

**Companies Act No. 7 of 2007**  
**List of papers prepared by Review Committee**

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**Companies Act No. 7 of 2007**  
**Objects of the company**

1. Objects of a company

The articles of the company may provide for the objects of the company – Section 13(a)

Note: It is not mandatory for the articles to specify the objects of the company

2. Amendment of objects

Subject to any conditions in its articles, a company may by special resolution amend/delete the objects contained in the articles under the general powers to amend its articles – Section 15(1)

3. Effects of statement of objects in the articles

3.1. Unless the articles provide otherwise, the statement of objects in the articles shall be deemed to be a restriction on the company carrying on any business or activity that is not within those objects- Section 17(1).

3.2. Where the articles provide for any restriction on the activities in which a company may engage, the capacity and powers of the company shall not be effected by such restriction and no act of the company or contract or other obligation entered into by the company or transfer of property by or to the company shall be invalid by reason only that it as done in contravention of such restriction. – Section 17(2).

3.3. Nothing in section 17(2) shall affect-

3.3.1.the ability of a shareholder or director to apply to court under section 233 to restrain the company from acting in a manner inconsistent with the restriction placed in the articles, unless the company has entered into a contract or binding obligation to do so,

3.3.2.the liability of a director for acting in breach of section 188 – Section 17(3)

Notes: (a) Section 233 provides for an application to court for a restraining order against the company or a director engaging in conduct that would contravene the articles.

(b) Section 188 prohibits a director acting in a manner that contravenes any provision of the Act or of the articles.

**Companies Act No. 7 of 2007**  
**-Pre-emptive rights of existing shareholders- Section 53**

1. Existing shareholders of a specified class must be offered the right to subscribe to any new issue of shares before such shares are offered to non-shareholders or shareholders of other classes of shares except under the following circumstances:
  - 1.1. the articles provide otherwise, or
  - 1.2. such new shares rank below the existing shares of the specified class under consideration, in relation to both voting rights and distribution rights.
2. If the existing shareholders become entitled to subscribe to the new issue in the manner described in paragraph 1, each such shareholder must be offered such number of new shares to ensure that the relative voting rights and distribution rights which he enjoyed before such distribution are maintained.
3. Section 53(2) provides that the existing shareholder who becomes entitled to subscribe to the new shares must be afforded *reasonable time* in which to make such subscription. '*Reasonable time*' will depend on the circumstances, but in general a period of one month would appear to be sufficient unless in exceptional circumstances.
4. *From 1.1 above it would be noted that the articles can provide for the removal of such pre-emptive rights from all/any class of shareholders.*

**Companies Act 7 of 2007**  
**'Solvency test' - Section 57**

1. The solvency test has two elements, namely the ability of the company to pay its debts as they become due in the normal course of business, and secondly, that the value of the company's assets is greater than the sum of the value of its liabilities and its stated capital. The first element does not present difficulty in its application but the second does; in particular, 'value' and 'assets'.
2. Section 57(2) gives guidance in the application of the solvency test. Clause (a) requires that the most recent financial statements prepared in accordance with Section 151 shall be taken into account. Clause 151(2) (b) requires that such financial statements shall comply with the requirements which apply to it under any other law. Section 6 of the Accounting & Auditing Standards Act No. 15 of 1995 makes it compulsory for any 'specified business enterprise' to apply Sri Lanka Accounting Standards ('SLAS') in the preparation of its financial statements. Accordingly, companies that are 'specified business enterprises' are required to follow SLAS in the preparation of their financial statements referred to in section 151.
3. Read by itself 'assets' referred to in clause 57(1)(b) will include all forms of assets both tangible and intangible but read together with clause 57(2)(a), which makes SLAS 37 (inter alia) applicable, internally generated goodwill shall not be recognized as an asset in financial statements prepared in accordance with section 151. Accordingly, even if internally generated goodwill is a substantial asset, its value is excluded in the financial statements prepared in accordance with section 151 and consequently in determining the value of the company's assets for the purpose of the solvency test if the company is a 'specified business enterprise'. Similar reasoning will ensure that only assets and liabilities that appear in financial statements prepared in accordance with SLAS will be taken into account in applying the solvency test.
4. As regards 'value' too, for the reasons set out in paragraph 2 above, the provisions of clause 57(2)(a) require that account is taken of the value of assets and liabilities in financial statements prepared in accordance with SLAS. Some of the provisions in SLAS governing valuation are given in annexe A. However it appears from clause 57(2) (c) that it is possible to substitute the value ascertained in accordance with SLAS with a 'fair valuation or other method of assessing value'. For instance, if an asset is valued at cost in accordance with SLAS and its fair value is higher, it appears permissible to substitute its fair value in applying the solvency test.
5. Paragraphs 3 and 4 apply to 'specified business enterprises' as defined in Accounting & Auditing Standards Act No. 15 of 1995. However financial statements of any other enterprise that are prepared/audited by a member of ICA must comply with SLAS, thus ensuring that the same rules as specified in paragraphs 3 and 4 apply for the solvency tests for such enterprises.

**Conclusion**

For the purpose of the solvency test:

- (a) what constitutes assets and liabilities shall be based on data in financial statements prepared in accordance with SLAS.
- (b) the value of such assets and liabilities shall be as in the financial statements prepared in accordance with SLAS except that it is permissible to substitute fair value for the value of any asset if such fair value is higher.

**Companies Act 7 of 2007**  
**'Solvency test' - Section 57**

**Provisions in Sri Lanka Accounting Standards regarding valuation of assets**

1. P, P&E in accordance with SLAS 18. Initial recognition is at cost and subsequent recognition is at cost less accumulated depreciation if the cost model is followed, or at revaluation less depreciation since revaluation, if the re-valuation model is followed. Both methods are subject to provision for impairment.
2. Investment property in accordance with SLAS 40. Initial recognition at cost and subsequent recognition either at cost or at fair value applied to all investment property.
3. Intangible assets in accordance with SLAS 37. Initial recognition is at cost. Subsequent recognition is either at cost less accumulated amortization and accumulated impairment losses or at fair value less any subsequent amortization and impairment losses.
4. Financial assets in accordance with IAS 32 and IAS 39. Initial recognition is at fair value plus (except in the case of financial assets at fair value through profit & loss), transaction costs. Subsequent recognition is at fair value without any deduction for transaction costs except for the following:
  - 4.1. Loans, receivables and held to maturity investments, at amortised cost.
  - 4.2. Unquoted equity instruments whose fair value cannot be reliably measured and derivatives that must be settled by delivery of such unquoted equity instruments, at cost.
5. Investments in accordance with SLAS 22. Current investments are carried either at market value or at the lower of cost and market value, the latter at either individual, portfolio or category basis. Long-term investments are carried at either cost or re-valued amount or, in the case of marketable equity securities, the lower of cost or market value determined on a portfolio basis. The carrying amount of individual long term investments shall be reduced to recognise a decline in value other than temporary.
6. Investments accounted for using the equity method in accordance with SLAS 26. Recognised at cost or in accordance with SLAS 22- Accounting for Investments
7. Plantations in accordance with SLAS 32
  - 7.1. Bare land is either acquired outright or on lease. The former is recognised in accordance with SLAS 18 (P, P&E) and the latter in accordance with SLAS 19, Leaseholds.
  - 7.2. Permanent land development costs are not depreciated except on leasehold land
  - 7.3. Limited life land development costs are depreciated over their useful lives or over the balance period of the lease, if on leasehold
  - 7.4. Infilling costs are capitalised if future benefits are beyond the assessed standard performance and depreciated over the remaining life of the relevant plantation. If not they are expensed
  - 7.5. Consumables are accounted for as inventories in accordance with SLAS 5
  - 7.6. Unsold produce is valued at net realisable values and expenses to bring such produce into saleable condition are expensed in the accounting period in which such produce is harvested
  - 7.7. Nursery costs such as direct material costs and labour costs and directly attributable overheads are charged to the nursery account which is credited with the cost of suitable plants at the lower of cost or net realisable value. Plants sold/utilized are charged to P&L at cost/net realisable value and any profit/loss accounted for in P&L
8. Inventories in accordance with SLAS 5. Inventories are recognized at the lower of cost or net realisable value

**Companies Act No. 7 of 2007**  
**Dividends -Section 60**

1. What is a dividend?

Section 60 (1) defines a dividend as 'a distribution out of profits of a company, other than an acquisition by the company of its own shares or a redemption of its shares by the company'.

The significant points to note are:

- a. The company must distribute its assets which have an economic value to the shareholder in satisfaction of the dividend
- b. It does not distribute its profits, as a literal interpretation seems to imply; but off sets the book value of the assets distributed against its accumulated profits as an accounting entry.
- c. The profits for any year will be the profits brought out in the financial statements prepared in accordance with section 151 of the Act, which, inter alia , requires compliance with Sri Lanka Accounting Standards (as more fully explained in the note titled ' "Solvency test" - section 57')

2. "Distribution"

A dividend comes within the definition of a 'distribution' in section 529 of the Act and, consequently, the following provisions covering distributions apply to dividends:

- b. payment of a dividend must be authorised by the board and, unless the articles provide otherwise, by the shareholders by ordinary resolution (section 56(1))
- c. the board can authorise a dividend at its discretion but it must satisfy itself that the company will meet the solvency test (see section 57) immediately after the distribution is made and must obtain a certificate of solvency from the auditors (section 57(2)). In applying the solvency test for this purpose, "debts" include the amount payable on shares entitled to fixed preferential returns, which rank above the shares on which dividends are payable, except where such preferential dividend is subject to specific board authorization. (sections 57(2) and 57(4))
- d. The directors who vote in favour of the distribution of the dividend must sign a certificate stating that in their opinion the company will satisfy the solvency test after the payment of the dividend (Section 57(3))

3. Equitable payment of dividends

The directors must authorise the same dividend to all shareholders of the same class unless the dividend is reduced in proportion to any liability attached to the shares in accordance with the articles or the shareholder has agreed in writing to a lesser or no dividend. (Section 60(2))

**Companies Act Review Committee**  
**Purchase shares/redemption of own shares**

1. Accounting treatment of the purchase of its own shares (section 64) or the redemption of its shares (section 66)

Section 63(3) provides that shares that are purchased or redeemed must immediately be deemed cancelled. This implies that the stated capital representing such shares must be eliminated. However, section 58(1) defines stated capital as the ‘total of all amounts received by the company or due and payable to the company in respect of the issue of shares and in respect of the calls on shares’ (my emphasis). In other words the stated capital consists of all amounts received or due and payable for all issues of such shares, starting from the first issue of such shares and without any deduction for shares that are cancelled. This interpretation is supported by the provision that the definition of stated capital in section 58(1) is subject only to section 59 (which deals with the reduction of capital) and not to sections 64 or 66, implying that stated capital is reduced only when there is a capital reduction in terms of section 59. The purchase price/redemption price must therefore be set off against reserves. If as a result the company fails the solvency test, section 59(4) provides for the restoration of solvency by eliminating the required amount of stated capital. A consequence of this interpretation is that there is only a memorandum record of the number of shares remaining after elimination of the shares cancelled

Note: The purchase/redemption price includes all direct expenses incurred in such purchase/redemption.

2. Impact of IAS 32 – Financial Instruments, disclosure and presentation

IAS 32 is shortly to be issued as a Sri Lanka Accounting Standard. Paragraph 33 is titled ‘Treasury Shares’ and contains an unequivocal statement that, “If an entity reacquires its own equity instruments those instruments (‘treasury shares’) shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity’s own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. *Consideration paid or received shall be recognised directly in equity*”. (our emphasis). The accounting treatment proposed in paragraph 1 above does not conflict with this provision of IAS 32 because the deduction of the purchase price/redemption price is from equity.

**Companies Act No. 7 of 2007**  
**Registration of charges- Sections 102 to 112**  
**Floating charges- Sections 427 to 433**

1. Charges to be registered-section 102(1)
  - 1.1. charge for securing any debentures
  - 1.2. charge on uncalled share capital
  - 1.3. charge created or evidenced by an instrument, which if executed by an individual, would require registration as a bill of sale
  - 1.4. charge on land or on any interest in land
  - 1.5. charge on book debts
  - 1.6. a floating charge on the undertaking or property of the company
  - 1.7. a charge on calls made but not paid
  - 1.8. a charge on a ship or aircraft or on any part thereof
  - 1.9. a charge on goodwill or intellectual property
  - 1.10. a trust receipt to which section 4 of the Trust Receipts Ordinance applies or an inland trust receipt within the meaning of the Inland Trust Receipt Act. 24 of 1990

Note: (a) Where a negotiable instrument has been given to secure the payment of a book debt of a company, the deposit of the instrument for purpose of securing an advance to the company shall *not be treated as a charge on those book debts* –section 102(5)  
(b) Holding of a debenture entitling the holder to a charge on land shall *not be treated as an interest in the land*- section 102(6)  
(c) ‘Charge’ includes a mortgage-section 102(13)
2. Company’s register of charges –Section 110
  - 2.1 Every limited company, shall maintain a register of charges at its registered office or at such other place as notified to the Registrar under section 116.
  - 2.2 Every limited company shall enter in the register all charges, including floating charges, specifically affecting the property of the company specifying in each case:
    - 2.2.1 short description of the property
    - 2.2.2 amount of charge
    - 2.2.3 names of persons entitled to the charge (except in the case of bearer securities)It shall also keep a copy of the instrument creating the charge and in the case of a series of uniform debentures, a copy of one such debenture. - section 109
3. Registration of charges with Registrar
  - 3.1 Instruments executed in Sri Lanka must be registered with the Registrar within 21 working days of its execution and those executed outside Sri Lanka, within three months of execution- section 102(3)
  - 3.2 Registration of a charge under section 102 may be affected by any person interested in it.-section 102(10)
  - 3.3 A copy of the instrument creating the charge together with a certificate in the *prescribed form* issued by a director or secretary or an attorney at law must be furnished to the Registrar – section 102(1)
  - 3.4 The Registrar will issue a certificate upon registration of the charge *which is conclusive evidence that the requirement for registration has been complied with* –section 105(2)

Note: The requirement in section 102 for registration of charges shall be in addition to the requirement for registration under any other law-section 102(12)
4. Special provisions applicable to debentures secured by a charge – section 102(7)
  - 4.1 Where a series of debentures is secured *pari passu* by a charge contained or given by any other instrument it is sufficient for the purposes of section 102 if *within fifteen working days* of the execution of the deed containing the charge, or if there is no deed, from the date of execution of any debentures of the series the following particulars:
    - 4.1.1 total amount secured by the whole series of debentures

- 4.1.2 the dates of the resolution authorising the issue of the debentures and the date of the covering deed, if any, by which the security is created
  - 4.1.3 general description of the property covered, and
  - 4.1.4 the name of the trustee, if any, for the debenture holders together with copy of the deed verified in the prescribed manner, or if there is no deed, one of the debentures of the series are delivered to the Registrar
  - 4.2 If more than one issue of the series of debentures is made there shall be sent to the Registrar particulars of the date and amount of each issue. However, the omission to send such information will not affect the validity of the debentures.
  - 4.3 Where any commission, allowance or discount has been paid or made by the company either directly or indirectly to any person in consideration for his:
    - 4.3.1 subscribing or agreeing to subscribe for any debentures
    - 4.3.2 procuring or agreeing to procure subscriptions for any debentures
 Particulars of such payment shall be included in the information sent to the Registrar. However, the omission to send such information will not affect the validity of the debentures.
  - 4.4 The certificate of registration issued by the Registrar shall be endorsed on every debenture or certificate of debenture stock issued by the company. However, such endorsement shall not be required on any debenture issued before such charge was created – section 106
- 5 Consequences of failure to register a charge with the Registrar
- 5.1 *Failure to register a charge in the prescribed manner and within the time specified shall render the charge void against any creditor or the liquidator of the company –section 103(1)*
  - 5.2 Failure to register a charge will not affect any contract for repayment of money secured by the charge. *If the charge becomes void the money which it secured shall become immediately payable – section 103(2)*
  - 5.3 Failure to register a charge already existing on property acquired (see paragraph 7.2 below) will not render such charge void in terms of section 103(1)
  - 5.4 The company and every officer in default are liable to be punished
6. Rectification of register of charges maintained by the Registrar-section 108
- A court may, on the application by the company or any person interested, grant an extension of time for registration or permit the rectification of any misstatement in the registration, under such terms or conditions that the court deems just, if it is satisfied that such delay in registration or misstatement:
- 6.1 was accidental, or
  - 6.1 was due to inadvertence, or
  - 6.2 was due to some other sufficient cause, or
  - 6.3 such rectification will not prejudice the position of creditors or shareholders, or
  - 6.4 such rectification is otherwise just and equitable
- 7 Registration of charges existing on property acquired
- 7.1 Where a company acquires any property which is subject to a charge that would, if created by the company after acquisition require registration, it shall register such charge within twenty one working days after acquisition is completed, except in the case of a charge on property situated outside Sri Lanka on which the charge was registered outside Sri Lanka where the registration may be within three months of acquisition – section 104(1)
  - 7.2 Failure to register such charge will render the company and every officer liable to a fine-section 104(2) but will not void such charge (See also paragraph 5.3 above).
- 8 Entries of satisfaction and release from charges-section 107
- Where the Registrar is satisfied that:

8.1 the debt for which any registered charge was given has been satisfied in whole or part; or  
8.2 any property or undertaking charged has been released from the charge or has ceased to form a part of the company's property or undertaking  
he may enter in the Register a memorandum of satisfaction recording the above.

9. Floating charge effective as security

9.1 Notwithstanding the provisions in any other law, a floating charge created under Part XIV of the Act will have effect as a security over the property of the company to which it is expressed to apply, in the manner and to the extent specified in this Part – section 427(3)

9.2 A floating charge may be created only by the execution of an instrument which is expressed to create such a charge, in accordance with the provisions of section 19(1) (a) of this Act – section 428(1)

9.3 An instrument which creates a floating charge over property which includes land shall be registered under the Registration of Documents Ordinance as an instrument affecting land-section 428(2)

9.4 An instrument which creates a floating charge over property which includes moveable property shall be registered under the Registration of Documents Ordinance as if it were a bill of sale-section 428(3).

10. Property over which a company may grant a floating charge

Section 63 of the Mortgage Act (Cap 89) prohibited the creation of a mortgage over the generality of the assets of a Company or any other person. Consequently mortgages were executed in respect of specific property (ie movable or immovable) which were described in a Schedule to the mortgage bond. The new Companies Act specifically provides that a company may grant a floating charge over the whole or any part of the property and undertaking of the company. –section 427(1). Furthermore it specifically states that nothing in Section 63 of the Mortgage Act shall apply to or in relation to any instrument creating a floating charge.

The floating charge may apply to any property of the company, *whether held by the company at the time of creation of the floating charge or acquired thereafter* including:

10.1 moveable and immoveable property;

10.2 uncalled capital

10.3 circulating assets, including cash, stock in trade, raw materials, book debts and other receivables –section 427(2).

11. Provisions of instrument creating a floating charge

11.1 The terms specified in the Eleventh Schedule of the Act shall be implied terms of every instrument except to the extent that the terms in such instrument expressly exclude or are inconsistent with the implied terms –section 429(1)

11.2 An instrument creating a floating charge may contain:

11.2.1 provisions prohibiting or restricting the creation of any fixed security or any other floating charge having priority over or ranking equal with the floating charge

11.2.2 provisions regulating the order in which the floating charge shall rank with any other subsisting or future floating charges or fixed securities over that property or any part of it – section 429(2)

12. Dealing with property subject to a floating charge before attachment-section 430

12.1 Subject to the terms of the instrument creating the floating charge, the creation of such floating charge will not affect the ability of the company to deal with the property in the normal course of business.

12.2 Where a company disposes of property subject to a floating charge which has not attached to that property, any person who receives that property from the company shall be liable to account to the person entitled to the benefit of the floating charge for the value of the property in the following circumstances:

- 12.2.1 the disposal did not take place in the normal course of the company's business and the person who received the property knew or ought to have known that the disposal did not take place in the normal course of business
  - 12.2.2 the disposal of the property is a breach of the instrument creating the floating charge and the person who received the property knew or ought to have known of the terms of the instrument and the circumstances giving rise to the breach of those terms.
13. Circumstances under which a floating charge attaches to the property - section 433(1)  
A floating charge shall attach to and constitute a fixed charge in respect of all property comprised in the charge on the occurrence of any of the following events:
- 13.1 the appointment of a receiver of the whole or any part of the property or undertaking of the company
  - 13.2 the commencement of the winding up of the company
  - 13.3 disposal by the company of the whole or any part of its undertaking, other than in the normal course of business
  - 13.4 company ceasing to carry on business
  - 13.5 any other event the occurrence of which is expressed in the instrument creating the floating charge to have the effect of causing the charge to attach to the property comprised in it.
14. Consequences of the sale/disposal of a property to which a floating charge has attached  
Where a floating charge has attached to a property and the company sells/disposes of the property the person who has acquired the property shall be liable to account to the person entitled to the benefit of the floating charge for the value of the property if:
- 14.1 a receiver has been appointed in respect of the property and the person who acquired the property had notice of such appointment, or
  - 14.2 the person who acquired the property knew or ought to have known, because of his relationship with the company, that:
    - 14.2.1 the floating charge had attached to the property, or
    - 14.2.2 the sale/disposal was in breach of the instrument creating the floating charge, or
    - 14.2.3 the sale/disposal did not occur in the normal course of business – section 433(2)
  - 14.3 A person who is liable to account to the holder of the floating charge for the value of the property disposed of by the company shall be given credit for the value of any consideration provided to the company for that purpose *which may have become available to the holder of the floating charge in substitution of that property*-section 433(4)
15. Alteration/discharge of floating charge
- 15.1 A floating charge may be altered or released in the same manner in which a floating is created-section 432(1), (5)
  - 15.2 Sections 102(1), 102(3), 103 and 108 shall apply to the alteration of a floating charge as if:
    - 15.2.1 references to a charge were references to an alteration to a floating charge, and
    - 15.2.2 references to the creation of a charge were references to the execution of an instrument of alteration – section 432(3)
16. Ranking of a floating charge
- 16.1 When property of a company is subject to both a floating charge and to a fixed security *arising by the operation of law*, the fixed security shall have priority over the floating charge – section 431(1)

- 16.2 When any property of a company is subject both to a floating charge and a fixed security *granted by the company*, the fixed security shall have priority over the floating charge unless:
- 16.2.1 the instrument creating the floating charge prohibited the granting by the company of a fixed security and the floating charge had been registered under Part VI of the Act before the fixed security was granted by the company, or
  - 16.2.2 the instrument creating the floating charge provides for the floating charge to take priority over the fixed security and the person entitled to the benefit of the fixed charge has consented in writing to that priority, or
  - 16.2.3 before the date on which the fixed security was granted by the company, the floating charge had attached to the property pursuant to section 433 and either:
    - 16.2.3.1 a receiver had been appointed in respect of the property and the person to whom the fixed security was granted had notice of the appointment of the receiver, or
    - 16.2.3.2 the person to whom the fixed security was granted knew or by reason of his relationship with the company ought to have known that:
      - (a) the floating had attached to the property, or
      - (b) the granting of the fixed security was in breach of the instrument creating the floating charge, or
      - (c) the grant of the fixed security did not occur in the normal course of the company's business – section 431(2)
- 16.3 Where any property of a company is subject to more than one floating charge, those floating charges shall rank among themselves according to the dates of registration under Part VI, subject to any provision to the contrary in an instrument creating a floating charge which has been consented to in writing by the person entitled to the benefit of the floating charge, the priority of which is postponed by that provision – section 431(3).
- 16.4 Subject to the terms of the instrument under which it was created, the priority of floating charge shall not be affected by the fact that all or any part of the debts or obligations secured by the floating charge were incurred or arose after:
- 16.4.1 the creation and registration by the company of a subsequent floating charge, or
  - 16.4.2 the grant by the company of a fixed security in respect of the whole or part of the property comprised in the floating charge – section 431(4)
- 16.5 Where land owned by a company is subject to a floating charge and to a fixed security which has been registered under the Registration of Documents Ordinance, the fixed charge shall have priority over the floating charge unless the floating charge was registered in respect of that land under the Registration of Documents Ordinance prior to the registration of the fixed security – section 431(6)

**Companies Act No. 7 of 2007**  
**Accounting records**

1. Section 148(1)a  
“ 148(1)Every company is required to maintain accounting records that correctly record and explain the company’s transactions and will-  
(a) **at any time enable the financial positions of the company to be determined with reasonable accuracy”**

The phrase ‘at any time’ does not mean *immediately*. It means that the financial position should be ascertainable as at any given point in time. Normal double entry book-keeping with sufficient detail recorded in books of prime entry will, subject to the required closing entries, enable the P&L and balance sheet to be drawn up at any given point in time.

2. Section 148(2)  
“148(2) Without limiting the provisions contained in sub-section (1), the accounting records shall contain –  
(a) entries of money received and expended each day by the company and the **matters in respect of which such money was spent;**  
(b) record of assets and liabilities of the company;  
(c) if the company’s business involves dealing in goods-
  - i. record of goods bought and sold, except for goods sold for cash in the ordinary course of carrying on a retail business that identifies both the goods and the buyers and sellers and the relevant invoices
  - ii. a record of the stock held at the end of the financial year together with records of any stock taking during the year;  
(d) if the company’s business involves providing services, **a record of services provided** and relevant invoices”

‘**matters in respect of which such money was spent**’ should be determined on a case-by-case basis but, in general, should provide sufficient detail to determine the purpose for which the money was expended and to identify the other party to the transaction.

‘**a record of services provided**’ should be determined on a case-by-case basis but, in general, should provide sufficient detail to ascertain the nature of the service provided and to identify the recipient of the service.

3. **Retention of accounting records**  
Section 116(1)k requires that accounting records for the current accounting period and for the last ten accounting periods should be retained.

**Companies Act No. 7 of 2007**  
**Group financial statements**

1. Requirement for group financial statements

Group financial statements are required which consolidate the financial statements of the parent with the financial statements of all the subsidiaries (Section 152)

2. Form of group statements

Group financial statements are required to comply with any relevant regulations under this Act **and** with any requirements which apply to group financial statements under any other law. (Section 153(2))

No regulations have as yet been made under this Act relevant to group financial statements. However, Sri Lanka Accounting Standards (particularly SLAS 26) deal with group financial statements and since SLAS's are enacted under Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995, the provisions of relevant SLAS apply to group financial statements of "specified business enterprises". Further, the financial statements of any other enterprise prepared/audited by a member of the Institute of Chartered Accountants must comply with SLAS in terms of the definition of "professional misconduct" in the 2<sup>nd</sup>. Schedule to the Institute of Chartered Act No.23 of 1959 (as amended)

3. Definition of 'subsidiary'

The Companies Act defines a company as a subsidiary of another company

3.1 if the latter company either:

3.1.1 controls the composition of its board,

3.1.2 controls more than half the maximum votes that may be exercised at a meeting of the company,

3.1.3 holds more than half of the issued shares (excluding shares which may not participate beyond a specified amount in a distribution of profits or capital), or

3.1.4 is entitled to receive more than half the dividends paid on shares of the company (excluding shares which may not participate beyond a specified amount in a distribution of profits or capital)

3.2 if the first mentioned company is a subsidiary of another company which is itself the subsidiary of latter company (Section 529)

SLAS 26 defines an entity as a subsidiary of a company if the company has control over that entity. (para.4 of SLAS 26). "Control" is the power to govern the financial and operating policies of any entity so as to obtain a benefit from its activities

The definition of 'subsidiary' in the Companies Act is wider than in SLAS 26, because if the parent has the required shareholding (3.1.3 & 3.1.4) even without the control (3.1.1 & 3.1.2) it is a subsidiary. An example is where the majority shareholding is achieved by a holding of non-voting shares

4. Non consolidation of certain subsidiaries

4.1 Group financial statements need not incorporate the financial statements of a subsidiary if any of the following conditions apply:

a. It is impracticable to do so

b. It would be of no real value to the shareholders of the company

c. Involve expense or delay out of proportion to the value to shareholders

d. The result would be misleading or harmful to the business of the company or to any of its subsidiaries

e. The business of the company and that of the subsidiary are so different that they cannot be reasonably treated as a single undertaking (section 153(6))

Section 153(7) requires that any omission of the financial statements of a subsidiary under Section 153(6) receives the prior approval of the Registrar.

SLAS 26 does not permit non-consolidation in the above circumstances and consequently, a conflict arises between the requirements the Companies Act and SLAS's.

## 5 Exemption from the preparation of consolidated financial statements

5.1 Group financial statements are not required in relation to a company if, on the balance sheet date it is a *wholly owned* subsidiary of another company (section 152(2))

The provision in SLAS 26 is that any company need not prepare consolidated financial statements if it is a subsidiary of another entity and all its shareholders agree. The Companies Act is more restrictive.

SLAS 26 also provides that group financial statements are not required in the following circumstances:

- a. Parent company's debt or equity is not traded in a public market
- b. Parent company did not file nor is in the process of filing financial statements for the purpose of issuing any class of instrument in a public market
- c. The ultimate or intermediate parent produces consolidated financial statements available to the public.

There are no similar provisions in the Companies Act.

## 6. Conflict between the provisions of the Companies Act and SLAS 26

Except in relation to section 153(6), the Companies Act is more demanding in the need for consolidated accounts. Consequently, compliance with the requirements of the Companies Act is recommended as it would avoid conflict with the Act whilst not falling short of any provisions of SLAS 26 (though some of its requirements for consolidated accounts will be exceeded).

With regard to section 153(6), it is unlikely that such a situation will arise except in the most rare/exceptional circumstances, but if it does, the auditor must qualify the accounts for failure to comply with SLAS 26. Whilst this may exonerate the auditor it would render the specified business enterprise liable to penalties under Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 for failure to comply with SLAS

(A letter has been sent to the Minister of Trade, Commerce and Consumer Affairs by the President of the ICASL in October 2007 requesting an amendment to the Companies Act to provide that SLAS will prevail when there is a conflict with the Companies Act)

## 7 Differing accounting periods for parent and subsidiary

Where the accounting period adopted by a subsidiary differs from that of the parent by more than three months, interim financial statements prepared by the subsidiary for the accounting period of the parent are utilised for the preparation of consolidated financial statements. (Section 153(4))

The question arises whether such interim financial statements of the subsidiary need to be audited. Section 154(1) requires that the auditor audits the group financial statements. This requires that the auditor audits the financial statements of the subsidiary which are incorporated in the group financial statements.

8. Information in group financial statements

A company which is required to include group financial statements in its annual report is required to provide the following information in regard to its subsidiaries;

- a. Financial statements of each subsidiary
- b. Auditor's report on the financial statements of each subsidiary
- c. Change in accounting policies
- d. Entries in the interests register
- e. Remuneration and other benefits of directors
- f. Donations made
- g. Directors at the end of the accounting period and those who ceased to hold office during the period
- h. Audit fees and fees for other services by the auditor
- i. Particulars of any relationship other than auditor that the auditor has with or any interests that the auditor has in the company or any of its subsidiaries (Section 168(2))

*This is an onerous requirement (particularly 'a') but the Sinhala version of the Companies Act (which prevails in the case of conflict), requires only that the information at 'c' to 'i' is provided.*

**Companies Act No. 7 of 2007**  
**Audit of the accounts of companies**

1. Appointment of auditor
  - a. At each AGM the company is required to appoint an auditor to hold office from the conclusion of that meeting to the conclusion of the next AGM. The auditor is required to audit the financial statements of the company and, if the company is required to prepare group statements, the group financial statements for the accounting period next after the financial statements last audited. (section 154(1))
  - b. The board may fill a casual vacancy in the office of auditor, but the surviving or continuing auditor, if any, may continue to act while the vacancy remains. (section 154(2))
  - c. Where no auditor is appointed or re-appointed at an AGM or a casual vacancy is not filled within one month of it occurring, the Registrar may appoint an auditor. The company is bound to give notice to the Registrar that he is entitled to appoint an auditor within five working days of such power becoming exercisable by the Registrar. (sections 154(3) & 152(4)).
  
2. Auditor's fees & expenses

The fees and expenses of the auditor shall be fixed:

  - a. if appointed at a meeting of the company, at such meeting or in such manner as the company determines at the meeting
  - b. if appointed by the board, by the board, or
  - c. if appointed by the Registrar, by the Registrar (section 155))
  
3. Appointment of a partnership as auditor

A partnership may be appointed by the firm's name to be auditor of the company if the partners are qualified to be appointed as auditors of the company. Such appointment shall be deemed to be the appointment of all the persons who are partners from time to time. (section 156)).
  
4. Qualifications of auditors
  - a. Only members of the Institute of Chartered Accountants of Sri Lanka may be appointed as auditors of any company. As an exception a registered auditor may be appointed as auditor of a private company or of a company limited by guarantee. (sections 157(1) & (2))
  - b. There is provision for regulations to be made specifying the qualifications necessary to become a registered accountant and the procedure and fees for such registration. (section 157(5))
  
5. Disqualification for appointment as auditor

None of the following shall be appointed as auditor:

  - a. a director or employee of the company
  - b. a person who is a partner or in the employment of a director or employee of the company
  - c. a liquidator or an administrator or a person who is a receiver in respect of property of the company
  - d. a body corporate
  - e. a person who by virtue of (a), (b) or (c) may not be appointed to act as auditor of a related company

A person who held office as at (a), (b) or (c) may not be appointed as auditor for a period of two years after such person ceased to hold such office. (sections 157(3) & (4)).

6. Appointment of first auditor
- a. The board may appoint the first auditor of the company before the first AGM and such auditor shall hold office until the conclusion of that AGM
  - b. If the board does not make such appointment, the company shall appoint the auditor at a meeting of the company
  - c. (a) or (b) above will not apply if the shareholders pass an unanimous resolution that no auditor be appointed; such resolution shall cease to have effect at the commencement of the first AGM. (section 159)
7. Automatic re-appointment of auditor
- a. Except for the first auditor appointed by the board, an auditor shall be deemed to be re-appointed at an AGM unless:
    1. he is not qualified for re-appointment
    2. the company resolves at the meeting to appoint another person to replace him
    3. the auditor has given notice to the company that he does not wish to be re-appointed
  - b. An auditor is not automatically re-appointed if the person who it is proposed to replace him dies or becomes incapable of or disqualified from being appointed. (section 158)
8. Replacement of the auditor by the company
- A company shall not replace an auditor who is qualified for re-appointment unless:
- a. at least twenty working days written notice of a proposal to replace him is given to the auditor
  - b. the auditor is given a reasonable opportunity to make representations to the shareholders on the appointment of another auditor either in writing or by the auditor or his representative speaking at a shareholders meeting (whichever the auditor may choose)
- The auditor is entitled to reasonable fees and re-imburement of expenses for making representations to the shareholders (section 160)
9. Statement of auditor ceasing to hold office
- a. If the auditor resigns or ceases to hold office for any other reason he shall deliver to the company a statement of any circumstances connected with his ceasing which he considers should be brought to the notice of shareholders or creditors of the company, or if he considers there are no such circumstances, a statement that there are none.
  - b. Such statement shall be delivered to the company as follows:
    1. if he resigns, with the notice of resignation
    2. if he gives notice that he does not wish to be re-appointed, with such notice
    3. if he ceases to hold office for any other reason, within ten working days of his ceasing to hold office
  - c. Section 161(3) provides that the company is bound to deliver to each shareholder and to the Registrar a copy of the statement which contains circumstances that the auditor believes should be brought to the notice of shareholders/creditors. However, the company may apply to court for an order granting permission to refrain from sending copies of such statement to shareholders. The costs of obtaining the order from court must be paid for by the auditor. Presumably costs are not payable by the auditor if the application to court is unsuccessful.
- Note: The auditor must exercise extreme caution before he makes a statement of the reasons for ceasing to hold office. (section 161)

10. Conflict of interest

In carrying out the duties of auditor, the auditor shall ensure that his judgment is not impaired by reason of any relationship with or interest in the company or any of its subsidiaries (section 162)

Note: Attention is invited to the statement on professional misconduct in the second schedule to the Institute of Chartered Accountants Act 23 of 1959, as amended

11. Auditor's report

- a. The requirements of the audit report as given in section 163(2) are detailed in SLAuS 26. A specimen of the unqualified audit report appears at paragraph 27 thereof
- b. At the same time as he delivers the audit report to the company, the auditor is required to deliver the following statement to the company:
  1. the existence of any relationship (other than that of auditor) which the auditor has with, or any interests which the auditor has in the company or any of its subsidiaries; and
  2. the amount payable by the company to the person or firm holding office as auditor as audit fees and expenses and *as a separate item*, any fees and expenses payable by the company for other services provided by that person or firm (section 163)

12. Auditor's access to information

- a. The board of a company shall ensure that the auditor has access at all times to the accounting records and other documents of the company. Where the board fails to comply with this requirement every director who is in default shall be guilty of an offence and shall on conviction be liable to a fine not exceeding rupees one hundred thousand
- b. An auditor is entitled to require from a director or employee of the company such information and explanations as he thinks necessary for the performance of his duties as auditor. A director or employee who fails to comply with this requirement shall be guilty of an offence and shall on conviction be liable to a fine not exceeding rupees one hundred thousand  
An *employee* charged with this offence can defend himself if he proves that he did not have the information in his possession or under his control or that by reason of the position occupied by him or the duties assigned to him, he was unable to give the required information

*Note: This defense is not available to a director* (section 164)

13. Auditor's attendance at shareholders meetings

The board shall ensure that the auditor:

- a. is permitted to attend every meeting of the shareholders
- b. receives the notices and communications that a shareholder is entitled to receive relating to a meeting
- c. may be heard at a meeting of shareholders on any part of the business that concerns him (section 165)

**Companies Act No. 7 of 2007**  
**Director's duties- Sections 187,188, 189 & 190**

1. A director must act in good faith and in the interests of the company, except where the company is a wholly owned subsidiary of another company, where the director may act in the interests of the holding company if permitted by the articles. (section 187)
2. A director may not act or agree to the company acting contrary to the provisions of this Act or to the provisions of the articles (section 188)
3. A director shall not act in a manner that is reckless or grossly negligent. He is also required to exercise the degree of skill and care that can reasonably be expected of a person of his knowledge and experience  
The latter requirement is subjective in that the degree of skill and care would depend on the director's personal skill and knowledge and would vary from director to director. For instance, a chartered accountant who is a director will be expected to act with greater perception on accounting information than a non accountant (section 189).
4. A director is entitled to rely on reports, statements, financial data and other information given by:
  - a. an employee of the company
  - b. professional or expert advisor in relation to matters the director believes to be within the person's professional or expert competence
  - c. any other director or committee of directors in which the director did not serve, in relation to matters within the director's or committee's designated authorityThese provisions will apply to a director only if the director;
  - i) acts in good faith
  - ii) makes proper inquiry where required by the circumstances
  - iii) has no knowledge that such reliance is unwarranted (section 190(1))
5. The provisions relating to the duty or liability of directors or officers of the company contained in Act 7 of 2007 are in addition to and not in derogation of any provision contained in any other law (section 190(2))  
As an example, a director may not participate in any act that wrongfully seeks to reduce the income tax liability of the company even though it benefits the company.

**Companies Act 07 of 2007**  
**Interests Register**

**Inspection of company records by shareholders**  
**Section 119**

A company shall keep the interests register of the company available for inspection

Where a company fails to comply with the above requirements

- The company shall be guilty of an offence and be liable on conviction to a fine not exceeding two hundred thousand rupees ; and
- Every officer of the company who is in default shall be guilty of an offence and be liable on conviction to a fine not exceeding one hundred thousand rupees

**Copies of documents**  
**Section 122**

A person may require a copy of or extract from a document which is made available for inspection by him to be sent to him within five working days after he has made a request in writing for such copy or extract and has paid a reasonable copying and administration fee as may be determined by the company.

Where a company fails to provide a copy of or extract from a document in compliance with a request

- The company shall be guilty of an offence and be liable on conviction to a fine not exceeding one hundred thousand rupees ; and
- Every officer of the company who is in default shall be guilty of an offence and be liable on conviction to a fine not exceeding fifty thousand rupees

**Transactions in which a director is interested:**  
**Section 191**

A director of a company is interested in a transaction to which the company is a party if, and only if the director –

- Is a party to or will or may derive a material financial benefit from the transaction;
- Has a material financial interest in another party to the transaction
- Is a director, officer or trustee of another party to or person who will or may derive a material financial benefit from the transaction, not being a party or person that is –
  - The company's holding company being a holding company of which the company is a wholly-owned subsidiary
  - A wholly owned subsidiary of the company; or
  - A wholly-owned subsidiary of a holding company of which the company is also a wholly-owned subsidiary

- Is the parent, child or spouse of another party who may derive a material financial benefit from the transaction; or is otherwise directly or indirectly materially interested in the transaction (section 191(1))

Unlike in the previous Act, the Act No 7 of 2007 refers to material financial benefits. However, if the director is a party to a transaction the director of the company is deemed to be interested in a transaction even if the financial benefit is not material. (section 191(1)a)

If an enterprise or another party where the director has financial interest benefits from a transaction with the company the director is deemed to be interested in the transaction only if he has a material financial interest in that enterprise or party. (section 191(1)b)

A director of a company is not deemed to be interested in a transaction to which the company is a party, if the transaction comprises only of giving by the company of security to a third party which has no connection with the director at the request of the third party, in respect of a debt or obligation of the company for which the director or another person has personally assumed responsibility in whole or in part under a guarantee, indemnity or by the deposit of a security (section 191(2))

### **Disclosure of interests in transactions Section 192**

A director of a company shall, after becoming aware of the fact that he is interested in a transaction or proposed transaction with the company, forthwith enter the nature and extent of that interest in the interests register and disclose such interest to the board (section 192(1)).

However, a general notice entered in the interests register to the effect that a director is a shareholder, director, officer or trustee of another named company or other person or is otherwise connected with another named company or other person, shall be a sufficient disclosure of interest in relation to any transaction with that company or person on the date of such disclosure or in future. (section 192(2))

Every director who fails to comply with the above requirement shall be guilty of an offence, and be liable on conviction to a fine not exceeding two hundred thousand rupees

### **Avoidance of Transaction Section 193**

A transaction entered into by a company in which a director of a company is interested may be avoided by the company at any time before the expiration of six months after the transaction and the director's interest in it has been disclosed to all shareholders. (whether by means of company's annual report or otherwise) (Section 193(1))

A transaction shall not be avoided under this section if the company receives fair value under it, such fair value being determined on the basis of information known at the time of the transaction.(section 193(2) & (3))

If the transaction is entered into by the company in the ordinary course of its business and on usual terms and conditions the company shall be presumed to have received fair value under the section (section 193(4)).

**Effect on third parties**  
**Section 194**

The avoidance of a transaction under section 193 shall not affect the title or interest of a person in or to property which that person has acquired, if the property was acquired

- from a person other than the company
- for valuable consideration ; and
- in good faith without notice of the circumstances as a consequence of which the transaction becomes voidable

**Interested director may vote**  
**Section 196**

Subject to the provisions contained in the articles of the company, a director of a company who is interested in a transaction entered into or to be entered into by the company, may

- vote on a matter relating to the transaction;
- attend a meeting of directors at which a matter relating to the transaction arises and be included among the directors present at the meeting for the purpose of a quorum
- sign a document relating to the transaction on behalf of the company ; and
- do any other thing in his capacity as a director in relation to the transaction

as if the director were not a party interested in that transaction

**Disclosure of directors interests in shares**  
**Section 200**

A person who is a director on the appointed date (i.e. 3<sup>rd</sup> May 2007) or becomes a director subsequently has to disclose to the board the number and class of shares in which a relevant interest is held and the nature of the relevant interest and ensure that the particulars are entered in the interests register (section 200(1))

A director of a company who acquires or disposes of a relevant interest in shares issued by the company shall, disclose the following information to the board and ensure that the particulars disclosed to the board are entered in the interests register

- The number and class of shares in which the relevant interest has been acquired or the number and class of shares in which the relevant interest was disposed of, as the case may be;
- The nature of the relevant interest;
- The consideration paid or received; and
- The date of the acquisition or disposition (section 200(2))

'Relevant interest' is defined in section 198

**Disclosure of remuneration and other benefits**  
**Section 216**

The board shall ensure that after approving the following, particulars of the payment or benefit or contract are entered in the interests register

- The payment of any remuneration or the provision of the benefit by the company to a director for services as a director or in any other capacity
- The payment by the company to a director or former director, of compensation for loss of office
- The entering into of a contract to do any one of the things referred to above

Note: The requirement for entry in the interests register is more fully discussed in the separate note titled “directors’ remuneration and entries in the interests register”

**Disclosure of indemnity and insurance**  
**Section 218**

The board of a company shall ensure that particulars of any indemnity given to or insurance effected for any director or employee or former employee of the company or related company, are entered in the interests register.

**Private companies need not keep an interests register**  
**Section 30**

Private companies may by unanimous resolution of its shareholders dispense with the keeping of an interests register. An unanimous resolution shall cease to have effect, if any shareholder gives notice in writing to the company, that he requires it to keep an interests register

**Companies Act No. 7 of 2007**  
**Indemnity & insurance for directors/employees – Section 218**

**1. Director/employee**

In section 218 a director/employee includes a former director/employee – section 218(8)

**2. Indemnity for costs**

If *expressly authorised by the articles*, a company may indemnify a director/employee of a company or a related company for any costs incurred by him in any proceeding:

- 2.1. that relates to liability for any act or omission in his capacity as director/employee, and
- 2.2. judgement is given in his favour or in which he is acquitted, or which is discontinued or in which he is granted relief under section 526 – section 218(2).

Note: (a) Section 526 provides for court to excuse an officer of a company who is liable in respect of negligence, default, breach of duty or breach of trust if it is satisfied that in all the circumstances he ought to be excused from his liability.

(b) indemnity is available for criminal liability, provided the condition in 2.2 above is satisfied

**3. Indemnity for costs and for liability**

If *expressly authorised by the articles*, a company may indemnify a director/employee of a company or a related company in respect of:

- 3.1. liability to any person, other than to the company or any related company for any act or omission in his capacity of director/employee
- 3.2. costs incurred by that director/employee in defending or settling any claim or proceeding relating to such liability, *not being criminal liability* or in the case of a director, liability in respect of a breach of duty specified in section 187 – section 218(3)

Note: Section 187 provides for a director to act in good faith and in the interests of the company

**4. Insurance against liability**

4.1. If expressly authorised by the articles and with the prior approval of the board, a company may provide insurance to a director or employee of the company or of a related company in respect of:

- 4.1.1. liability, not being criminal liability, for any act or omission in his capacity as director or employee
- 4.1.2. costs incurred by that director or employee in defending or settling a claim or proceeding relating to such liability
- 4.1.3. costs incurred by that director or employee in defending any criminal proceedings *in which he is acquitted*. - section 218(4).

4.2. Where insurance is affected and the provisions at 4.1 above and/or the provisions of para.5 have not been complied with, the director/employee shall be personally liable to the company for the cost of affecting insurance except to the extent that he proves that it was fair to the company when it was affected– section 218(7).

**5. Record in the interests register**

The board is required to enter particulars of any indemnity or insurance in the interests register – section 218(5).

**Companies Act No.7 of 2007**  
**Duties of directors in insolvency – Section 219**  
**Duties of directors on serious loss of capital – Section 220**

**A - Duties of directors in insolvency**

1. Section 219(1) requires a director who believes that the company will not be able to meet its debts as they fall due shall forthwith call a meeting of the board to decide whether to place the company in liquidation. Section 219(2) provides that where a director fails to call such a meeting and at the time of such failure the company was unable to pay its debts, he may be held personally liable for losses incurred by creditors.
2. There is an element of subjectivity involved in arriving at the decision to call a meeting of the board, but such subjectivity must be viewed in the context of the provisions in the Act dealing with director's duties, namely sections 187, 189 and 190. Section 187 requires the director to act in good faith and in the interests of the company. Section 189 requires the director to exercise the degree of skill and care that may reasonably be expected of a person of his knowledge and experience. Section 190 permits a director to rely on information given by employees or professional advisors provided he makes proper inquiry when needed and has no knowledge that such reliance is unwarranted. In this context a director's belief of the company's solvency may be based, in practice, on information made available to the board by employees or executive directors of the company subject to his seeking clarification or further information as warranted in the circumstances. Even if the director acts with excessive caution in summoning a meeting, there is the additional safeguard that the decision to liquidate must be made by the board as provided for in section 219(3).
3. Section 219(3) provides that if the board fails to place the company in liquidation despite having no reasonable grounds to believe that the company can pay its debts as they fall due, the directors, other than those who voted in favour of liquidation, may be liable for the loss incurred by the creditors by the company continuing to carry on business. This provision cannot be held to be onerous because the directors who voted in favour of the company continuing in business acted without reasonable grounds. The directors also have the alternate course of seeking a compromise with the creditors in accordance with sections 247 et al instead of placing the company in liquidation.

**B Duties of directors on serious loss of capital**

1. Section 220(1) provides that, if it appears to a director that the net assets of the company are less than half the stated capital, the board shall within twenty working days of that fact becoming known to the director, call an extraordinary general meeting of the shareholders of the company, to be held within forty days of calling the meeting. The notice calling the meeting must be accompanied by a report prepared by the board of:
  - a. the losses incurred by the company
  - b. the cause(s) for the losses
  - c. the steps, if any, which are being taken by the board to prevent further such losses and/or to recoup such losses

The business of the meeting shall be to discuss the report and the financial position of the company and reasonable opportunity must be given to the shareholders to ask questions in relation to and to discuss the report and to comment on the report and the management generally (section 220(2)). Where the board fails to comply with these requirements, every director who knowingly permits the failure shall be guilty of an offence and be liable to a fine (section 220(3)).

2. The net assets should be ascertained from financial statements prepared in accordance with section 151. Consequently a director can come to know that section 220 applies only upon such financial statements becoming available to him and the time periods specified in section 220(1) will commence only from then. This does not mean that there can be an inordinate delay in making the financial statements available as inaction by the director in this regard will be a dereliction of his duties as explained in paragraph A2 above.

**Companies Act No. 7 of 2007**

**Comments on press notice by Registrar of Companies regarding issue of bonus shares**

1. The Registrar of Companies, in a notice published in the newspapers on 21<sup>st</sup> May 2007, stated that the Companies Act No. 7 of 2007 ("the Act") does not prohibit the issue of bonus shares and went on to state how the bonus shares could be issued in accordance with the provisions of the Act.
2. The notice envisaged two alternate procedures for the issue of bonus shares :
  - a. Paragraph 2 of the notice states that bonus shares could be issued as fully paid up shares and this would constitute a 'distribution' within the meaning of section 529 of the Act
  - b. Paragraph 4 of the notice states that bonus shares can be distributed by way of a dividend
3. Section 529 states that:

" 'distribution' means –

  - (a) the direct or indirect transfer of money or property, *other than the shares of a company*, to or for the benefit of a shareholder; or
  - (b) the incurring of a debt to or for the benefit of a shareholder, in relation to a share or shares held by the shareholder, whether by means of a payment of a dividend, redemption or other acquisition of the share or shares, a distribution of indebtedness or otherwise" (our emphasis).

It appears that the distribution of fully paid up shares is not a 'distribution' in terms of section 529. Consequently, the proposal in clause 2(a) above is not valid
4. Section 60 defines a dividend as a distribution out of profits but such distribution cannot be applied for the acquisition of its own shares or redemption of shares. The procedure would be to issue shares to existing shareholders for a consideration which "is fair and reasonable to the company and to all existing shareholders" (section 51(1)) and to declare a dividend sufficient to cover the consideration out of profits, which the shareholders resolve will be applied in settlement of the consideration. The difficulty with this procedure is that the declaration of the dividend will attract dividend tax in accordance with the Inland Revenue Act