Neutral Citation Number: [2006] IEHC 12

**THE HIGH COURT**

**[2004 No. 9 COS]**

**IN THE MATTER OF AMS I.T. CONSULTANTS LIMITED (IN VOLUNTARY LIQUIDATION)**
**AND IN THE MATTER OF SECTION 150 OF THE COMPANIES ACT, 1990 AND SECTION 56 OF THE COMPANY LAW ENFORCEMENT ACT 2001**

**BETWEEN**

**THOMAS L. KEANE**

**APPLICANT**

**AND**
**JAS KALSI AND MAEVE KALSI**

**RESPONDENTS**

**Judgment of Mr. Justice Clarke delivered the 25th of January, 2006.**

**1. Introduction**
1.1 In this case the applicant ("the liquidator") seeks a declaration that both respondents should be subjected to the order as specified in s. 150 of the Companies Act 1990 (as amended) restricting their activities in relation to companies for a period of five years.

**2. Background Facts**
2.1 On 31st March, 2003 it was resolved, pursuant to s. 251 of the Companies Act 1963 (as amended), that AMS I.T. Consultants Limited ("the company") be wound up and that the liquidator be appointed. Both respondents were directors of the company at the date of the commencement of the winding up. It is not disputed but that the company is unable to pay its debts within the meaning of s. 214 of the Companies Act 1963.

2.2 When the application of the liquidator was initially brought before the court a contention was made to the effect that the directors had been involved in dishonest activity amounting to the fraudulent preferring of creditors. During the early part of the life of the application before the court the concentration of the parties was, understandably, on this contention. That matter is, however, no longer proceeded with. The remaining matters which are brought to the courts attention by the liquidator stem from an alleged failure of the company to keep proper books and records and to make returns to the Revenue and the Companies Office.

**3. The Hearing**
In the course of an initial hearing of the application before me a number of matters were mentioned by counsel for the liquidator which had, in my view, not been properly adverted to in the affidavits filed on behalf of the liquidator but which, nonetheless, were matters which I felt I should consider as part of the overall assessment which the court is required to carry out under s. 150. In those circumstances I afforded both the liquidator and the respondents additional time to file further affidavits in relation to those matters. A second part of the hearing then followed. As I indicated at the initial hearing, it seemed to me that the difficulty which had emerged at that stage was, in no small way, a result of the fact that the focus of the application had changed significantly as a result of the dropping of any allegations of dishonesty.

**4. The Current Contentions**
4.1 While the liquidator brings to the court's attention two minor matters (the fact that sales appear, in one instance, to have been overstated and the fact that a VAT repayment which the company was obliged to make was not in fact made), neither of these matters are (as counsel for the liquidator fairly points out) such as should, of themselves, give rise to a finding of a sufficient lack of responsibility to warrant making an order under the section.

4.2 The remaining matters all concern compliance by the company with its obligation to keep proper books and records and make returns and, for reasons which will become apparent, all really stem from one single issue.

4.3 It is correctly stated by the liquidator that the company did not make any returns to the Revenue Commissioners. Secondly it is correctly stated that the company did not (save in the first year of its existence) make returns to the Companies Office. Furthermore it is correctly stated that the company never produced audited accounts. It is clear on the evidence that each of the above three matters are closely connected. In order to make returns to the Revenue and to the Companies Office, it would have been necessary for the company to have audited accounts. I am satisfied on the facts of this case that all three failures stem from the failure of the companies to have audited accounts. There was not, in my view, any independent reason (beyond the absence of audited accounts) for the failure to make returns to the Revenue and to the Companies Office. It should also be noted that it would not appear that the failure to make returns to the Revenue gave rise to any underpayment of tax in that, at the relevant time, the company would not appear to have made any profits upon which corporation tax would have been required to be paid. There was not, therefore, any failure to pay corporation tax associated with the failure to make returns.

4.4 Furthermore, as indicated above, it should be noted that the company did make an annual return effective to the 10th January 2000, the return being received by the Companies Office on the 19th September 2002. As the company had not traded before the effective date, the absence of audited accounts did not inhibit the filing of those returns. The following two years returns would have been overdue as of the company going into liquidation.

4.5 Nonetheless it is clear on the authorities (to which I will refer) that a failure on the part of a company to comply with its obligations in respect of the keeping of books and records, auditing accounts, and making returns on such audited accounts, can, in an appropriate case, amount to grounds for concluding that the Directors responsible for any such failures have acted with a sufficient lack of responsibility to warrant the making of an order under the section. It is therefore necessary to analyse the circumstances surrounding those failures in more detail so as to reach an appropriate assessment. Before so doing it is necessary to place that analysis in its proper legal context.

**5. The Law**
5.1 In *McLaughlin v. Lannen and Another* (Unreported, High Court, Clarke J. 4th November, 2005), having reviewed a number of authorities, I noted that in broad terms there were three types of situation with which the court is typically faced in applications under this section which do not involve dishonesty.

At paragraph 3.7 of the judgment I identified those situations as:-

"1. Issues involving compliance by the company with its formal obligations under the Companies Acts including keeping books and records, making returns, holding meetings and the like;

2. The commercial management of the company, most particularly at the period when the company was insolvent or heading in that direction; and

3. Compliance by the Directors with the obligations identified in *Frederic Inns* to ensure that, once the company was facing insolvency, its assets were dealt with in a manner designed to ensure the proper distribution of those assets in accordance with insolvency law".

5.2 In assessing the actions of Directors under the various headings I noted that the consideration of the court will necessarily be different depending on the sort of issues which the court was dealing with. At paragraph 3.8 of the judgment I said the following:-

"In the first category it is of course particularly important to have regard to the entire history of the involvement of the Directors concerned with the company. For the very reason identified by Murphy J. in *Costello Doors*, it would be difficult to make a finding of irresponsibility where there is a relatively short term failure to comply with formal obligations in the light of an historical compliance which such obligations over a longer period. On the other hand a failure to comply with formal obligations which might be said to have contributed either to the insolvency or to the knowledge of parties dealing with the company of the likelihood of that insolvency will necessarily be regarded more seriously".

5.3 Finally at paragraph 3.12 I noted that:-

"Having identified the typical types of case which the court is called upon to consider I should emphasise that Directors are, of course, entitled to rely upon the fact that they have a clean bill of health under one or more of those categories as a mitigating factor to be taking into account in the overall assessment of the case, and to be set against any failings which they might be shown to have been guilty of in respect of another category."

**6. Application to Facts of this Case**

6.1 It seems clear that the matters brought to the courts attention by the liquidator in this case fall within the first category. However, as pointed out in *McLaughlin*, it is also appropriate to have regard to the fact, if it be so, that no proper criticism can be made of the Directors under any of the other headings.

6.2 In this case it does not appear that any proper criticism can be levied against the Directors in relation to the commercial management of the company in the immediate run-up to insolvency.

6.3 On the evidence I am satisfied that the company, along with many others in the IT sector, suffered an immediate and serious reverse in the aftermath of the unfortunate events of September 11th 2001. The company, at that stage, was completing its start up phase and there is no evidence to suggest that the commercial picture, to that point, was not positive. Indeed the evidence suggests significant growth.

6.4 There can, again, be no doubt on the evidence that, as a result of, amongst other things, the significant downturn experienced by the sector, the company got into significant financial difficulties. However the evidence also makes clear that the company had come to certain arrangements with the Revenue Commissioners (who were a significant creditor) for a periodic reduction of the company's principal liabilities. The Directors have deposed on oath to the fact that they believed that the company could trade out of it's difficulties in the light of the fact that the Revenue appeared prepared to accept a phased reduction of the company's tax liabilities. It should be noted that the Revenue liability itself would appear to have stemmed from increased trading in 2001 (prior to September) and the fact that the company had switched accounting systems from Sage software to an Exchequer software. It would appear that due to technical problems connected with the software switch, there was an understatement of VAT liability which did not come to light until June 2002. This coupled with the downturn in the business would appear to have left the company with a significant revenue liability. I am not, however, satisfied that the manner in which that liability arose is suggestive of an irresponsible attitude on the part of the Directors. Furthermore I am satisfied that the Directors had reasonable grounds for believing that they could trade out of their financial difficulties and reduce (and ultimately eliminate) their Revenue liabilities by means of the phased payments which were in place and were being complied with.

6.5 However it would appear that in the immediate run-up to the liquidation of the company the Revenue came to a different view as to the appropriateness of facilitating the company by means of phased payments. In the light of that changed view the Revenue (as they were undoubtedly entitled to do) sought to attach all of the company's bank accounts on 18th February, 2003.

6.6 Thereafter it became clear to the Directors that the company was no longer in a position where it could trade out of its difficulties due to the absence of accommodation from the Revenue Commissioners. In the circumstances I am satisfied that the Directors acted promptly in moving to have the company brought into voluntary liquidation as soon as that situation became clear.

6.7 In all those circumstances it does not seem to me that the Directors can be open to any criticism as to the manner in which the commercial management of the company was conducted at any stage and, in particular, in the critical stage immediately prior to liquidation.

6.8 Furthermore there is no suggestion now before the court that the Directors acted in any inappropriate way which would have prevented the assets of the company (once it was facing liquidation) from being distributed in accordance with the requirements of the Companies Acts.

6.9 As I set out in *McLaughlin* it is necessary to take the Directors clean bill of health under both of those headings into account in assessing any failure under the first heading.

**7. Failure to keep proper books**

7.1 There can be little doubt but that the failure under this heading is significant. For the reasons indicated above it is clear that each of the failures stems from the fact that the company never had audited accounts. Such failures would, *prima facie*, be serious enough to warrant the making of an order under s. 150 unless, on proper analysis, there was an explanation for that failure which, when taken in conjunction with all other relevant factors, would show the activities of the Directors not to have been sufficiently irresponsible to warrant the making of an order. In that context it is necessary to analyse the reason for the failure to have audited accounts and also to consider the nature of the books and records which were, in fact, kept by the company.

7.2 I am satisfied on the evidence that the failure of the company to produce audited accounts stems almost entirely from one single issue. It would appear that the company spent significant sums of money in its start up phase on the development of IT product. The company used standard accounting software. There is, therefore, no question but that the company kept adequate records of its income and expenditure. The problem in converting those income and expenditure records into audited accounts stemmed from the question as to the proper accountancy treatment of the expenditure incurred on the development of product. It would appear that the Directors were anxious that that expenditure be treated as having created an asset which would appear as such in the accounts. Their accountants disagreed.

7.3 There is some dispute on the evidence as to whether the company ever had a formally appointed auditor. There seems to be little doubt but that Deloitte and Touche carried out significant work leading towards an audit and gave significant accountancy services to the company. Apparently conflicting correspondence was produced to the court written by Deloitte and Touche to, on the one hand, the company and, on the other hand, the liquidator, as to whether Deloitte and Touche were, in fact, ever auditors to the company. It may be that that conflict can be explained by a difference between a formal appointment and an informal carrying out of works which might lead to a formal appointment and a formal audit. Be that as it may, it does not seem to me that I can resolve that issue of fact on the affidavit evidence before me, and for that reason it seems to me that I must approach this case on the basis that, at a minimum, significant work was done towards producing audited accounts. In that context it should also be noted that the company had a relatively short life and that, as a matter of practicality, it was only the accounts for what were, substantially, its two start up years which were outstanding at the time of the liquidation. Furthermore I am satisfied that the company had regular management accounts available to the Directors which, save for the question of the proper accountancy treatment of the IT development expenditure, gave the Directors an accurate view of the companies financial position at all material times.

7.4 There would also appear to be evidence that the Directors consulted another firm of accountants who, it would appear, were inclined to take a different view of the proper treatment of the relevant development expenditure. While the liquidator has put before the court evidence of the relevant accountancy statement of practice which seems to support the Deloitte and Touche view, I am not satisfied in this case that the Directors were guilty of an irresponsible refusal to take professional advice on board.

7.5 In all those circumstances I am not satisfied, on the particular facts of this case, that the failure to produce audited accounts can be said to demonstrate a lack of responsibility of a sufficiently serious nature which, when taken in conjunction with the clean bill of health for which the Directors are entitled to credit under other headings and, not least, the fact that the company had full detailed and accurate records as to all of its income and expenditure, should lead to a finding of a degree of irresponsibility in the conduct of the affairs of the company sufficient to make an order under s. 150.

7.6 In coming to that view I should make it clear that there is an obligation on the Directors of any company (with, where appropriate, the assistance of professional advisors) to resolve in a timely fashion any questions concerning the accounts of the company necessary to enable the signing off of final audited accounts. There can, undoubtedly, be difficult questions of interpretation which need to be resolved in order that accounts, prepared in accordance with the appropriate practice, can be finalised. The fact that the Directors in this case appear to have obtained at least potentially conflicting advice as to the proper treatment of the money expended on the development of product may provide a partial explanation for the delay in finalising audited accounts. The fact of such difficulties should not absolve directors from an obligation to resolve such issues and produce audited accounts. The existence of such issues may, however, provide a partial explanation for a delay (provided it is not excessive). The existence of such difficulties is also an element in the assessment of the seriousness with which the court should treat any failure to keep proper books and records. Where the underlying financial information is all there and the only question remaining is one of interpretation or treatment for the purposes of audited accounts somewhat different considerations may apply to that type of case, with which this court is all too frequently faced, where the underlying financial information itself is patchy, or in some cases non existent.

**8. Conclusion**

8.1 There is no doubt that the Directors must be said to have been at fault in failing to resolve the issues surrounding of the treatment of the relevant expenditure in a timely fashion. However having regard to the fact that all of the failures alleged in respect of compliance with the company's obligations under the Companies Acts stem from the absence of audited accounts, and the fact that no criticism can be made of the underlying income and expenditure records, it would not be appropriate to characterise the culpability of the Directors in this regard at too high a level. When the otherwise good record of the Directors in their conduct of the company's affairs is taken into account it seems to me appropriate to regard their overall record in the management of the company as not demonstrating a level of irresponsibility sufficient to make an order under the section.