

# Innocent Director :

## A Director who knows nothing and sees nothing

*Dishonesty or gross negligence, which is the case? when bad things happened with the company and shareholders have passed ?*



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In the previous article, I analyzed the case of an innocent director who signed a promissory note years after the company's liquidation and, in the end was held personally liable for the THB 3 million debt owed to the bank.

In this next case, the Board approved nomination of an auditor and determined the auditor's remuneration, which actually falls under the authority of the shareholders. This is a case where the legal rights and duties of the Board and the shareholders, which are clearly different (different hats), was not separated.

In this case, a limited company (i.e. a private company) failed to prepare the audited financial statements for several years (from 1995 to 2002). This is quite common among SMEs and family businesses. The Board then hastily and without authority appointed the auditor to audit and certify the financial statements before proposing it to the shareholders' meeting.

Later on, the shareholders disagreed with the Board for appointing the auditor which is not under the Board's authority.

Furthermore, the Board subsequently asked the shareholders' meeting to ratify (1) the appointment of auditor and (2) the determination of auditor's remuneration previously approved by the Board. The ratification was probably meant to whitewash what the Board had done. But will the ratification by the shareholders actually make the Board's action legally right?

*If you were a corporate director of either a private company or a public company and found this matter in the meeting agenda for approval, what would you do?*

The shareholders, who are direct stakeholders, brought the matter of their disagreement with the Board to the Court. The Civil Court (first round) ruled that the Board's action was legitimate. The Shareholders then appealed the case to the Appeals Court (second round). In 2015, the Supreme Court (final round)

ruled based on the fundamental principles of company law and interestingly analyzed the principles and rationalization for the Board to comply:

- 1) The primary objective of appointing an auditor is to audit financial statements prepared by the company through auditing practice, in which they would consider and comment if the financial statements prepared by the company complies with accounting principles.
- 2) Therefore, the status and role of the auditor is deemed as a representative of the company in controlling the administration by management (i.e. the Board) to check whether their actions are legitimate and in compliance with the company's Articles of Association, Board's meeting resolutions, and shareholders' meeting resolution.
- 3) Thus, the auditor(s) is clearly separated from management, i.e., they are prohibited from being a director, representative, or employee of the company while assuming the role of the company's auditor.
- 4) The auditor reports directly to shareholders and only the shareholders' meeting has the authority to appoint, remove, and determine remuneration of the auditor as specified by the company law. This is not the Board's authority.
- 5) Where the Board has appointed the auditor beyond their legitimate authority (i.e. ultra vires) and later seeks ratification from the shareholders' meeting, such ratification shall not be binding on the company non-ratifiable matter.

*If you were a corporate director and found yourself in a similar situation, particularly those concerning the company's financial statements, did you know that there are also other issues that a director must be particularly cautious about?*

### Legal Risks & Liabilities

The company has not prepared the financial statements for eight consecutive years, it is doubtful whether its operations are running normally. If the operations are running normally, but the company did not prepare accurate financial statements for that long, both the Board and the company must have violated several laws and regulations such as failed to submit the financial statements to the Ministry of Commerce, failed to submit the financial statements and the Form PND 50 (corporate income tax return) to the Revenue Department. Both are obligations that companies are required by law to prepare and submit to the authorities annually. Failure to comply to such obligations would expose the directors and the company to criminal punishment.

In addition, failure to submit financial statements for a number of years may cause the Ministry of Commerce to revoke the registration of the company. This could turn the company's status into a defunct company, resulting in the company being incapable of running its business. This, however, does not free the company from its legal liability and outstanding debt (including tax debts).

The Ministry of Commerce has (even to this day) stipulated a remark in the company affidavit (that can be obtained by the general public) indicating whether or not the company has submitted its financial

statements to the Ministry of Commerce or not. This action is meant to alert the public that, where the company has failed to submit its financial statements, people involved with the company should be cautious about the credibility of the company's financial status.

Going forward, the amendment of the Public Limited Company Act that is soon to become effective stipulates that the Ministry of Commerce's Registrar can disclose information of companies that violate the law and the relevant convicts. This is a form of social sanction by the law in addition to civil sanction and criminal sanction. The disclosure of the convicts' information will indirectly benefit the public by alerting them to be cautious in being involved or doing business with companies that violated such laws.

### Director Risks & Liabilities

According to company law, directors have the legal duty to arrange for the company (both "private company limited" and "public limited company") to prepare accounts and financial statements for shareholders to examine and be aware of their interests. Financial statements must have the auditor's notes that reflects comments to shareholders about risks concerning the company's accounts. They must be disclosed to the public, creditors, and stakeholders at the Ministry of Commerce. Financial statements are company information accessible by the general public through the Department of Business Development, Ministry of Commerce. For public companies listed on the Stock Exchange of Thailand, shareholders and the general public can access their financial statements through [www.set.or.th](http://www.set.or.th) and their corporate website.

Public companies listed on the Stock Exchange of Thailand must have at least one independent director who has fair understanding of finance and accounting in the audit committee because they are obliged to provide their opinion on the financial statements in accordance with the Thai Financial Reporting Standard (TFRS) after the financial statements were examined by the auditor. The financial statements must comply with financial accounting principles, which are different from tax accounting principles under taxation laws. Therefore, the company's Board, particularly the audit committee, cannot claim to be unaware of the applicable accounting standards and cannot claim to be unaware of tax issues.

According to the Public Limited Company Act, the company's Board must meet at least four times a year, though the law does not set requirements on the meeting agenda or why at least 4 times. However, the quarterly financial statements of public companies listed on the Stock Exchange is required to be screened by the audit committee before submitting to the Board to consider and approve.

In the past, there was a life insurance company that was in financial deficit for several years and eventually went "bankrupt". The Court found that the Board failed to inform the shareholders about the causes of losses, did not investigate on missing life insurance premiums, and did not follow up on outstanding premiums and other issues that affect corporate viability. In this particular case, the Supreme Court ruled in 1976 that though the Board's practices are condemnable, but they were not held responsible because they assigned the managing director" (referring to the CEO) to handle such affairs. Therefore, the responsibility lied solely on the managing director and not the Board.

However, in the present day, the Court would have ruled cases like this differently than 40 years ago because the legislations have been amended and the expectation for the Board' to perform their duties is much higher than in the past. More importantly, the Board nowadays must possess director leadership qualifications to lead the organization. They must properly perform their Duty of Care and Duty of Loyalty, not being a mere a sitting-duck director or an innocent Director who fails to assume their duties as a professional director.

### CFO Risks & Liabilities

The CFO is expected by stakeholders to act as the first line of defense to protect interests of the company and shareholders (corporate beneficiary). Listed companies must disclose to the Stock Exchange of Thailand and shareholders should its CFO resign, be unable to perform duties, or if there is any change in the CFO position.

In the Stock Exchange of Thailand, many CFOs are not accountants by education but can work with the accountant and auditor. Their comprehension with financial statements and the Thai Financial Reporting Standard: TFRS derives from their experience and expertise though they may not have studied accounting directly but graduated from other fields such as engineering, art, agriculture, international trade etc.

Since the capital market principle requires that listed companies have CFOs, professional CFOs must have training and direct experience. Therefore, remuneration of CFO position becomes higher along with the demand-supply principle while the post also comes with greater legal liabilities.

Companies planning to launch an IPO must have a full-time CFO for at least one year prior to the listing to take care and be responsible for the company's financial statements together with the Board. The CFO also has to collaborate with internal auditors to examine and assess corporate risks. The examination results must be disclosed to the Board both quarterly and annually.

Normally, CFO of listed companies act as the center to compile financial information for quarterly and annual auditing and examination. The CFO has to propose the audited financial statements to the Board for approval and inform the Stock Exchange of Thailand within the required periods (45 days and 60 days respectively).

Many listed companies failed to submit quarterly and annual financial statements to the Stock Exchange of Thailand by the deadline due to several reasons such as conflicts between major shareholders, legal disputes in courts, insolvency, issues with business rehabilitation, and problems concerning debt restructuring.

However, these matters are not excuses for the company the Board and CFO for not filing financial statements and could be a substantial circumstance for the Court to consider such actions as a criminal offence and penalties on the Board and management.



In 2022, the Securities and Exchange Commission (SEC) filed a complaint against four “former directors and management” including ex-CFO of a “major media” listed company to the Department of Special Investigation (DSI) for jointly “providing false statements or omission of material or related statements from the company’s account or documents to deceive other persons”, which caused damage to the company. This case concerns recording of fake advertising fees” worth THB 700 million in the company’s financial statements.

In this case, the SEC filed the complaint against former directors and management to the DSI to commence the criminal procedure. The Criminal Court will eventually rule if the former directors and management are guilty or not guilty. Details of the case can be found at [https://www.sec.or.th/TH/Pages/News\\_Detail.aspx?SECID=9282](https://www.sec.or.th/TH/Pages/News_Detail.aspx?SECID=9282).

Besides the “creation of fake income” incident, the CFO is also obliged to monitor how the company “spends” money, both in the forms of expense and investment to ensure that there are no abusive expenses or siphoning without transparent procurement process and protect the company’s interests.

### Corporate Secretary

While CFO is an essential role for public company listed in the stock market, another alongside position that works closely with the CFO and the Board on matters concerning meeting and disclosure of important information to the exchange and shareholders is the corporate secretary.

A corporate secretary is not the secretary of the Chairman, nor secretary of the Board, nor secretary of any executive but is the secretary of the organization, not “personal secretary” nor “secretary of any group.

Corporate Secretary is a position by-law. The law does not stipulate that it needs to be an in-house position specified in the organizational chart or outsourced position. Therefore, listed companies have the flexibility to assess the work volume required of the corporate secretary, especially a listed holding company or investment company with many associate companies.

Responsibilities of the corporate secretary mainly involves the Public Limited Company Act and Securities and Exchange Act. They also concern rule and compliance with relevant regulators such as the Securities and Exchange Commission, Ministry of Commerce, and Federation of Accounting Profession. Therefore, the corporate secretary must have basic knowledge about relevant legislations and risks.

Another key responsibility is to conduct a Board meeting. Corporate Secretary must be the person who collaborates all fronts, both internal and external. The roles include: (1) making meeting appointment with directors and management; (2) setting the meeting agenda; (3) preparing related information for each agenda item; (4) recording the minutes of the meeting; (5) preparing meeting minutes; and

(6) disclosing information to the stock exchange as well as provide information/warning against securities trading during silent period and collaborate with external consultants such as the auditor and Internal Audit.

Therefore, the Board, CFO, corporate secretary as well as shareholders are all players in the same team. A company without team building, teamwork and one man show players may risk making mistakes in one of the key issues. That mistake could be about finance and accounting or the financial statements of the company as in the aforementioned case study.

There are a dozen other case studies about (mistakes of) corporate director that I will discuss further on. Stay tuned.

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