

Directors and Secretary

Chartered Accountancy Corporate Level Corporate Law (LAW)

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DIRECTORS

Who is a Director?

As per Sec.529 “director” includes a person occupying the position of director of the company, by whatever name called. As per this definition, whether a person is a director or not does not depend on his title, but it depends on his function. The main functions of a director is attending board meetings, taking part in decision making and controlling the company’s business.

Anyone who does these functions is treated as a director even though he is called by some other name. Therefore, if a person does not attend board meetings and contribute to the management of the company, he will not be treated as a director even though he is called as a director.

Number of Directors

As per Section 201, a company shall have at least one director, except a public company which should have at least two directors. There is no maximum limit in the Companies Act. The minimum number stated above can be increased by the articles but cannot be reduced.

CLASSIFICATION OF DIRECTORS

Directors



Executive Directors	Non-Executive Directors
<ul style="list-style-type: none">• They are fulltime employees involved in day-to-day management• Perform a specific role under a service contract• May be distinguished by a special title such as ‘Managing Director’, ‘Sales	<ul style="list-style-type: none">• They are working part time for the company• Not treated as employees.• Bring outside expertise to Board.• Contribute independent view.• Exert control over executive directors.• NEDs are subject to the same duties,

<p>Director' or 'Finance Director'</p> <ul style="list-style-type: none"> Executive directors are agents as well as employees of the company. 	<p>controls and potential liabilities as executive directors.</p> <ul style="list-style-type: none"> According to Corporate Governance Rules, the board of directors of the company should include at least - <ul style="list-style-type: none"> i. two non-executive directors; or ii. such number of non-executive directors equivalent to one third of the total number of directors whichever is higher.
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Executive and Non-Executive

The law does not classify directors as executive directors and non-executive directors. But in practice, directors are classified as executive directors and non-executive directors by the roles they play in the company's activities. Generally, all the directors have **non-executive functions**, such as **attending board meetings, advising, and taking constructive part in making decisions**; but some directors, in addition to these general duties, may also take special responsibility in the day-to-day management of the company's activities. Such directors are known as Executive Directors. Example - managing directors, finance directors, director-legal etc.

However, in small private companies, generally one or two directors will be there, such directors will perform both non-executive and executive functions. The Companies' Act doesn't impose any **mandatory** requirement that a board should consist of Non-Executive directors but the **Listing Rules of the Colombo Stock Exchange** require **Public Listed Companies** to have a **minimum of two non-executive directors**.

It is important to note that the duties imposed by the companies' act apply to both Executive and Non-Executive Directors in the same way.

Executive Directors

- They are fulltime employees involved in day-to-day management
- They receive a salary for their post
- Perform a specific role under a service contract
- May be distinguished by a special title such as 'Managing Director', 'Sales Director' or 'Finance Director'
- Executive directors are **agents** as well as **employees** of the company.

Non-executive directors (NED)

- They are working part time for the company
- Not treated as employees.
- They receive an allowance for working as NED
- Bring outside expertise to Board.
- Contribute independent view.
- **Exert control over executive directors.**
- NEDs are subject to the same duties, controls and potential liabilities as executive directors.
- **According to Corporate Governance Rules,** the board of directors of the company should include **at least** -
 - iii. **two non-executive directors;** or
 - iv. such number of non-executive directors equivalent to **one third of the total number** of directors whichever is higher.

Any change occurring to the above ratio should be rectified within ninety (90) days from the date of the change.

Managing Director (Chief executive officer)

- A director appointed to carry out overall day to day management functions
- MD/CEO has the **apparent authority** to enter into all contracts of a commercial nature

Alternate Director

- Appointed by a director to attend and vote for him at board meetings which he is unable to attend.
- Can be another director within the same company or an outsider.

Shadow Directors

The term shadow director is not used in the Act, but as per Sec.529, the word “director” includes ‘a person in accordance with whose directions or instructions the board of the company is accustomed to act’. Therefore, if a person instructs the board of directors how to act and if the board of directors has the habit of acting in accordance with such instructions, such a person will be treated as a shadow director. Therefore, a shadow director is not appointed to the director board, but he directs the board of directors from outside.

According to the Companies Act, a shadow director is liable similar to validly appointed directors for the purposes of directors’ duties and obligations. However, a consultant is not a shadow director by reason only of the fact that he gives advice to directors in a professional capacity.

QUALIFICATION OF DIRECTORS

As per section 202 (1) any person who is not disqualified under section 202(2) may be appointed as a director of a company.

Disqualified Persons - Sec. 202 (2)

The following persons shall be disqualified from being appointed or holding office as director of a company—

- (a) a person who is under eighteen years of age;
- (b) a person who is an undischarged insolvent;
- (c) a person who is prohibited from being a director under the Companies Act, No. 17 of 1982;
- (d) A person who is prohibited from being a director or promoter under section 213 or section 214 of this Act;
- (e) A person who has been adjudged to be of unsound mind;
- (f) A person that is not a natural person;

- (g) a person who does not comply with **any qualifications** contained in the **articles** of a company.

Appointment of Directors

As per Sec. 203 a person shall not be appointed as director of a company unless he has, (a) consented to be a director; and (b) certified that he is not disqualified from being appointed as a director of a company. For this purpose, he should sign Form 18.

Appointment of First Directors (Sec. 204)

A person named as a director in an application for incorporation (Form 1) shall hold office as a director from the date of incorporation until that person ceases to hold office as a director.

Appointment of Subsequent Directors (Sec. 204)

Unless the articles provide otherwise all subsequent directors of a company shall be appointed by **ordinary resolution** at a meeting of shareholders.

Removal of Directors (Sec. 206)

Subject to the provisions contained in the articles of a company, a director may be removed from office at a meeting of shareholders by way of **an ordinary resolution**. In the notice calling the meeting the removal of the director should be stated.

When notice is given of an intended resolution to remove a director such a director may make **representations** within a period of **fourteen days of such notice** with a request to send copies to all shareholders, the company shall send copies of the said representations to all shareholders. If the representations are not sent due to the company's default, such a director may require that the representations be read at the meeting.

Director Ceasing to Hold Office- Vacation of Office (Sec. 207)

The office of director of a company shall be vacated in any of the following circumstances

- (a) If the director **resigns** his post
- (b) If he is removed from office by the company-i.e. by way of an ordinary resolution
- (c) If he becomes disqualified from being a director
- (d) If he dies;
- (e) If he vacates office due to age limit i.e. attaining the age of 70 years (applicable to public companies)
- (f) If he vacates office in accordance with the articles of the company.

Resignation by a Director

A director of a company may resign by signing a **written notice** of resignation and **delivering** it to the **registered office** of the company, **the notice is effective** when it is received at the registered office. According to section 208, where **a company has only one director**, that director may not resign office until that director has called a meeting of shareholders to receive notice of the resignation, and to appoint one or more new directors.

Retiring Age of Directors (Sec. 210)

No person shall be capable of being appointed as a director of a **public company** or of a **private company** which is a **subsidiary of a public company**, if he has attained the age of **seventy years**. **Such a director vacates office at the conclusion of the annual general meeting commencing next after he attains the age of seventy years;**

Appointment of a Director who has attained the age of 70 Years (Sec. 211)

If a resolution is passed by the company at a general meeting which declares that **the age limit** referred to in section 210 **shall not apply to a particular person**, then the appointment of such a person as a director will be valid.

The notice of any such resolution should state the age of that person. However, his **appointment is valid only for one year**.

DIRECTORS' DUTIES

Before the Companies Act 2007 was introduced, the duties of directors were mainly governed by the Common Law. The Companies Act 2007 recognizes most of these duties and they are discussed below.

1. **Duty to Act in good Faith and in the Interests of Company** Sec.187

He should act in good faith in **what that person believes** to be in the interests of the company.

2. **Duty to Comply with Act and Company's Articles** (Sec.188)

He should always act without violating the Companies Act and the articles of the company.

3. Duty of **skill and care** (**standard** of care) (Sec.189)

- a) He should not act in a manner which is **reckless** or **grossly negligent**; and
- b) He should exercise the **degree** of skill and care that may be reasonably expected of a person of **his knowledge and experience**.

Dorchester Finance Co. Vs Stebbings (1989)

The company had **one executive director** and two other **non- executive directors both of whom were accountants**. The company had granted some loans, which were **irrecoverable** due to **non-compliance** with the **statutes**. The non-executive directors **used to sign blank cheques** without checking the other director's work. Held that the executive director was liable for **misappropriation** of the company's funds and the non-executive directors too were liable in **negligence** for signing blank cheques.

4. Use of Information and Advice (Sec.190)

A director of a company may rely on reports, statements, financial data **and other information** supplied, and on **professional or expert advice** given by any of the following persons:

- (a) an employee of the company;
- (b) a professional adviser or expert
- (c) any other director or
- (d) committee of directors in which the director did not serve.

But when making **such reliance** on such reports, statements etc. the director should (a) act in good faith; (b) make proper inquiry; and (c) should not have knowledge that such reliance is unwarranted.

Other Duties and Responsibilities

- **Disclosure of Interest Sec. 192**

If a director is **getting** a **material financial benefit** **directly or indirectly** from **a transaction** to which **the company is a party** such a director is said to be **interested** in the transaction. A director after becoming aware of the fact that he is interested in a transaction should enter his interest in the **interests register** and if

the company has more than one director, he should disclose to the board of the company, the nature and extent of that interest.

Every director who fails to comply with these requirements shall be **guilty of an offence**, and be liable **on conviction** to a fine not exceeding two hundred thousand rupees.

Directors Interest Register

The companies act requires every company to maintain an interest register, in the interest register; the directors should enter the details of **personal benefits** received by them from the company and in the transactions involving the company if they get any personal benefits such details also should be disclosed in the interest register.

A private company can dispense with (avoid) the maintaining of such a register if a unanimous resolution is passed by the shareholders, but such a unanimous resolution shall cease to have effect, if any shareholder gives notice in writing to the company, that he requires it to keep an interest register.

Avoidance of transaction

As per Sec.193(1) a transaction entered into by the company in which a director of the company is interested, **may be avoided (cancelled) by the company** at any time **before the expiration of six months after** the transaction, and the director's interest in it have been disclosed to all the shareholders (whether by means of the company's annual report or otherwise). **As per Sec.193(2) a transaction shall not be avoided if the company receives fair value under it.**

- **Duty of Directors on **Insolvency** Sec. 219**

A director who **believes** that the company **is unable to pay its debts** as they fall due, **should call** a **meeting of the board** to consider whether the **board should apply to court for the winding up** of the company **or carry on further the business** of the company. Failure to do so may make **the director liable for any loss** suffered by creditors of the company.

- **Duty of Directors on Serious Loss of Capital Sec. 220**

If at any time it appears to a director that the **net assets** of the company are **less than half** of its **stated capital**, the board should within **twenty working days** of that fact becoming known to the director, **call an extraordinary general meeting of shareholders** of the company to discuss the financial position of the company. Failure to do so is a **criminal offence** and every director who knowingly and willfully permits the failure is liable to a fine.

$$\text{Net Assets are } 5\text{M} \qquad \text{Stated Capital } 11\text{M} \quad \times \quad \frac{1}{2} \quad = 5.5\text{M}$$

POWERS OF DIRECTORS

Management of Companies

In companies the ownership and management are divided and exercised by two different hands. The **ownership** is vested in the hands of **shareholders** and the **management** of the company is vested in the hands of **directors**.

Sec.184 provides that **subject to the provisions in the articles** 'the board' of the company has **all the necessary powers** for the management of the business and affairs of the company.

As per Sec.215, the articles of a company shall govern the proceedings of the board of a company.

Major Transactions Sec. 185

"Major Transaction" means

- (a) The **acquisition** or the **disposition** of the **whole** or **more than 50%** of the **value** of the **assets** (whether corporal or incorporeal) of the company;
- (b) acquiring rights or interests or **incurring obligations** or liabilities of a **value** which is **greater than 50% of the assets**;
- (c) transactions which have the purpose or effect of **substantially altering** the **nature of the business** carried on by the company.

A company shall not enter into any major transaction, unless such transaction is—

- (a) approved by special resolution;
- (b) contingent on approval by special resolution;
- (c) consented to in writing by **all** the shareholders of the company; or
- (d) a transaction which the company is expressly authorised to enter into by a provision in its articles, which was included in it at the time the company was incorporated.

CORPORATE GOVERNANCE

Corporate governance has been defined **as the system** through which companies are directed and controlled. It refers to the way in which companies are run and operated effectively and properly and is not mismanaged.

Corporate governance developments in the UK

The need for corporate governance emerged after the collapse of several high-profile companies in the UK, most of them failed as a result of **large-scale fraud** by **their directors**.

Therefore, the need for a **proper system** of corporate governance was realized. This led to the establishment of the **Cadbury Committee** which published its report in 1992 (known as Cadbury Report). It made a number of **recommendations** and focused on **standards of** corporate behaviour and ethics. The Cadbury Report was developed from time to time in UK through a series of re-workings in the forms of reports and codes.

Corporate governance in SL

In Sri Lanka also in order to ensure the effective corporate governance from time-to-time rules, regulations and voluntary codes have been created. In this regard the Institute of Chartered Accountants of Sri Lanka has published certain codes such as the **Code of Best Practice (1997)**- relate to **Financial Aspects** of Corporate Governance, the **Code of Best Practice on Audit Committees (2002)** and the **Code of Best Practice on Corporate Governance (2003)**

Corporate governance codes set out what are considered 'best practices' for running companies. Therefore, some codes are voluntary and some other codes are Mandatory. The Code of Best Practice on Corporate Governance (2003) is a voluntary code. In relation to listed companies; the Mandatory Code of Corporate Governance was adopted in 2008.

As per the Code of Best Practice on Corporate Governance (2003), the Boards of directors are responsible for the governance of their companies. The board should

1. set up the company's strategic aims
2. provide the leadership to put the aims into effect
3. supervise the management of the business and
4. report to shareholders about their activities.

As per the Code of Corporate Governance (2008), in public listed companies the board should include an appropriate combination of executive and independent non-executive directors. The independent non-executive directors do not usually have a full-time relationship with the company; they are not employees and only receive directors' fees.

The independent non-executive directors bring outside experience and expertise to the board of directors and they should appoint and remove executive directors and determine the remuneration of executive directors.



COMPANY SECRETARY

The Companies' Act **does not define** the term Secretary. But sec. 221(1) provides that **every company should** have a secretary.

APPOINTMENT AND REMOVAL

The First Secretary

The first secretary of the company is appointed at the time the company is incorporated; that is by Form 1 (Application form for incorporation).

Subsequent Secretaries

Subsequent Secretaries can be **appointed** and **removed** by the **directors**. If the board appoints a new secretary that appointment must be notified to the Registrar of Companies by way of **Form 20 within 20 working days** of his appointment.

The first secretary and the subsequent Secretaries should sign **Form 19** before acting as a Secretary.

Qualifications of a Secretary Sec. 222

Generally, a company can have any person as its secretary. But if a company has a **turnover of Rupees One Million (Rs.1,000,000/-) or more** or **stated capital of Rupees Five Hundred Thousand (Rs.500,000/-) or more**, such a company should have a qualified person as its secretary.

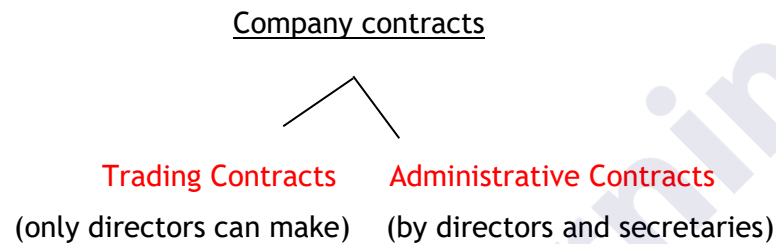
A qualified person should be a **citizen of Sri Lanka** and **ordinarily resident** in Sri Lanka and he should have one or more of the following qualifications

1. An Attorney at Law of the Supreme Court
2. Members of the Institute of Chartered Accountants of Sri Lanka (CASL)
3. Members of the Institute of Chartered Secretaries and Administrators of Sri Lanka
4. Members of the Chartered Institute of Management Accountants (CIMA)
5. Members of Certified Management Accountant (CMA) Sri Lanka

Even **a company** or **a partnership** may be appointed as the secretary of a Company. In such a case **at least one** director or a partner must have one of the above qualifications.

Apparent or Ostensible Authority of a Secretary

A secretary has apparent authority to make **administrative contracts** on behalf of the company. When he makes such a contract the Company is bound by it even though he makes use of that contract for his personal advantage. Administrative contracts include purchasing stationeries, hiring or purchasing vehicles for the administrative purposes, recruiting employees etc.



However, a Secretary does not have Apparent Authority to do the following Activities

1. Borrow money on behalf of the company
2. Make trading contracts on company's behalf

The Position of a Company Secretary

A Company Secretary was earlier treated as a clerk or as a servant of a company. He **did not have any power or authority** to represent the Company. This position was clearly reflected in

Barnett & company Vs South London Transways Company (1887)

In this case **Lord Esher** said "A Secretary is a mere servant; his position is that he should do **what he is told to do**. **No one can presume** that he has any authority to represent a company in making **contracts**".

But over the years a Company Secretary became a much more important person. Now he is treated as a **Chief Administrative Officer** of the company. He is entitled to make **administrative contracts on behalf of the company**. He is required to possess **professional qualifications** to function as a Secretary. Even directors or any other officers are not expected to have these qualifications. This shows the importance of the company Secretary in the modern Company Law.

Panorama Developments (Guilford) Ltd. Vs Fidelis Furnishing Fabrics Ltd. (1971)

In this case a company secretary hired a car stating it to be for the company purpose. But in fact, he used the car for his own private purposes. The company refused to pay for the hire. But court held that the company secretary may hire cars on behalf of the company because it is an **administrative contract**. Therefore, if he has hired a car, company is liable to pay even though it was used for his own purposes. Because the secretary has an apparent authority to make administrative contracts.

Lord Denning in giving the above judgement said “company secretary is a much more important person nowadays than he was in 1887. **He is an officer** of the company with extensive duties and responsibilities. This appears not only in the Company’s Act but also by the role he plays in the day-to-day business of Companies. He is no longer a mere clerk. He is entitled **to sign contracts** with the **administrative side** of a company’s affairs”.



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Notice of
CHANGE OF DIRECTOR/SECRETARY AND PARTICULARS OF DIRECTOR/SECRETARY
 Section 223(2) of the Companies Act No. 7 of 2007
[If there is insufficient space on the form to supply the information required, attach a separate sheet containing the information set out in the prescribed format]

No. of Company

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Company Name

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Indicate the purpose for which this notice is given by placing in the appropriate box

- (a) Change of Director and/or particulars of Directors.
- (b) Change of secretary and/or particulars of secretary.

Directors/Secretary ceasing to hold office

Full name *	Office eg: Director/Secretary	Residential address	Date on which he ceased to hold office	Reason**

Appointment of new Directors/Secretaries

Full name *	Office Director/Secretary ***	NIC No or Passport No (Specify Country)	Residential Address	Email Address (optional)	Date of appointment ***

In the case of appointment of a new Director/Secretary, the consent and certificate of the new Director/Secretary must be attached to this Form. (Please use Form 18 or 19 (as the case may be) for this purpose)

Presented by		Email (Optional)
		Telephone:
		Facsimile :

*Please give first name(s) followed by surname in Block letters:
 ** State whether resignation/death
 *** in the case of the secretary please give the registration number if applicable.

Change of name or residential address of Director/Secretary
 Complete only those details that apply [Attach separate sheets for multiple entries]

Name of Director/Secretary
 Director/Secretary

First names

Residential address

Former Name of

Former first names

Former Residential address

Date of change

Day

Month

Year

Set out below are the names and residential address of the every person who is a Director/Secretary of the company from the date of this notice

Full name *	Residential Address

Signature of Director / Secretary **

Full Name of Director / Secretary**:

Date :

Day

Month

Year

Notice should be delivered to the Registrar of Companies, **within 20 working days** of the change occurring.

* Please give first name(s) followed by surname in Block letters:

** Delete what is not applicable