judgement this is too wide. It would cover any act of negligence - any actionable wrong by an officer of a company which did not involve any misapplication of the assets of the company. The object of this section of the Act is to enable the liquidator to recover any assets of the company **improperly dealt with** by any officer of the company, and **must be interpreted bearing that object in mind**. It doubtless covers any breach of duty by an officer of the company in his capacity of officer resulting in any improper misapplication of the assets or property of the company..... It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog, but not a blood bound. He is justified in believing, tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and so rely upon their representations, provided, he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful. It is not the duty of an auditor to take stock; he is not a stock expert; there are many matters in respect of which he must rely on the honesty and accuracy of others. He does not guarantee the discovery of all frauds..... The duties of auditors must not be rendered too onerous. Their work is responsible and laborious, and the remuneration moderate. I should be sorry to see the liability of auditors extended any further than in RE LONDON AND GENERAL BANK.....

Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable.....

KAY, LJ.: ".... The words of the section are "any misfeasance or breach of trust in relation to the company.... misfeasance means something other than a breach of trust..... it does not mean mere non-feasance: RE WEDGWOOD COAL AND IRON CO..... I think the only safe interpretation to adopt is that it includes all cases other than breaches of trust in which an officer of the company has been guilty of a breach of his duty as such officer which has caused pecuniary loss to the company by misapplication of its assets, and for which he

might have been made liable in a action....."

2. RE LONDON AND GENERAL BANK

An auditor represented a confidential report to the directors calling their attention to the insufficiency of the securities in which the capital of the company was invested, and the difficulty of realizing them, but in his report to the shareholders merely stated that the value of the assets was dependent on realization, and in the result the shareholders were deceived as to the condition of the company, and a dividend was declared out of capital and not out of income.

HELD:

The auditors had been guilty of misfeasance under S.10 of the Companies (winding-up) Act, 1890, and was liable to make good the amount of dividend paid (amounting to $14,433.3s).

LINDLEY, LJ.: "..... it is the duty of the directors, and not of the auditors, to recommend to the shareholders the amounts to be appropriated for dividends and it is the duty of the directors to have proper accounts kept, so as to show the true state and condition of the company..... it is for the shareholders, but only on the recommendation of the directors, to declare a dividend. It is impossible to read the section of the Companies Act without being struck with the importance of the enactment that the auditors are **to be appointed by the shareholders, and are to report to them directly**, and not to or through the directors. The object of this enactment is obvious. It evidently is to secure to the shareholders **independent** and **reliable** information respecting the true financial position of the company at the time of the audit..... It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is **to ascertain and state the true financial position of the company** at the time of the audit, and his duty is confined to that. But then comes the question, how is he to ascertain that position? The answer is, by examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves show the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this his audit would be worse than idle farce. Assuming the books to be so kept as to show the company's true financial position, the auditor has to frame a balance showing that position **according to the books** and to certify that the balance sheet represented is correct **in that sense**. But his first duty is to examine the books, not merely for the purposes of ascertaining what they do show, but also for the purposes of satisfying himself that they show the true financial position of the company..... An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries, and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not even guarantee that his balance sheet is accurate according to the books of the company. If he did, he would be responsible for error on his part, even if he were himself deceived without any want of reasonable care on his part, say, by the fraudulent concealment of a book from him. His obligation is not so onerous as this.

Such I take to be the duty of the auditor; he must be honest.... i.e.**he must not certify what he does not believe to be true**, and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case depend upon the circumstances of that case.

Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient, and in practice I believe businessmen select a few cases at haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary; but, still, an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion, and he is perfectly justified in acting on the opinion of an expert where special knowledge is required..... It is satisfactory to find that the legal standard of duty is not too high for business purposes, and is recognized as correct by businessmen..... A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them,or some of them, to ask for more. Information and means of information are by no means equivalent terms.... The auditor is to make a report to the shareholders, but the **mode of doing** so and the form of the report are not prescribed..... an auditor who gives shareholders means of information instead of information respecting a company's financial position does so at his peril and runs the very serious risk of being held judicially to have failed to discharge his duty . In this case I have no hesitation in saying that Mr. Theobald did fail to discharge his duty to the shareholders in certifying and laying before them the balance sheet..... **without any reference to the report which he laid before the directors** and with no other warning than is conveyed by the words, "The value of the assets as shown on the balance sheet is dependent upon realization". It is a mere truism to say that the value of loans and securities depends on their realization. We were told that a statement to that effect, is so unusual in an auditor's certificate that the mere presence of those words was enough to excite suspicion. But, as already stated, the duty of an auditor might infer from an unusual statement that something was seriously wrong, it by no means follows that ordinary people would have their suspicion aroused by a similar statement, if, as in this case, its language expresses no more than any ordinary person would infer without.....the balance sheet and profit and loss account being true and correct in the sense that they were in accordance with the books. But they were, nevertheless, entirely misleading, and misrepresented the real position of the company. Under these circumstances I am compelled to hold that Mr. Theobald failed to discharge his duty to the shareholders... Possibly he did not realize the extent of his duty to the shareholders as distinguished from the directors, and he unfortunately consented to leave the Chairman to explain the true state of the company to the shareholders instead of doing so himself. The fact, however, remains, and cannot be got over, that the balance sheet and certificate of February 1892 did not show the true position of the company at the end of 1891, and that this was owing to the omission by the auditor **to lay before the shareholders** the material information which he had obtained in the course of his employment as auditor of the company, and to which he called the attention of the directors.... Where did the money come from with which the dividends were paid? The money came from **cash** at the bankers or in hand; but this cash could not be properly treated as **profit**, and the directors and auditors knew this perfectly well...."

RIGBY, LJ. "....The articles of association cannot absolve the auditors from any obligation imposed upon them by the statute.... Under the statute the members of the company are entitled to have the safeguard of an expression of opinion of the auditors to the effect, first, that the balance sheet, is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs.

The words "**as shown by the books of the company**" seem to me to be introduced to relieve the auditors from any responsibility as to affairs of the company kept out of the books and concealed from them, but not to confine it to a mere statement of the correspondence of the balance sheet with entries in the books. A full and fair balance sheet must be such a balance sheet as to convey any known causes of weakness in the financial position, or suggest anything which cannot be supported as fairly correct in a business point of view."

3. RE ALLEN CRAIG & CO. (LONDON) LTD. (1934) Chapter.483

The reports and balance sheets for the years ending June 30, 1925, and, June 30, 1926, were signed by two directors. The reports annexed to these balance sheets were signed by the auditors. The question was: What was the duty of auditors in respect of these two balance sheets?

The auditors merely sent the reports and balance sheets to the secretary of the company, and they never got beyond the secretary. The directors never called a general meeting to consider theses balance sheets and reports.

By S.162 (1) of the Companies Act "The auditors shall make a report to the members on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office....."

BENNET, J:

"....Does the statute impose on the auditors the duty of making their report to **every member of the company**?

Now if you give the words their plain meaning it would seem that that obligation is imposed on them. But when you begin to reflect on the question it cannot, I think, have been the intention of the legislators to impose that duty on the auditors and it certainly has never been the practice, since the obligation has been imposed, for auditors themselves to send their reports to every member of the company... **I do not think it possible to hold that the words "the members".... mean "all the members"**. It cannot be that the auditors are to be at the expense and trouble not merely of sending their report through the post but of delivering a copy to every member. It seems that **one is forced by circumstances to limit the meaning of the words "the members" and I hold that they mean "the members assembled in the general meeting"**.... if the report is to be made to the members in general meeting, then it would not be right, I think, to hold that the duty of the auditors is to make that report themselves to the members in general meeting unless they can themselves call a general meeting or can compel someone else to call a general meeting. **There are no means by which they can call a general meeting or compel other persons to convene a general meeting**. The only persons who can call a general meeting are the directors or **the meeting who have called upon the directors to do so and they have failed to do so**. The audience themselves are powerless.

In my judgement the duty of the auditors, after having affixed their signatures to the reports annexed to a balance sheet, is confined to forwarding, that report to the secretary of the company, leaving the secretary of the company or the directors to perform the duties which the statute imposes of **convening a general meeting to consider the report**....The statute compels directors to convene a meeting once a year and compels directors to present reports to the general meeting and it is for the shareholders to see that the directors do their duty...**the duty of the auditors is discharged by sending the report to the secretary of the company**....."

REINFORCEMENT QUESTIONS

1. "Compare the auditor's duties to the company which has appointed him with his duties to prospective investors in that company".

2. a. What advantages does a company enjoy in securing its debentures by way of a floating charge? *(4 marks)*

   b. What are the rules relating to **priority** of charges? *(6 marks)*

   c. In what circumstances will a floating charge "crystallise?" *(4 marks)*

   d. What provisions ought to be included in a debenture trust deed for the benefit of a creditor that is to lend money to a company on the security of a floating charge? *(6 marks)*

Check your answers with those given in Lesson 9 of the Study Pack

COMPREHENSIVE ASSIGNMENT No.3

TO BE SUBMITTED AFTER LESSON 6

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the College.

EXAMINATION PAPER. TIME ALLOWED: THREE HOURS. ANSWER ANY FIVE QUESTIONS

1. Kaiuki and Munene trade in partnership as garage mechanics. They are considering changing their form of business association and trading as a private registered company limited by shares.

   Explain to them the legal procedures that they must follow in order to form such a company, and advise them on the advantages and disadvantages of trading as a private compay as opposed to a partnership.

2. Give an account of the procedures a company must follow when it wishes:

   a. to reduce its capital; and
   b. to issue shares at a premium.

3. a. "A company must take great care when issuing share certificates". Explain this statement.

   b. G presents to H Ltd a valid document transferring 250 shares into his name. By mistake, HLtd issues him with a certificate for 2,500 shares. What are the possible consequences for H Ltd.?

4. The articles of Happy Days Ltd. include the following provisions:

   i. All disputes between the company and its members shall be referred to arbitration in the first instance.

   ii. Greg, Paul and Brian shall be the directors of the company for life.

   iii. Michael shall be employed as the company accountant.

   iv. The direcors shall have the power to declare dividend to paid to the shareholders

   v. Every member who intends to transfer his shares inform the directors who will take the shares between them at a fair value. Greg, Paul and Brian are members of the company. Michael is not.

      a. Philip, a shareholder, wishes to sell his shares in the company and offers to sell them to Greg, Paul and Brian. They refuse to buy them. Philip intends to bring action against Greg, Paul and Brian for breach of contract.

         Advise Philip.

b. At a properly convened and conducted extraordinary general meeting the second article referred to above is altered to read as follows:
Greg, Paul and Brian shall be directors of the company until they attain the age of 65 years. Brian will be 65 years of age next month and wishes to challenge the alteration. Brian holds 15% of the issued share capital of the company.

Advise Brian.

c. Michael's work has been unsatisfactory and for the last 2 years the directors have employed Frank as a company accountant. Michael wishes to challenge the failure to employ him in accordance with the article.

Advise Michael.

d. The company has made substantial profits and a dividend has been declared. The directors resolve to distribute this in a form of debentures stock carrying interest at 10% and redeemable at par in 1995. John, a shareholder, wishes to have his dividend in cash and to challenge the directors resolution.

Advise John.

5. a. What are the provisions of the Companyies Act relating to quorum at general meetings of a registered company and calling of such meetings?

b. The article of association of Pole Ltd. provide that "no business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business".

Matata, a hot-tempered member of the company, attended the annual general meeting of the company which was held last week. He argued at length against an ordinary resolution which had been proposed. In the end, he lost his temper and left the meeting. His absence reduced the quorum below requisite minimum but the resolution was passed by the remainder of those present. He has come to enquire from you as to whether the resolution is valid.

What advise would you give him?

6. a. What is the rule in Royal British Bank V. Turguand (1856), and what defence against its application are available to a company?

b. Beetlecrush Ltd. was a company involved in pest control. In 1991 Pellet was appointed as a Managing Director of the company by a board resolution, which gave him exclusive power to manage the company, subject only to a requirement to get the approval of the board for all the contracts in excess of £50,000.

On behalf of the company, Pellet began negotiation for the purchase of the insecticides from Toxin, who had supplied the company with similar products for a number of years. Before these negotiations were concluded, Toxin accepted an invitation to become a member of the board of Beetlecrush Ltd. and henceforth duly attended its board meetings. Some months after this, Pellet, without getting the approval of the board, signed a contract with Toxin for the supply of £80,000 worth of insecticides.

Preliminary trials with these insecticides have revealed that they are not as effective as the company has been hoping. The board, with exception of Pellet and Toxin, is now seeking a way in which the company can claim that it is not bound by its obligations under the contract.

Advise the board.

7. What are the characteristics of a floating charge?

What is the effect of crystallisation?

State two advantages and two disadvantages of a floating charge.

8. Under what circumstances may a company be wound up on the ground that "it is just and equitable" to do so?

END OF COMPREHENSIVE ASSIGNMENT No.3

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