CORPORATE GOVERNANCE SESSION - FACT PATTERN FOR DISCUSSION

Acme Computing Ltd ("**Acme**") was incorporated on 2 April 2009. Acme's main business was software development. In particular, Acme developed a programme that would protect computer servers from hackers. At the time of incorporation, Acme had four directors: Mr Carter, Ms Lewis, Mr Benton, and Dr Corday, each of whom owned 25% of the shares in Acme. Acme also hired managers, including a General Manager, Mr Pratt, and Ms Lockhart (who had qualified as a chartered accountant in 2008) to keep the company's books. While Mr Carter, Ms Lewis and Mr Benton all had experience running small businesses, Dr Corday did not.

In 2010, when Acme had made only a small number of sales of the software, it purchased 75% of the shares in Bohrium Media Ltd ("**Bohrium**") which was 50% owned by Mr Carter (who continued to hold the remaining 25% of Bohrium shares following the sale). Mr Carter knew that Acme was looking to develop a marketing strategy, and told the other owners of Bohrium that Acme would pay a premium for a company that was already operating in that space.

From June 2010 to April 2012, Acme's business appeared to be improving both locally and in the US. The board decided to pursue US government contracts as an avenue for potential future growth. In March 2012, Mr Carter, Mr Pratt and Ms Lewis travelled to Washington DC to visit the Pentagon and to discuss the possibility of running a test programme. The board believed that Acme would secure a lucrative contract as the software was so effective.

While the team was in Washington, Ms Lockhart prepared a draft set of accounts for the period of 6 months to 31 December 2011. Those accounts showed that Acme had made a trading loss of approximately $12.7 million for that period, although the company had a balance sheet equity of $3.4 million. Ms Lockhart showed these draft accounts to Dr Corday. Dr Corday noted that she was confident that a lucrative contract would be secured, and that it would bring in more than enough income to cover the "minor shortfall". In the meantime, she told Ms Lockhart that showing the draft accounts to other directors would "stress them out", concluding that "we'll be fine".

Although Ms Lockhart was hard-working and honest, she sometimes made mistakes in the company's accounts. In particular, she regularly characterised facilities that the company had with Greene Bank incorrectly, thereby failing to classify them as current liabilities. Acme's accounts were audited regularly by a well-respected firm of accountants, Staid & Old, but that firm never picked up the mistake.

The pilot programme was a spectacular failure and no contract eventuated. Following the failure, in June 2012 Mr Pratt recommended that Acme enter an agreement with Bohrium to "ramp up" its marketing of the product. The board resolved, on Mr Pratt's recommendation, to enter into an agreement with Bohrium to spend no less than $30,000 per month on marketing.

Acme received a substantial amount of bad press following the pilot's failure and a number of their clients refused further to do business with the company. The members of the board decided to issue a statement announcing their half-year results, in an attempt to "stem the tide". They sent the company's accounts to Staid & Old, requesting sign-off. Staid & Old responded by noting that they had only performed a high level review (and not a full audit), that their report was intended for the use of the audit and risk management committee only, that they had assumed all the information provided to them by Acme was accurate and complete, and stating that, based upon the information provided, they had not found any issues with the accounts. The statement was drafted by Mr Pratt and approved by Acme's Audit and Risk Management Committee, which recommended to the board that the statement be approved at its board meeting on 15 February 2013. Acme released the statement on 25 February 2013. (It was later discovered that there were a variety of "slips" in the accounts that caused Acme's revenue position to be misstated in a way that suggested it was in better financial health than it was).

On 30 June 2015, Acme received a letter from the local taxation authorities advising that the company owed more than $19 million in outstanding tax not including penalties (Ms Lockhart had stopped remitting tax on behalf of Acme when cash flow became tight following the failed pilot). On 3 July 2015 an insolvency practitioner appointed is appointed in respect of Acme.

Potential issues for discussion

The insolvency practitioner is now considering the actions of the directors, and whether they have any grounds to bring proceedings against them for compensation.

1. Did each of the directors exercise the care, diligence, and skill that a reasonable director would exercise in the circumstances?

2. Did the directors permit the business of the company to be carried on recklessly?

3. Did the directors have reasonable grounds to believe that the company would be able to perform its obligations under the agreement with Bohrium?

4. The board at various times relies upon:

   (a) Ms Lockhart to prepare the company's accounts;

   (b) Mr Pratt's advice with respect to the company's marketing strategy;

   (c) The company's auditors as to whether there were issues with the accounts.

   Was that reliance acceptable/reasonable in the circumstances?