

health adviser

Grant Thornton 

Corporate Governance...

...has always been important. Simplistically it aims to ensure that a company manages its business in the correct fashion, with accountability and transparency.

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"Your majesty there is no second best."

It all started in 1851 as the schooner **America** raced by a syndicate from the New York Yacht Club challenged England to a race. 16 yachts participated, 15 of them English. One of the spectators was Queen Victoria who enquired who was leading. The answer "America". "Who is second?" she asked. "Your majesty, there is no second best."

Some five years later, the American syndicate donated the British Royal Yacht Squadron's "100 Guinea Cup" to the New York Yacht Club who renamed it "America's Cup" in honour of the boat that took it to the USA. Attached to it was a Deed of Gift which formed the basis of the rules to use the cup as an "eternally challenging trophy for friendly competition between different countries". Thus the America's Cup Challenge was born.

When Sweden's entry into the America's Cup challenge, **Victory Challenge** established their base here in 2001, they needed an accounting firm that was second to none and they approached Grant Thornton for assistance.

Our challenge, is to ensure that all their financial and business advisory matters are dealt with smoothly and in a way that adds to the efficiency of the administration of Victory Challenge. Paul McCormick, Partner for the group commented:

'We were delighted to be of assistance to Sweden. An America's Cup challenger's needs were no different to any other new business. Along with their business advisory and regular management reporting needs we assisted them with ensuring they complied with all statutory requirements for such matters as ACC, GST, and PAYE as well as being involved with the more difficult cross-border tax issues faced by such a company.'

Grant Thornton also helped them establish their company under New Zealand law. While Victory Challenge is a New Zealand registered company, its corporate governance is complicated by the fact that its directors are based overseas. Here in New Zealand the company is run by a CEO and an administration group whose task it is to not only comply with all the New Zealand statutory requirements, but to also ensure the "staff" (crew!) meet the wealth of regulations and protocols required by the Louis Vuitton and America's Cup rules. That's one challenge that Grant Thornton can't help them with!

Create certainty with buy/sell agreements

Whilst some businesses may already have shareholder agreements in place to deal with the day to day operational issues of their business, many rely solely upon the company constitution when it comes to determining what should happen in the event of the death, illness or total and permanent disablement of any one of the owners.

Create certainty

Remove all the pitfalls and problems, by making sure that if tragedy strikes, everybody knows what is going to happen, when it is going to happen and how it is going to happen.

For shareholders and partners this can easily be achieved with an up to date, robust, Buy/Sell Agreement. You may have one of these already, but when was it last reviewed? Many agreements we come across are often well out of date, inadequately funded, and often don't reflect the new ownership arrangements where the family trusts may now own a portion of the shares. They are often silent on some of the key ingredients of a comprehensive agreement.

What should an effective Buy/Sell Agreement contain?

It should clearly state that it takes precedence over the company constitution.

It should also state when the agreement comes into operation. Is it only in the event of death, or should it also cover the more likely events of a major health crisis or trauma, or even worse total and permanent disablement? Many people do recover from a major trauma or health crisis, return to the business and carry on

as a vital and valuable contributor. So in those cases where the event has triggered the Buy/Sell Agreement how do you deal with continuing participation? Further still, you will need to work out how you are going to deal with any proceeds that have been received from the trigger event.

Valuation Process

A mechanism for valuing the shares or partnership interest must be included within the agreement. Formulas are popular, especially in businesses that are growing quickly. At any time the parties can agree a new figure; particularly useful if, halfway through the year a new contract is secured or the business value changes dramatically for any reason.

Funding

The agreement needs to set out how the transaction will be funded. Many use life insurance, as it is often the most cost effective way, but the agreement will need to deal with the situation if there is a shortfall or a surplus on any insurance claim, as well as the possibility that there is no funding arrangement in place at all.

If insurance solutions are to be used, then it is crucial to get the ownership of those policies in the right hands. Cross-owned contracts can be fraught with potential difficulties. A modern agreement may include the establishment of an insurance trust, using a common trustee, whose task will be to ensure that the proceeds of any claim and the shares of a deceased or disabled partner end up in the right hands. Shareholder current account repayment may also need to be funded.

Common mistakes in Buy/Sell Agreement Planning

- Lack of funding or inadequate funding.
- Lack of any agreement at all, or an inadequate agreement.
- Failure to set up an agreed valuation formula, which is positive and not subject to opinion or challenge.
- No annual sign off on valuation.
- Failure to provide the ability for a shareholder to buy back his or her life and living assurance policy in the event of the dissolution of the company or partnership.
- Failure to penalise any shareholder or partner for non-disclosure (at time of application for insurance) thereby invalidating any insurance claim.
- Failure of the deed to provide for the shares owned by spouses or family trusts, and to have those parties as signatories to the deed.
- No funding arrangements for current account repayment.
- No provision for regular reviews if shareholders change. When did you last review the entire agreement?
- Failure to emphasise the value of a Buy/Sell Agreement as a valuable ingredient of an individual's retirement planning and estate planning.

The dangers of doing nothing

A recent New Zealand case has emphasised the need for directors to ensure they are actively involved in the running and governance of companies.

In the case of Benchmark Building Supplies Limited vs Jackson, the Court, having found that the directors were guilty of reckless trading and incurring obligations that could not be met, was also asked to consider the personal liability of a "silent" director for these charges.

The silent director, Mrs Jackson who was one of only two directors, raised that as the Company was her husband's, she was significantly less involved in the running of the Company and was probably not involved at all in the making of a critical decision to continue trading when the Company was in serious financial difficulty.

This decision to continue trading which was taken some nine months before the Company was liquidated, led to the Company incurring trade debts that could not be met. The Court subsequently held that the directors were personally liable to repay all debts incurred from the time of the fatal decision to the date of liquidation.

In reaching this decision, the Court noted that reckless directors range from the crooked to those who are honest but hopelessly and unreasonably optimistic. The fact that Mrs Jackson was not involved in the critical decisions was an issue of her own making. The judge stated **"Directorship of any Company involves acceptance of all the directoral duties imposed by the law. There is no halfway house"**. Mrs Jackson was therefore liable for half of all amounts payable.

When considering this case directors should also be aware that abstaining from voting on any issue does not remove their liability. This arises by virtue of Schedule Three of the Companies Act 1993 which deems a director who is present at a board meeting and does not vote, to have agreed with the decision made by the Board.

If you are a director and you do not agree, say something, have it noted in the minutes and vote against the resolution!

For clients who also operate in Australia and by way of comparison, we note that the Australian Corporations' legislation provides that directors who are able to prove "because of illness or for some other good reason" they do not take part in the management of the Company, have a defence against claims they breached their directors' duties.

This was highlighted in the recent case of Southern Cross Interiors Pty Limited (In Liquidation) where a wife successfully argued that she had only consented to act as a director of her spouse's company to ensure continued matrimonial harmony and thus was not found guilty of any wrong doing.

While New Zealand Courts may move to the Australian view - point long term, in the meantime New Zealand company directors must be aware that directorship is anything but a passive role.

Audit Committees

In New Zealand there is currently no requirement, either under the Companies Act 1993, the Financial Reporting Act 1993 or the NZ Listing Rules, for a listed public or private company to have a formal audit committee. However this is expected to change soon for listed companies, based on recent proposals by the NZSE.

An audit committee is a committee of the board of directors numbering between three and six members dependent on the size of the organisation. It has two main objectives:

1. It assists the governing body in fulfilling their responsibilities to shareholders, potential shareholders and the investment community, by overseeing that appropriate accounting policies and internal controls are established and followed; and that the entity issues financial statements and reports on time and in accordance with its regulatory obligations.
2. It encourages and facilitates communication among the governing body, entity management, and internal and external auditors to ensure open and accurate exchange of ideas and information.

Audit committees provide the governing body with a level of comfort that the entity has sufficient corporate governance to identify and establish any corrective action necessary. The audit committee should maintain a free and open communication between the governing body and external auditors, the internal auditors and the financial management of the company.

Audit committees are most commonly found where there is a separation of ownership and management of the entity. In future these may become mandatory for certain companies.

The Corporate Governance checklist

1. Do we have an independent director?
2. Are all directors aware of their requirements to advise the company and other directors of any conflicts of interest?
3. Do we have employment agreements in place for senior management and if applicable, directors?
4. Do we have a shareholders' agreement in place in case of disputes or forced shareholder changes?
5. Do we have an audit committee?
6. Do we have a meeting agenda emphasising the standard matters we need to address at each meeting?
7. Do we have directors' and officers' liability insurance and if so, is it specifically approved by our constitution?
8. Are we fully aware of our directors' duties?
9. Have we established short and long term strategic plans for the company?
10. Do we have a succession plan in place for directors?

Whilst this is not an exhaustive checklist for good corporate governance, it does highlight the minimum clients should strive for.

If you have answered no to any of these questions, you should contact your Grant Thornton Partner.

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