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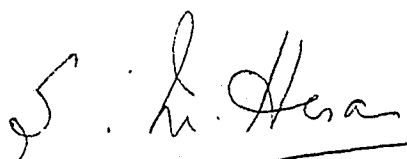
THE LEGAL ACCOUNTABILITY OF DIRECTORS FOR FINANCIAL
MANAGEMENT OF A COMPANY: A COMPARATIVE STUDY OF
ENGLISH AND MALAYSIAN LAW

A Z H A R I

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PETALING JAYA, JUNE 30, 1995

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IN THE NAME OF ALLAH MOST GRACIOUS MOST MERCIFUL

M O T T O :

إِنَّ اللَّهَ يَأْمُرُكُمْ أَنْ تُؤَدُّوا الْأَمَانَاتِ إِلَىٰ أَهْلِهَا
وَإِذَا حَكَمْتُمْ بَيْنَ النَّاسِ أَنْ تَحْكُمُوا بِالْعَدْلِ
إِنَّ اللَّهَ نِعِمَّا يَعِظُكُمْ بِهِ إِنَّ اللَّهَ كَانَ سَمِيعًا
بَصِيرًا [سُورَةُ النِّسَاءِ : ٥٨] أنهرے ۱۹۹۵

GOD DOTH COMMAND YOU TO RENDER BACK YOUR
TRUSTS TO THOSE TO WHOM THEY ARE DUE; AND
WHEN YE JUDGE BETWEEN MAN AND MAN THAT YE
JUDGE WITH JUSTICE VERILY HOW EXCELLENT IS
THE TEACHING WHICH HE GIVETH YOU? FOR GOD IS
HE WHO HEARETH AND SEETH ALL THINGS.

(Q.S. AN NISAA' : 58)

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Subsequently, my sincere thanks to all my colleagues and those who have generously assisted me to complete this work. Last but not least, I realize that this dissertation still has some weaknesses, certainly, due to lack of my knowledge, experience and out look. Hence, any suggestion for the betterment of this work is highly appreciated.

Petaling Jaya, June 30, 1995.

Yours sincerely,

A z h a r i

ABSTRACT

The main purpose of a company is to earn the profit as much as possible. This purpose cannot be achieved without body to run it. Hence, it is needed to choose some persons known as directors to well manage it. The chosen directors hold some accountabilities obligated by the Companies Act and Company's Articles. One of the accountability which is extremely important to be taken into account is financial accountability. Section 221 of English Companies Act 1985 similar to section 167 of Malaysian Companies Act 1965, require every director of a company to keep accounting records which are sufficient to show and explain the company's transactions with reasonable accuracy at any time. The accounting records must also be adequate to enable the directors to ensure that any balance sheet and profit and loss account prepared complies with the requirement of the Companies Acts. However, the phenomena found in the reported cases whether in England or Malaysia, shows that the cases involving directors concerning this financial accountability occur so frequently. This is really one of the serious problems faced by the law and business world today.

The objectives of this study are to scrutinize and ascertain the factors which cause the problem arisen above. Besides, it is also aimed to highlight the nature of directors concerning their financial accountability to the company. It also compares the concept of accountability in the English and Malaysian company law. Finally, this study attempts to provide solutions for improvement of the law.

This study includes qualitative study with applying Comparative Analysis Method. The primary data of this study are met directly from reported cases and statutes of the both countries. While secondary data are gained from recent selected references of both legal systems.

The study identifies that the main factors which cause the problems highlighted above are some directors intentionally ignore the provisions of the Companies Acts. Some of them do not really understand the provisions of the Companies Act due to lack of knowledge of the company law. Sometimes the directors in cooperation with the other officers misuse the company's funds to purposes which are beyond the company's objectives.

It is submitted that the directors who hold the top position of a company shall at all the time act honestly and manage efficiently towards all company's transactions especially in utilizing financial structure. The provisions of sections 221 until 226 of English Companies Act and sections 167 until 169 of Malaysian Companies Act concerning financial accountability, need amendment. Those sections should apply strict sentences or fines for directors and officers who misuse the funds of the company to eradicate the frequency of the problems. Besides, the provisions of insider trading also should be amended to adequate enough to cover the problems.

TABLE OF CONTENTS

ACKNOWLEDGMENT.....	i
ABSTRACT.....	iii
TABLE OF CONTENTS.....	iv
TABLE OF CASES.....	vii

CHAPTER ONE

INTRODUCTION

1. An Overview of a Company	1
2. Background of the study.....	7
3. Objectives of the study.....	10
4. Methodology of the Study	11
5. Structure of the study.....	13

CHAPTER TWO

NATURE OF DIRECTORS IN A COMPANY

1. Who are directors.....	15
a. English law.....	15
b. Malaysian law.....	19
2. Legal Entities of Directors	23
a. English law.....	23
b. Malaysian law.....	27

3.	Appointment Managerial Structure of Directors	32
	a. English law.....	32
	b. Malaysian law.....	39
4.	Directors as Agents, Trustees and Servants of a Company.....	45
	a. English law.....	45
	b. Malaysian law.....	53

CHAPTER THREE

DIRECTORS' ACCOUNTABILITY FOR RAISING FINANCIAL STRUCTURE OF A COMPANY

1.	Raising Capital is the Accountability of Directors..	60
	a. English law.....	60
	b. Malaysian law.....	69
2.	Issuing Shares to Raise Financial Structure and Shareholders	74
	a. English law.....	74
	b. Malaysian law.....	81
3.	Issuing Debentures is one of the ways to Increase Financial Structure of a Company	87
	a. English law.....	87
	b. Malaysian law.....	91
4.	Insider Trading and Its Problem in Raising Financial structure.....	96
	a. English law.....	96
	b. Malaysian law.....	101

CHAPTER FOUR

**DIRECTORS' ACCOUNTABILITY FOR MAINTAINING
FINANCIAL MANAGEMENT OF A COMPANY**

1.	The Obligation of Directors to Render Annual Accounts of a Company.....	109
	a. English law.....	109
	b. Malaysian law.....	118
2.	How to Access Balance Sheet and Profits and Loss of a Company	125
	a. English law.....	125
	b. Malaysian law.....	133
3.	Distribution of Dividends to the Company's Members... ..	140
	a. English law.....	140
	b. Malaysian law	147
4.	Winding up of a Company and Its Solution	154
	a. English law.....	154
	b. Malaysian law.....	162

CHAPTER FIVE

CONCLUDING REMARKS

1.	Conclusions	170
2.	Suggested Reforms.....	174
BIBLIOGRAPHY		178

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CHAPTER ONE

CHAPTER ONE

INTRODUCTION

1. An Overview of a Company

The word company literally means an association of persons formed for the purpose of some business or undertaking carried on in the name of the association.¹ It means that company is a body of persons associated together for the purpose of trade or business. Each member of company has the right of assigning his share(s) to the others and all of them subject to the regulation of the company.

A company under the English Companies Act 1985 is only the company limited by shares or limited by guarantee and having share capital.² Any two or more persons associated for a lawful purpose may, by subscribing their names to a memorandum of association, form an incorporated company, with or without limited liability. The company which is formed may be either :

-
1. Henry Campell Black, *Black's Law Dictionary*, (1990).
 2. English Companies Act 1985, s. 1 (3).

a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them (a company limited by shares); or

a company having the liability of its members limited by memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up (a company limited by guarantee); or

a company not having any limit on the liability of its members (an unlimited company).³

While under the Malaysian Companies Act 1965 "company" means a company formed or incorporated or existing within Malaysia or out side Malaysia and includes any foreign company.⁴

From definitions mentioned earlier, it can be assumed that company is a cooperation of some persons which is laid down by virtue of mutual understanding to achieve business purpose. It obviously contains three organs as follows :

- a. Company is a legal institution. It has its own propertiewhic are separated from shareholders' properties and its common purpose is business.
- b. Shareholders have limited liabilities with few exceptions where they are only responsible for their own share. Their responsibilities are limited to the amount of their shares. They are not liable for the debts of the company beyond their capital contributions. Members may transfer

3. *Ibid.*, s. 1 (2).

4. Malaysian Companies Act 1965, s. 4.

their interests in the association to the other person without the consent of the other members. The purchasers who become new shareholders must have the same rights and duties which the sellers had.

- c. Directors and board of directors are appointed to carry on and control the daily activities of the company.

Generally known that company is the most effective vehicle to manage and control modern business enterprises. It permits the combination of capital and skill for vast business operations with the minimum risk of loss. The existence of the company depends on its owner and directors. Its life is unaffected by the retirement or death of its shareholders, directors and officers. The company may acquire, hold, and convey properties in its own name. It also may sue and be sued in its own name. Harm to the company is not harm to its shareholders. Therefore, with a few exceptions, shareholders may not sue to enforce a claim of the company.⁵

Generally, shareholders owe no fiduciary duties to the company. The shareholders who are not officers or directors may deal with the company as may other persons do it, whereas the directors and officers may hold fiduciary duties to the company. Like natural person, the company is protected from

5. Daniel Davidson (et. al), *Business Law Principles and Cases* (1989), p. 674.

unreasonable searches and seizures under the law and it also has free speech rights and own domicile.⁶

Besides, in a company is also known limited liability concept. The concept of limited liability⁷ should not be confused with the principles concerning the independent legal personality of a company. In a limited company, the member's liability for the debts of the company is normally limited to the amount unpaid (if any) on his shares. Therefore, if he buys 1,000 shares with the price \$1 each and pays up to 50 sen on each share, he has paid up \$ 500 and can be made to pay another \$ 500, but he cannot be made to pay more than \$ 1,000 in all. It is only the member's liability for the company's debts is limited.

The company itself is always fully liable and has unlimited liability. As long as the company has assets, it must pay its debts. If there are insufficient assets, the company will then be dissolved by liquidation like a natural person being made a bankrupt in similar circumstances.⁸ However, this condition of insolvency is in no way connected to limited liability. Insolvency is a matter of fact, viz a person is unable to pay his

6. Domicile of company is determined by where the company's activities taking place, or where its directors carrying out the businesses.

7. Limited liability means the extent to which a person can be made to account to the law.

8. Walter Woon, *Company Law*, (1991), p. 472.

debts because he has insufficient funds.⁹ Liability is a matter of law, viz a person is liable to pay his debts to a limited or unlimited extent irrespective of whether or not he has sufficient funds.

It is stated that each company must have at least two directors. Section 122 of the Malaysian Companies Act 1965 requires the first directors to be named in the Articles of Association and that the directors must be natural persons of full of age. If for some reasons the minimum two directors vacate office, eg by death, incapacity, etc., and no replacements are made, it is considered that those who are managing the business are occupying the position as directors. In a small private company, especially family business, the shareholders and the directors are usually the same persons.

In considering what the powers of the company are, it is impossible to ascertain those by solely examining the Companies Act. The Act only specifies what a company may not do. Clearly the legislators consider the subject of Company's powers as an internal matter to be specified in the internal regulations.¹⁰ A company derives its capacity from the legislation under which it was incorporated, ie the Companies Act and the extent of its

9. Robert R. Pennington, *Directors' Personal Liability*, (1989), p. 93.

10. Christopher Ryan, *Company Directors Liabilities, Rights and Duties*, (1989), p. 19.

power depends on the construction of its Memorandum of Association.

A company may do all things which are expressly authorised by its Memorandum which may be regarded as fair incidental or necessary attainment of its objects. The company is also provided that it may not do anything which is prohibited by the Act. The Articles of Association may decide how those powers are to be allocated between such organs as the company has established for its management. In this regard, most companies adopt Article 73 of Table A of the 4th Schedule to the Act, which states inter alia. "... the business of the company shall be managed by the directors who may pay all expenses incurred in promoting and registering the company."

They may exercise all such powers of the company based upon the Act or regulations. The provisions of the Act and such regulations which are being not inconsistent with the objectives of the company may be prescribed in general meeting; but no regulation made by the company shall invalidate any prior act of the directors, which should have been valid if that regulation had not been made.

It will be noted, therefore, that the Articles may delegate all the powers of management of a company to the directors except those powers which the Companies Act or Articles dictate must be exercised by the shareholders in general meeting. However, the above Articles need not necessarily be adopted

and alternative Article can be inserted by the shareholders in general meeting.

2. Background of the Study

Nowadays reasonably people all over the world involve in business activities to survive their lives. The very first step which is extremely necessary to be taken into account before establishing a business is to decide what kind of business organization is best suit for them. The form of business organization adopted will determine the degree of personal control over the business, and one of the most common form used is company.

Currently, company plays important role in business world. The growth of modern company has been largely responsible for dynamic economic development. Through the company people are able to invest their own properties in to business enterprise. Besides, the law as medium protector also encourages the investors and shareholders to do so in order to enhance their economic scale.

The Company established by the shareholders cannot be run without personnel who are qualified to manage it. Therefore, they elect qualified persons as directors who are responsible

for all company's transactions. Here, the directors have to handle all company's activities in accordance with company law provisions and company's Articles, and if they fail to do so they will be liable under the Act and company's Articles.

One of the liabilities which is extremely important to be conducted by the directors who hold the top position of a company is to access financial accountability in each financial year in order to ascertain the accurate financial position. Section 221 of English Companies Act 1985 requires the directors of each company to prepare a balance sheet, and profit and loss account of the company for each financial year. Besides, this balance sheet has to describe a true and fair view of the profit and loss account of the company. In addition, they are also obligated, in regard to this financial accountability, to liable to shareholders. Similar provision is also stipulated in section 167 of Malaysian Companies Act 1965. Each accounting record of the company, furthermore, shall be properly kept by the directors in proper place in order to be easily inspected whenever it is needed.

However, the phenomena found in the reported cases whether in England or Malaysia shows that the cases involving directors concerning this financial accountability of company occur so frequently. This is really one of the serious problems faced by the law and business world today. This condition is really a great challenge for the scholars especially lawyers who

need the exact answers.

Hence, this problem should be taken into account by government, legislators, judges, lawyers and practitioners in order to create a healthy climate in business and law world today. Hence, a comprehensive study which will cover all aspects of the matter is really required. The causes, the magnitude of the problem and the remedies will be dealt with.

Briefly, the problems which will be scrutinized and remedied in this study are as follows:

1. Why do the cases involving directors concerning financial accountability of a company wether in England or Malaysia occur so frequently?.
2. How do English and Malaysian law deal with these problems?.
3. What are the concepts of English and Malaysian law on legal position of directors concerning financial accountability of a company?.
4. How do the solutions offered by English and Malaysian law effectively deal with the situation?.

3. Objectives of the study

The objectives of this study can be summarized as follows:

1. To scrutinize and ascertain the factors which cause the cases involving directors concerning financial accountability of a company frequently happen.
2. To highlight the nature and position of directors concerning financial accountability viewed from English and Malaysian legal perspectives.
3. To compare the concept of English and Malaysian company law especially on financial accountability as well as directors' responsibilities.
4. To find out the solution on the discussed matters in order to create clear picture and real answers.
5. To contribute some proper ideas for improvement of English and Malaysian law especially on company's directors and its financial accountability.

In order to achieve all the objectives mentioned above, relevant statues, cases and judicial decisions in England and Malaysia will be examined.

4. Methodology of the Study

a. Location of the study

Location of the study is England and Malaysia. It covers all geographical areas of those countries. It is not bound by certain geographical limitations because it only concerns relevant case study and not field research. Thus, all relevant cases and statutes in England and Malaysia will be covered in this study.

b. Methode of the study

This study can be included into qualitative study because it merely concerns legal point of views. This study applies comparative analysis method. By applying this method, it will describe the condition of study as it is by comparing and analyzing the data of both countries. After describing and analyzing all the data as found in investigation, this study will attempt to provide solutions and suggestions.

c. Source of data

1. Primary data

Primary data of this study is met from statutes and cases from both countries. The statutes and