

# Tutorial letter 103/3/2016

## LEGAL ASPECTS IN ACCOUNTANCY

### AUE1601

#### Semesters 1 & 2

#### Department of Auditing

**IMPORTANT INFORMATION:**

This tutorial letter contains the solutions to additional questions included in Tutorial letter 102

BAR CODE

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## 1 ABBREVIATIONS USED IN THIS TUTORIAL LETTER

**Companies Act = Companies Act 71 of 2008, as amended and the Companies Regulations; MOI = Memorandum of Incorporation.**

## 2 MARK ALLOCATION

Each question specified how long it should take you to answer it, as well as the maximum marks that could be obtained.

Remember to remain within the prescribed time limits and time yourself.

In some instances, the solution allows you to earn more marks than what is required by the question. This makes it an “easier” question; however you are limited to the maximum number of marks allocated to the question.

## 3 SUGGESTED SOLUTIONS TO QUESTIONS IN TUTORIAL LETTER 102

### QUESTION 1

**100 marks**

#### Solution

#### MATTER 1

##### 1.1 RELATED PARTY

In terms of section 2, a juristic person is related to another juristic person if either is a subsidiary of the other (1)

CFC is a subsidiary of Docex, since Docex holds a 70% interest in CFC. (1½)  
Therefore, CFC is related to Docex. (1½)

**Marks (4)**

##### 1.2 LIQUIDITY AND SOLVENCY TEST

In terms of section 4, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time (1)

(a) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and (1)

- (b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the date on which the test is considered. (1)

The company is not solvent, since the liabilities (R15.8 million) of Docex fairly valued, exceed the assets (R8.9 million) fairly valued. (1½)

Docex is not liquid, since the current liabilities (R9.2 million) exceed the current assets (R1.5 million), (1½)

thus, the company might not be able to pay its debts as they become due in the ordinary course of business, for a period of 12 months. (1½)

Therefore, Docex does not satisfy the solvency and liquidity test. (1½)

**Maximum marks (7)**

### 1.3 GRANTING OF THE LOAN TO JEREL SPEED

- (i) In terms of section 45, except to the extent that the MOI of a company provides otherwise, (1)

the board may authorise the company (1)

to provide direct or indirect financial assistance to a director or prescribed officer of the company or of a related or inter-related company, provided: (1)

any conditions or restrictions in respect of the granting of financial assistance set out in the MOI are satisfied; (1)

the board of directors is satisfied that immediately after providing the financial assistance the company will satisfy the solvency and liquidity test; (1)

a special resolution is adopted within the previous two years, approving the loan to the recipient/category of potential recipients; and (1)

written notice of the resolution is given to all shareholders (1)

and to any trade union representing the company's employees (1)

within 10 business days after adoption of the resolution by the board, (1)

if the value of the financial assistance exceeds 0.1% of 1% of the net worth of Docex (1)

else, the notice must be given within 30 business days after the end of the company's financial year. (1)

**Maximum marks (10)**

- (ii) The loan is granted to Jerel Speed, the managing director of CFC, the subsidiary of Docex (and therefore a person. related to Docex). (1½)

The board successfully evaluated that all the conditions and restrictions in respect of the granting of financial assistance set out in the MOI will be satisfied if the loan is granted. (1½)

Docex does not satisfy the liquidity and solvency test after granting the loan. (1½)

This is the first time this type of loan will be approved and granted since the incorporation of Docex and therefore a special resolution would not have been obtained within the previous two years, approving the loan to the recipient/ category of potential recipients. (1½)

A notice of the resolution were sent to all the shareholders within 15 business days, therefore not within 10 business days after adoption of the resolution. (1½)

It should have been sent out within 10 business days after adoption of the resolution, as the loan of R1 million to Jerel Speed exceeds one tenth of 1 percent the net worth of Docex of R6900 (R6.9 million x 0.1x1%). (1½)

Based on the information provided, a loan was granted illegally to Jerel Speed as the requisite approval was not obtained, thereby constituting a breach of section 45 of the Companies Act. (1½)

**Maximum marks (8)**

## **MATTER 2**

### **2.1 DISPOSAL OF HEAD OFFICE BUILDING**

(i) In terms of section 112, despite any provision in a company's MOI, (1)

a company may not dispose of all or the greater part of its assets, unless the disposal has been approved by a special resolution of the shareholders; and (1)

a notice convening the meeting of shareholders for considering the special resolution must be delivered within the prescribed time and in the prescribed manner to each shareholder of the company. (1)

Each such notice must be accompanied by

(a) a written summary of the precise terms of the transaction to be considered at the meeting; and (1)

(b) reference to the provisions of section 115, the specific authority required; and (1)

(c) reference to section 164, indicating the shareholders' rights, should the special resolution be passed, but where there are dissenting shareholders. (1)

Any part of the assets of a company to be disposed of, as contemplated in this section, must be given its fair market value as at the date of the proposal, in accordance with the financial reporting standards. (1)

**Maximum marks (5)**

- (ii) The transaction is in fact the selling of the greater part of the company's assets, (1½)
- since the book value of the building that will be sold (R5 million) is more than 50% of the book value of the total assets (R8.9 million). (1½)
- The disposal of the head office was approved by a director's resolution and therefore no special resolution was obtained as required. (1½)
- The directors also decided that the transaction should be completed as soon as possible and they did not deem it necessary to inform the shareholders of the company. Therefore, no notice has been sent out to any of the shareholders of the company. (1½)
- Patricia Post proposed to sell the head office building with a book value of R5 million at a profit of R2 million to an independent third party, which is an indication of the market value of the building and therefore the building is valued at its fair market value. (1½)
- Based on this information, the disposal of the head office building will be illegal, thereby constituting a breach of the Companies Act. (1½)
- Maximum marks (7)**

## 2.2 SHAREHOLDERS' MEETINGS

### (i) Requirements of a special resolution to be approved by shareholders

In terms of section 65, for a special resolution to be approved by shareholders, it must be supported by at least 75% of the voting rights exercised on the resolution. (1)

**Marks (1)**

### (ii) Notice of shareholders' meeting

In terms of section 62, the company must deliver a notice of each shareholders meeting in the prescribed manner and form to all of the shareholders of the company as of the record date for the meeting, at least (1)

15 business days before the meeting is to begin, in the case of a public company or a non-profit company that has voting members. (1)

**Maximum marks (1)**

### (iii) Shareholders' meeting quorum

In terms of section 64, a shareholders' meeting may not begin until sufficient persons are present at the meeting to exercise, in aggregate, at least 25% of all of the voting rights that are entitled to be exercised in respect of at least one matter to be decided at the meeting; and (1)

A matter to be decided at the meeting may not begin to be considered unless sufficient persons are present at the meeting to exercise, in aggregate, at least 25% of all of the voting rights that are entitled to be exercised on that matter at the time the matter is called on the agenda. (1)

If a company has more than two shareholders, a meeting may not begin, or a matter begin to be debated, unless (1)

at least three shareholders are present at the meeting. (1)

**Maximum marks (3)**

### MATTER 3

#### 3.1 SUBSIDIARY ACQUIRING COMPANY'S SHARES

In terms of section 48,

(a) the board of a subsidiary company may determine that it will acquire shares of its holding company, but ...

(i) no more than 10%, in aggregate, of the number of issued shares of any class of shares of a company may be held by, or for the benefit of, all of the subsidiaries of that company, taken together; and (1)

(ii) no voting rights attached to those shares may be exercised while the shares are held by the subsidiary, and it remains a subsidiary of the company whose shares it holds. (1)

Despite any provision of any law, agreement, order or the MOI of a company, (1)

the company may not acquire its own shares, and a subsidiary of a company may not acquire shares of that company if, as a result of that acquisition, there would no longer be any shares of the company in issue other than ... (1)

(a) shares held by one or more subsidiaries of the company; or (1)

(b) convertible or redeemable shares. (1)

The decision by a subsidiary or the company to acquire the company's shares must satisfy the requirements of section 46. (1)

In terms of section 46, a company must not make any acquisition of the company's own shares unless it ...

(i) is pursuant to an existing legal obligation of the company; (1)

(ii) or a court order; or (1)

(iii) the board of the company, by resolution, has authorised the transaction; and (1)

it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed transaction; and (1)

the board of the company, by resolution, has acknowledged that it has applied the solvency and liquidity test, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed transaction. (1)

Docex does not satisfy the solvency test after acquiring the company's own shares after considering all reasonable foreseeable financial circumstances of the company.

(1½)

Based on the information provided the acquisition of the company's own shares will be illegal, since it does not satisfy the solvency and liquidity test, thereby constituting a breach of section 48 of the Companies Act. (1)

CFC will acquire 40% (120 000/300 000) of the number of issued shares of Docex which is more than 10% in aggregate. (1½)

Therefore, as CFC is not permitted to acquire more than 10% of the issued shares of Docex it will be in contravention with the Companies Act. (1)

Docex and CFC will acquire 300 000 issued shares of Docex, which will result in there no longer being any shares of Docex in issue. (1½)

Therefore the acquisition of the full 300 000 shares in issue by Docex and CFC will be in contravention of the Companies Act. (1)

**Maximum marks (13)**

## **MATTER 4**

### **4.1 DIRECTORS CONDUCT**

In terms of section 76, a director of a company must not use the position of director, or any information obtained while acting in the capacity of a director to ... (1)

(a) gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or (1)

(b) knowingly cause harm to the company or a subsidiary of the company; and (1)

the director must communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless the director ... (1)

(a) reasonably believes that the information is immaterial to the company; or (1)

(b) generally available to the public, or known to the other directors; or (1)

(c) is bound not to disclose that information by a legal or ethical obligation of confidentiality. (1)

A director of a company, when acting in that capacity, must exercise the powers and perform the functions of director ...

(a) in good faith and for a proper purpose; (1)

(b) in the best interests of the company; and (1)

(c) with the degree of care, skill and diligence that may reasonably be expected of a person (1)

(i) carrying out the same functions in relation to the company as those carried out by that director; and (1)

(ii) having the general knowledge, skill and experience of that director. (1)

**Maximum marks (10)**



## 4.2 REMOVAL OF DIRECTOR

A company's MOI may provide for the removal of one or more directors by any person who is named in, or determined in terms of, the MOI. (1)

In terms of section 71, despite of anything to the contrary in the MOI, a director may be removed by an ordinary resolution at a shareholders' meeting (1)

by the persons entitled to exercise voting rights in the election of a director. (1)

If a company has more than two directors, and a shareholder or director has alleged that a director of the company has neglected, or been derelict in the performance of, the functions of director, (1)

the board must determine the matter by resolution and may remove that director. (1)

The director concerned may not vote on his removal. (1)

Before the shareholders or director of a company may consider such a resolution:

(a) The director must be afforded the chance to defend himself; (1)

(b) The director must be given notice of the meeting (15 business days for public company) and a copy of the resolution to remove him; (1)

(c) The director must be afforded a reasonable opportunity to make a presentation (in person or through a representative) before voting takes place. (1)

If the director is removed by the board, he has 20 business days to apply to court for a review. (1)

If the director is not removed, any director or shareholder who voted to have him/her removed, may apply to court for a review (20 business days). (1)

The board of directors consists of more than two directors. (1½)

Redwaan Road was allegedly involved in a fraudulent scheme where R3 million was stolen from Docex. (1½)

Redwaan Road was dismissed by a directors' resolution on a directors meeting. (1½)

Redwaan Road was not given any further notifications, neither a notice of the meeting nor a copy of the proposed resolution; or (1½)

a reasonable opportunity to make a presentation, in person or through a representative, to the meeting before the resolution is put to a vote as (1½)

Redwaan Road was not present at the directors meeting where the resolution was made to dismiss him. (1½)

Docex is therefore in contravention with the Companies Act regarding the removal of Redewaan Road. (1½)

**Maximum marks (16)**

## **MATTER 5**

### **5.1 INELIGIBILITY AND DISQUALIFICATION OF PERSONS TO BE A DIRECTOR**

In terms of section 69, a person is ineligible to be a director of a company if the person ...

- (a) is a juristic person; (1)
- (b) is an unemancipated minor, (1)  
or is under a similar legal disability; or (1)
- (c) does not satisfy any qualification set out in the company's MOI. (1)

A person is disqualified to be a director of a company if ...

- (a) a court has prohibited that person to be a director; (1)
- (b) or the person is an unrehabilitated insolvent; (1)
- (c) or the person is declared to be delinquent in terms of section 162 ... (1)
  - is prohibited in terms of any public regulation to be a director of the company; (1)
  - has been removed from an office of trust, on the grounds of misconduct involving dishonesty; or (1)
  - has been convicted, in the Republic or elsewhere, and imprisoned (1)
  - without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence. (1)

A court may exempt a person from the application of any provision of disqualification to be a director of a company. (1)

**Maximum marks (10)**

### **5.2 CANDIDATES PERMISSABLE TO BE APPOINTED AS DIRECTOR**

Air Mail, Patricia Post's 17 year old son who is has a strong financial background is ineligible to be a director of a company, since he is an unemancipated minor. (1½)

Container Incorporated, a partnership, is ineligible since a juristic person cannot be a director of a company. (1½)

Delores Stamp, Chartered Accountant of South Africa, is eligible and qualifies to be the new director of Docex, since the court declared her as rehabilitated insolvent. (1½)

Mpho Letter, was convicted due to his involvement with fraudulent activities at his previous company and is therefore is disqualified to be a director of a company since he has been convicted, in the Republic or elsewhere, and imprisoned. (1½)

A court may exempt a person from the application of any provision of disqualification to be a director of a company and therefore she is not an unrehabilitated insolvent. (1½)

**Maximum marks (5)**

## **Comments**

### **MATTER 1**

#### **Question 1.1**

It is important to know what the requirements are for a situation to constitute control, or for it to lead to a related party relationship. In this question, it is important to refer to section 3 of the Companies Act, which deals with subsidiary relationships.

#### **Question 1.2**

It is important to note that financial information is provided in the scenario and students are required to calculate whether the company satisfies the liquidity and solvency tests, using this information. You should know the definition of the liquidity and solvency tests, as dealt with in section 4 of the Companies Act. A company is solvent if the assets of the company, fairly valued, exceeds the liabilities of the company, fairly valued. A company is liquid if the current assets exceed the current liabilities of the company (which indicates that the company will be able to pay its debts as they become due, in the ordinary course of business).

#### **Question 1.3**

It should be noted that marks are awarded for theory in part (i), therefore stating the requirements as per the Companies Act. In part (ii), the given information in the scenario should be evaluated against all the requirements of the Companies Act, as listed in part (i). A conclusion should be reached on whether or not the matter complies with the requirements of the Companies Act, thereby concluding if the transaction is legal or not.

The given information should be evaluated against all the requirements of section 45 of the Companies Act.

The requirements of section 45 of the Companies Act state that the company should satisfy the solvency and liquidity tests immediately after completing the proposed distribution. Remember that you have already evaluated this requirement in question 1.2, and thus, you only need to state whether the company does, or does not comply with the liquidity and solvency tests.

Note that there is a requirement in this section, stating that if the value of the financial assistance exceeds one tenth of 1% of the net worth of the company, a written notice of the resolution must be given to all shareholders and to any trade union representing the company's employees, within 10 business days after adoption of the resolution.

If the value of the financial assistance does not exceed one tenth of 1% of the net worth of the company, the notice must be given within 30 business days after the end of the company's financial year. The amount of the loan is provided in the scenario, as well as other financial information, in order for you to calculate whether the value of the financial assistance (the value of the loan) exceeds one tenth of 1% of the net worth of the company. The total net worth of the company is equal to the net asset value of the company, which is provided in the question.

You will thus have to evaluate if the notice of the resolution has been given in time to all relevant parties.

## **MATTER 2**

### **Question 2.1**

It should again be noted that marks are awarded for theory, which is stating the requirements as per the Companies Act in part (i). In part (ii), the requirements (as given in part (i)) must be discussed in relation to the information provided in the scenario (whether or not the given information in the scenario complies with all the requirements of the relevant Companies Act sections).

Financial information is provided in order to calculate whether the greater part of the assets of the company is being sold.

Note that you should not discuss requirements regarding quorums for voting, thus, no time should be wasted on this in answering this specific requirement.

In this scenario, the greater part of the assets of the company is indeed being sold. You should note that the company owns total assets of R8.9 million. They want to sell assets with a book value of R5 million. Therefore, if R5 million is compared to the total assets of R8.9 million, more than 50% of the company's asset are being sold.

### **Question 2.2**

The question requires you to "list the requirements". It should be noted that marks are awarded for the theory, therefore stating the requirements as per the Companies Act.

The mark allocation is also provided as a guide in determining the extent of detail required in answering each specific point.

## **MATTER 3**

### **Question 3.1**

Note that you are required to "discuss the legality" in accordance with the requirements of the Companies Act. It should be noted that marks are awarded for theory, therefore stating the requirements as per the Companies Act. The given information in the question should subsequently be evaluated against all the requirements of the Companies Act. A conclusion should be made on whether the requirements of the Companies Act were met, thereby concluding whether the transaction is legal or not.

The requirements of section 48 of the Companies Act state that a company should satisfy the solvency and liquidity tests immediately after the acquisition of these shares. Remember once again that you have already evaluated this requirement in question 1.2, and you can therefore merely state that the company does or does not comply with the liquidity and solvency tests.

**MATTER 4****Question 4.1**

Note that you are only required to “list the requirements”. Marks are awarded for the theory, therefore stating the requirements as per the specific section of the Companies Act, applicable to directors’ conduct.

**Question 4.2**

This question requires you to “discuss the legality”. It should be noted that marks are awarded for theory, therefore stating the requirements as per the Companies Act. The given information in the question should subsequently be evaluated against all the requirements of the Companies Act. A conclusion should be reached whether the requirements of the Companies Act are met, thereby concluding if the removal of the director is legal or not.

**MATTER 5****Question 5.1**

Students should note that there are two parts to the question. The first part of the question, “list the requirements”, indicates that you should merely list all the requirements in terms of the Companies Act.

The second part of the question, “explain which of the candidates will be permissible in terms of the requirements of the Companies Act 71 of 2008”, indicates that you should evaluate each of the candidates in terms of the listed requirements as per the first part of the question. Therefore, each candidate should be individually evaluated and a conclusion should be reached if the candidate is permissible to be appointed as the new financial director of the company.

**QUESTION 2****45 marks****Solution****1.1 Share issue of 30 000 shares****Authority to issue shares**

The approval of the issue of the shares by the audit committee is presumably to make a submission to the directors to vote on at their board meeting after being requested by the board to advise them on the issue. The authority for issuing shares lies with the board as stated below. (1)

In terms of section 38, the **board of a company may resolve to issue shares of the company at any time,** (1)

but only within the classes and to the extent that the shares have been authorised by or **in terms of the company's MOI,** in accordance with section 36. (1)

**Maximum marks (2)**

## Authorised shares available for issue

In terms of section 38, if the board issues shares which have not been authorised or are **in excess of the number of authorised shares** per the MOI, (1)

the issue may be retroactively **ratified by special resolution** (section 36). (1)

In terms of section 36, the **authorisation, classification and numbers of authorised shares** as well as the preferences, rights and limitations, (1)

**may be changed only by ...** (1)

(a) an **amendment to the MOI by special resolution** of the shareholders; or (1)

(b) the **board of the company**, in the manner contemplated in section 36(3), (1)

**except to the extent that the MOI provides otherwise.** (1)

Marvel Entertainment Ltd has an **authorised share capital of 150 000 ordinary shares, 130 000 of which are issued** (1½)

and therefore the **30 000 share issue will be in excess of the 20 000 available authorised shares** as per the MOI. (1½)

Marvel Entertainment Ltd must **increase the authorised share capital.** (1½)

If the board of a company acts pursuant to its authority contemplated in section 36(3), the **company must file a Notice of Amendment of its MOI, setting out the changes effected by the board.** (1)

**Maximum marks (9)**

## Consideration for the shares

In terms of section 40 the board **may issue authorised shares only for adequate consideration** to the company, as determined by the board. (1)

Before a company issues any particular shares, the **board must determine the consideration** for which, and the terms on which, those shares will be issued. (1)

A **determination by the board of a company in terms of subsection (2) as to the adequacy of consideration for any shares may not be challenged** on any basis other than in terms of the requirements applicable to standards of directors conduct (section 76), read together with the requirements regarding liability of directors (section 77(2)). (1)

The shares will be **issued at the current market value** of the shares, which can be **regarded as adequate consideration, as determined by the board.** (1½)

**Maximum marks (3)**

## Share issue to the directors

In terms of section 41(1)(a), an **issue of shares must be approved by special resolution** of the shareholders of a company, (1)

if the shares are issued to a director, future director, prescribed officer or future prescribed officer of the company. (1)

**Shares are going to be issued to the directors of Marvel Entertainment Ltd and therefore a special resolution by the shareholders of Marvel Entertainment Ltd will be required.** (1½)

The proposed share issue will be **approved by the audit committee and not by a special resolution of the shareholders** of Marvel Entertainment Ltd. This will be contrary to section 41 and therefore any director who formed part of the audit committee and who is present when the resolution was passed and failed to vote against such issue, would be liable for any loss, damages or costs sustained by Marvel in terms of section 77(3) & (3)(e)(ii). (1½)

**Maximum marks (3)**

**Voting requirements regarding a special resolution to be approved by shareholders**

In terms of section 65(9), for a special resolution to be approved by shareholders, it must be **supported by at least 75% of the voting rights exercised on the resolution.** (1)

A company's **MOI may in terms of section 65(10) permit a different percentage of voting rights to approve any special resolution**, provided there is a difference of at least 10% between the highest requirement for an ordinary resolution and the lowest requirement for approval of a special resolution. (1)

**Maximum marks (1)**

**Total marks (18)**

## 1.2 **Mr Xavier's personal financial interest in the investment and acquisition of the controlling interest in DreamWorks Ltd**

### **Theory**

In terms of section 75(4), **if a director has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows that a related person has a personal financial interest in the matter, the director** (1)

**must disclose the interest and its general nature before the matter is considered at the meeting;** (1)

**must disclose to the meeting, any known material information relating to the matter;**

**may disclose any observations/pertinent insights** relating to the matter if requested to do so by the other directors; (1)

**if present at the meeting, must leave the meeting immediately after making any disclosures** as indicated above; and (1)

**must not take part in the consideration** of the matter (other than the above); (1)

while absent from the meeting ...

- is to be regarded as being present at the meeting for the purpose of determining whether sufficient directors are present to constitute the meeting; and (1)
- is not to be regarded as being present at the meeting for the purpose of determining whether a resolution has sufficient support to be adopted; and (1)

**must not execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board.** (1)

In terms of section 73(6) **any declaration given by notice or made by a director as required by section 75 must be included in the minutes of the board meeting.** (1)  
**1 marks per statement, limited to (7)**

### **Application**

**Mr Xavier, the managing director, has a personal financial interest** in the decision to invest and acquire the controlling interest in DreamWorks Ltd, (1½)

**since his wife is the chief executive officer of DreamWorks Ltd.** (1½)

**Mr Xavier disclosed his interest and its general nature before the matter was considered** at the meeting. (1½)

**Nobody required any further information;** therefore the requirement that **any insights may be disclosed if requested by the other directors was complied with.** (1½)

**Mr Xavier did not leave the meeting immediately** after making the disclosures because the voting progressed with him still in the meeting (sec 75(5)(d)). (1½)

**Mr Xavier voted at the meeting** and therefore took part in the consideration of this matter (sec's 75(5)(e) & (f)(ii)). (1½)

**The declaration made by Mr Xavier was included in the minutes** of the board meeting as **clearly indicated.** (1½)

Based on the information provided, the requirements in terms of section 75(5)(d),(e) & (f)(ii) were not met, therefore the decision of the board constitutes a breach of the Companies Act. (1½)

**1½ marks per statement, limited to (9)**  
**Maximum marks (16)**

### **1.3 Duties of the Audit Committee**

In terms of section of 94, an audit committee of a company has the following duties:

**(a) To nominate,** for appointment as auditor of the company under section 90, a **registered auditor** who, in the opinion of the audit committee, **is independent of the company;** (1)

**(b) To determine the fees to be paid to the auditor, and** (1)



- the **auditor's terms of engagement**; (1)
- (c) **To determine**, subject to the provisions of Chapter 3 regarding enhanced accountability, **the nature and extent of any non-audit services** that the auditor may provide to the company, (1)
- or that the auditor **must not provide to the company, or a related company**; (1)
- (d) **To prepare a report**, to be included in the annual financial statements for that financial year ... (1)
- (i) **describing how the audit committee carried out its functions**; (1)
- (ii) **stating whether the audit committee is satisfied that the auditor was independent** of the company; and (1)
- (iii) **commenting** in any way the committee **considers appropriate on the financial statements, the accounting practices and the internal financial control** of the company; (1)
- (e) **To receive and deal** appropriately with any **concerns or complaints**, whether from within or outside the company, or on its own initiative, relating to ... (1)
- (i) the **accounting practices and internal audit** of the company; (1)
- (ii) the **content or auditing of the company's financial statements**; (1)
- (iii) the **internal financial controls** of the company; or (1)
- (iv) **any related matter**; (1)
- (f) to make **submissions to the board** on any matter concerning the company's **accounting policies, financial control, records and reporting**; (1)
- Maximum marks (11)**

## Comments

### Question 1.1

It should be noted that marks were awarded for theory, therefore stating the requirements as per the Companies Act. The requirements must subsequently be discussed in regards to the information provided and it should be stated whether the given information in the question complies with all the requirements of the relevant Companies Act requirements as discussed.

Students should take note of any instructions in a question. In this question you had to discuss the requirements of the Companies Act, only in terms of certain points listed. The idea was to give you guidance, narrow down the possible answer in order that you do not waste any time discussing other points that might have been applicable in the question.

You should have taken into account the given fact that 130 000 shares out of a possible 150 000 shares have already been issued. The reason being that there are therefore insufficient authorised shares for the envisaged 30 000 shares issue and that you should have considered this in your answer. It should be noted that the question do not focus on one specific section of the Companies Act, however numerous concerns regarding the share issue are indicated. Various sections of the Companies Act should be noted, such as the fact that the shares are issued to directors (section 41) and the consideration of the shares (section 40). It should be noted that the audit committee authorised the share issue, whom do not possess the authority to approve such transactions.

Since a special resolution may be required to change the MOI or to issue shares to the directors, various sections in the range between 61 and 65 may apply, however the question only requires you to discuss the voting requirements (section 65). It is important to follow the instructions in the required part as otherwise you will lose marks and valuable time.

The mark allocation is also provided to guide you in the answering of the question and to determine how much to write per specific point.

### Question 1.2

It should be noted that marks were awarded for theory, therefore stating the requirements as per the Companies Act. The given information in the question should subsequently be evaluated against all the requirements of the Companies Act. A final conclusion should be made whether the situation complies with the requirements of the Companies Act, therefore concluding if the transaction is legal or not.

The given information should be evaluated against all the requirements of section 75 of the Companies Act. Your answer should be structured as follows to present a logical structure to your answer:

1. **Theory** (requirements of the Companies Act).
2. **Application** (evaluate the information provided in the question against each of the requirements of the Companies Act).
3. **Conclusion** (formulate a final conclusion, in this case if the personal financial interest matter is dealt with legally or not in terms of the Companies Act requirements).

### Question 1.3

You are required only to **list** the requirements in terms of the Companies Act. Therefore no discussion of the provided information was required.

Students should note that only the remaining duties of the audit committee should have been listed. You should first determine which duties have been provided in the question and ensure that you do not waste unnecessary time writing down the duties that have already been given. Only the remaining duties that have not been provided by the question should be provided in your answer.

## QUESTION 3

30 marks

### Solution

#### 1.1 Reckless Trading

##### Theory

According to section 22, a company must not **carry on its business recklessly**, with gross negligence, with intent to defraud any person or for any fraudulent purpose; (1)

**If the Commission has reasonable grounds to believe that a company is engaging in conduct prohibited as stated in the above paragraph, or is unable to pay its debts as they become due and payable in the normal course of business,**

(1)

the Commission may **issue a notice to the company to show cause why the company should be permitted to continue carrying on its business, or to trade, as the case may.**

(1)

**Should the company fail within 20 business days to satisfy the Commission that it is not engaging in conduct prohibited by the first paragraph above, or that it is able to pay its debts as they become due and payable in the normal course of business, the Commission may issue a compliance notice to the company requiring it to cease carrying on its business or trading, as the case may be.** (1)

### **Application**

In this instance **Distillique Ltd will not be able to satisfy the Commission** if it receives the notice indicated above, as:

**Distillique Ltd does not satisfy the solvency test**, since considering all reason-able foreseeable financial circumstances of the company, **the assets (R6 000 000) of the company fairly valued, do not exceed the liabilities (R11 000 000) of the company fairly valued, and** (1½)

**Distillique Ltd is not liquid**, since the current liabilities (R5 000 000) exceed the current assets (R2 000 000). (1½)

**Distillique Ltd is therefore trading recklessly** and is therefore in contravention with the Companies Act. (1½)

**Maximum marks (5)**

## **1.2 Proposals to Dispose of All or Greater Part of Assets**

The transaction is the **selling of the greater part of the company's assets,** (1½)

**since the book value of the assets that will be sold (R3.5 million) is more than 50% of the book value of the total assets (R6 million).** (1½)

The **MOI must provide for such transaction.** (1)

In terms of section 112, a company may not dispose of all or the greater part of its assets, unless the **disposal has been approved by a special resolution** of the shareholders; and (1)

section 112 also provides that the **notice** convening the meeting of shareholders **for considering the special resolution** must be delivered **within the prescribed time and in the prescribed manner** to each shareholder of the company. (1)

Each such notice must be accompanied by ...

(a) a written summary of the **precise terms of the transaction to be considered** at the meeting; and (1)

(b) reference to the provisions of section 115 (the **specific authority required**); and (1)

(c) reference to section 164 (indicating **the shareholders' rights, should the special resolution be passed, but where there are dissenting shareholders, which is not the case here**). (1)

**Any part of the assets of a company** to be disposed of, as contemplated in section 112, **must be fairly valued, as calculated in the prescribed manner, as at the date of the proposal**, in accordance with the financial reporting standards. (1)

**Maximum marks (6)**

### 1.3 Declaring of a Dividend

#### Theory

In terms of section 46, a company must not make any proposed distribution unless

- (a) the distribution
  - (iv) **is pursuant to an existing legal obligation** of the company, (1)  
**or a court order**; or (1)
  - (v) **the board of the company, by resolution, has authorised** the distribution; (1)
- (b) it reasonably appears that the company will **satisfy the solvency and liquidity test** (1)  
**immediately after completing the proposed distribution**; and (1)
- (c) the **board of the company, by resolution, has acknowledged that it has applied the solvency and liquidity test**, and **reasonably concluded** that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution. (1)

#### Application

**Distillique Ltd does not satisfy the solvency requirements** after making the dividend distribution, because considering all reasonable foreseeable financial circumstances of the company, (1½)

the **liabilities** (R11 000 000) of the company fairly valued, **exceed the assets** (R6 000 000) of the company fairly valued. (1½)

**Distillique Ltd is not liquid**, since the current liabilities (R5 000 000) **exceed the current assets** (R2 000 000). (1½)

Based on the information provided **the dividend distribution will be illegal, since it does not satisfy the solvency and liquidity requirement**, thereby constituting a breach of section 46 of the Companies Act. (1½)

Any director of Distillique Ltd is liable to the extent set out in section 77(3)(e)(vi), if that director was present at the meeting when the board approved a distribution and failed to vote against the distribution, despite knowing that the distribution was contrary to section 46 – which is the case here. The directors also did not apply their duties regarding the application of the solvency and liquidity test properly, otherwise the distribution would never have been approved. (1½)

**Maximum marks (8)**

#### 1.4 Financial Assistance to a subsidiary in order to purchase shares in the holding company

The exception where section 44 does not apply, is not applicable in this case, since Distillique Ltd does not lend money in the ordinary course of their business. (1)

Section 44 provides that to the **extent that the MOI of a company does not provide otherwise,** (1)

the **board may authorise Distillique Ltd to provide financial assistance by way of a loan to any person (which will include Aqua Vitae Pty Ltd), for the purpose of purchase of any securities of the company, subject to the following requirements:** (1)

The board may not authorise any financial assistance unless the **particular provision of financial assistance is pursuant to a special resolution of the shareholders, adopted within the previous two years, and which relates to the specific recipient, or generally for a category of potential recipients, and the recipient falls within that category;** and (1)

the **board is satisfied that immediately after providing the assistance, the company would satisfy the solvency and liquidity test;** and (1)

the **terms under which the assistance is proposed to be given are fair and reasonable to the company.** (1)

The **board must ensure that any conditions or restrictions** respecting the granting of financial assistance set out in the company's MOI have been satisfied. (1)

**Distillique Ltd will not satisfy the solvency requirements after providing the assistance,** because considering all reasonable foreseeable financial circumstances of the company, (1½)

the **liabilities** (R11 000 000) of the company fairly valued, **exceed the assets** (R6 000 000) of the company fairly valued. (1½)

**Distillique Ltd is not liquid,** since the **current liabilities** (R5 000 000) exceed the **current assets** (R2 000 000). (1½)

The board of directors approved the decision to provide the financial assistance and **therefore a special resolution would not have been obtained within the previous two years.** (1½)

Based on the information, the financial assistance provided **is illegal, since it does not satisfy the solvency and liquidity requirement,** thereby constituting a breach of section 46 of the Companies Act. (1½)

**Maximum marks (11)**

## Comments

### Question 1.1

The answer is straight forward and section 22 applies where a company trades recklessly – in this case the company did not meet the liquidity test.

### Question 1.2

Where a company disposes of all or the greater part of its assets, section 112 applies. Remember that if it is not specifically stated, it is very important that you evaluate/calculate if this is in fact the case in order to determine if section 112 applies.

### Question 1.3

In order to answer the question you had to know that a dividend is deemed a distribution in terms of section 1. Once you knew that, you would have been able to apply section 46. Take note that section 1 also includes a share buy-back as a distribution. If you therefore get a question on a share buy-back you may also apply the requirements of section 46 to that question.

### Question 1.4

As section 44 is the only section that applies, there is no comment.

## QUESTION 4

25 marks

### Solution

#### Requirements to be met in order to be appointed as an auditor of a company (section 90(2))

#### Theory

To be appointed as an auditor of a company a person or firm must be a registered auditor; (1)

in addition to the prohibition contemplated in section 84(5) (disqualified to serve as a director of any particular company), a person or firm must not be ...

- (a) a **director or prescribed officer of the company**; (1)
- (b) an employee or consultant of the company who was or has been **engaged for more than one year in the maintenance of any of the company's financial records or the preparation of any of its financial statements**; (1)
- (c) a **director, officer or employee of a person appointed as company secretary**; (1)
- (d) a person who, alone or with a partner or employees, habitually or **regularly performs the duties of accountant or bookkeeper**, or performs related **secretarial work**, for the company; (1)
- (e) a person who, at **any time during the five financial years immediately preceding the date of appointment**, was a person contemplated in any of subparagraphs (a) to (d) above; or (1)
- (f) a **person related** to a person contemplated in subparagraphs (a) to (e); and (1)  
must be **acceptable to the company's audit committee as being independent** of the company. (1)

## Application

Mr Murdock, the designated auditor for the audit of Pick-n-Play Ltd, was the **previous financial director** of Pick-n-Play Ltd, therefore will **not be seen as independent** of the Pick-n-Play Ltd by the audit committee. (1½)

Mr Murdock resigned as financial director of Pick-n-Play Ltd a year ago and therefore was a director at **any time during the five financial years immediately preceding the date of appointment**. (1½)

**Mr Murdock may therefore not be appointed as designated auditor**, somebody else in A-Team Incorporated may however be acceptable. (1½)

**Maksimum marks (7)**

## Requirements where a vacancy arises in the office of an auditor

### Theory

In terms of section 91, if a vacancy arises in the office of an auditor of a company, the board of that company ...

**must appoint a new auditor within 40 business days**, if there was only one incumbent auditor of the company (which is the case here). (1)

Before making an appointment ...

**(a) the board must propose to the company's audit committee,** (1)

**within 15 business days after the vacancy occurs**, the name of at least one registered auditor to be considered for appointment as the new auditor; and (1)

**(b) may proceed to make an appointment of a person** proposed in terms of paragraph (a) above **if, within five business days after delivering the proposal,** (1)

**the audit committee does not give notice** in writing to the board **rejecting the proposed auditor.** (1)

## Application

The **vacancy occurred on 10 February 2015**. Mr Shoprite, the managing director of Pick-n-Play Ltd **recommended A-Team Incorporated to the audit committee** of Pick-n-Play Ltd on **15 February 2015, therefore within 15 days after the vacancy occurred.** (1½)

As we do not have any information to confirm that the board appointed **A-Team Incorporated within five days after delivering the proposal to the audit committee, or that the audit committee rejected A-Team Incorporated**, we cannot comment on that.

**Bonus mark (1½)**  
**Maximum marks (3)**

## Rotation of auditors

In terms of section 92, the **same individual may not serve as the auditor or designated auditor** of a company **for more than five consecutive financial years.** (1)

If an individual has served as the **auditor or designated auditor of a company for two or more consecutive financial years** and then ceases to be the auditor or designated auditor, (1)

the individual may not be appointed again as the auditor or designated auditor of that company until after the expiry of at least two further financial years. (1)

**DTT Incorporated** has been Pick-n-Play Ltd's external auditors for the 6 preceding years. They would have been in **contravention** with this requirement of the Companies Act. However, since the Act only applies from 1 May 2012, they have another five years before they will be in contravention of this requirement. (1½)

**Maximum marks (3)**

## **Composition of the audit committee**

### **Theory**

In terms of section 94, **each member of an audit committee** of a company must ...

(a) **be a director** of the company, (1)

(b) who satisfies any applicable requirements **prescribed by the Minister** who may **prescribe minimum qualification requirements** for members of an audit committee as necessary to ensure that any such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions. (1)

The Minister prescribed in Regulation 42 that **at least one-third of the members of a company's audit committee at any particular time must have academic qualifications or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management.** (1)

(c) **not be ...**

(i) **involved in the day-to-day management** of the company's business, or (1)

**have been so involved at any time during the previous financial year;** (1)

(ii) **a prescribed officer, or full-time employee, of the company or another related or inter-related company,** or (1)

**have been such an officer or employee at any time during the previous three financial years;** or (1)

(iii) **a material supplier or customer of the company,** such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; and (1)

(d) **not be related to any person who falls within any of the criteria set out in (c) above.** (1)



## Application

**Mr Shoprite is currently the managing director** of Pick-n-Play Ltd and **a member of the audit committee.** (1½)

**He is therefore involved in the day-to-day management** of the company's business, (1½)

and **should not be a member of the audit committee** according to the requirements of the Companies Act. (1½)

**Marks limited to (7)**

## Considerations taken into account to determine if the registered auditor is independent

### Theory

In terms of section 94, in considering whether, a registered auditor is independent of a company, the audit committee of that company must ...

- (a) **ascertain** that the **auditor does not receive any direct or indirect remuneration or other benefit from the company**, except (1)
  - (i) **as auditor**; or (1)
  - (ii) **for rendering other services to the company**, (1)
- (b) **consider** whether the **auditor's independence may have been prejudiced** (1)
  - (i) **as a result of any previous appointment** as auditor; or (1)
  - (ii) **having regard to the extent of any consultancy, advisory or other work undertaken** by the auditor for the company; and (1)
- (c) **consider compliance with other criteria relating to independence or conflict of interest** as prescribed by the Independent Regulatory Board for Auditors established by the Auditing Profession Act, in relation to the company, and if the company is a member of a group of companies, any other company within that group. (1)

## Application

Since Mr Murdock, a partner of A-team Incorporated, is the previous financial director of Pick-n-Play Ltd and resigned as financial director of Pick-n-Play Ltd a year ago to pursue other opportunities, he can hardly be independent in terms of section 94 or the criteria in terms of the Code of Professional Conduct. (1½)

**Maximum marks (5)**

## Comments

The question required that you discuss the requirements of the Companies Act for the appointment of A-Team Incorporated as the new external auditors of Pick-n-Play Ltd, **only** in terms of certain points. It is important to discuss only those points and according to the sequence indicated.

Your answer had to be structured as follows to present a logical structure to your answer:

**Theory** (requirements of the Companies Act).

**Application** (evaluate the information provided in the question against each of the requirements of the Companies Act. In this case sections 90, 91, 92, 94 & Regulation 42 and section 94 again, respectively).

**QUESTION 5**

**30 marks**

**Solution**

**1.1 MOI REQUIREMENTS REGARDING THE ISSUE OF SHARES (PRIVATE COMPANY, SHAREHOLDERS' RIGHTS)**

**1.1.1** As Computer Services (Pty) Ltd is a private company, its Memorandum of Incorporation (MOI)

1.1.1.1 will prohibit it from offering the shares to the public, and

1.1.1.2 will restrict the transferability of its shares. (1½)

**1.1.2** In making the issue, the board will have to consider any requirements in the MOI related to the proposed issue. For example, the rights of existing shareholders of Computer Services (Pty) Ltd.

1.1.2.1 In terms of section 39(3) each existing shareholder of Computer Services (Pty) Ltd has a right, before any other person who is not a shareholder of Computer Services (Pty) Ltd, to be offered, and to subscribe for, a percentage of the shares to be issued equal to the voting power of that shareholders general voting rights before the offer was made, **but** (1½)

1.1.2.2 the company's MOI may limit, negate, restrict or place restrictions on this right. (1½)

1.1.2.3 In terms of section 39(4), if the shares are offered to existing shareholders as stated in 1.1.2.1 above, the shareholders may subscribe for fewer shares than entitled to and those shares not subscribed for by the existing shareholders within a reasonable time, may be offered to other persons (such as the directors in this scenario). (3)

**Maximum marks (6)**

**1.2 SHARES AVAILABLE FOR ISSUE & POSSIBLE AMENDMENTS TO MOI**

**1.2.1** Computer Services (Pty) Ltd's MOI sets out the number and class of authorised shares and as the existing authorised shares have all been issued, an amendment to the MOI will have to be made (refer 1.2.2). (1½)

**1.2.2** In terms of section 36(3), the **board** may increase the number of authorised shares, except to the extent the MOI provides otherwise – in other words the board may amend the MOI. (1½)

**1.2.3** The MOI must also set out the preferences, rights, limitations or terms as well as the classification of the shares and, in terms of section 36(3), this can also be decided by the board except to the extent the MOI provides otherwise. (1½)

**1.2.4** Since an amendment to the MOI is made (such as the changes to authorised shares in point 1.2.1 above), the company must file a Notice of Amendment to its MOI with CIPC. (1½)

**Maximum marks (4½)**

### 1.3 AUTHORITY REQUIRED FOR THE SHARE ISSUE

- 1.3.1 The **board** of Computer Services (Pty) Ltd may resolve to **issue** more shares at any time but only within the class and to the extent the shares have been **authorised** (section 38). (1½)  
(1½)

### 1.4 REQUIREMENTS APPLICABLE WHERE SHARES OF NO PAR VALUE ARE ISSUED AND THE CONSIDERATION FOR THE ISSUED SHARES

- 1.4.1 In terms of the Companies Act, shares have no par value. (This presents no problem for Computer Services (Pty) Ltd as its existing and proposed shares are of no par value.) Bonus (1½)
- 1.4.1.1 In terms of section 40, the board must determine the consideration for which the shares will be issued – this must be an adequate consideration from the perspective of the company. (1½)
- 1.4.1.2 The consideration determined by the directors cannot be challenged (say, by existing shareholders) **other** than on the basis that the directors did **not** act in good faith in the best interests of the company and with the degree of skill and diligence reasonably expected of a director. Bonus (1½)
- Maximum marks (3)**

### 1.5 REQUIREMENTS WHERE SOME SHARES ARE ISSUED TO DIRECTORS

In terms of section 41, this issue of shares must be approved by special resolution of the shareholders because it is intended that some of the shares be issued to the directors. (1½)

- 1.5.1 In certain instances a special resolution is not required, however that does not apply in this situation since ...
- the directors do not have a pre-emptive right as they are not shareholders.
  - the issue is not pursuant to an employee share scheme or underwriting agreement.
  - the issue is not in proportion to existing holdings.
- Anyone of the three for (1½)  
**Maximum marks (1½)**

### 1.6 REQUIREMENTS REGARDING NOTICES FOR THE MEETING WHERE THE ISSUE OF SHARES TO DIRECTORS IS TO BE AUTHORISED

- 1.6.1 As (see point 1.5 above) there is a need to hold a shareholders' meeting to pass a special resolution, the board will have to provide all shareholders with written notice
- of the date, time and place of the meeting
  - the specific purpose of the meeting (share issue) (a copy of the resolution must be provided)
  - the percentage of voting rights required for the special resolution
  - that any shareholder entitled to vote, may appoint a proxy (this must be reasonably prominently displayed on the notice)
  - that satisfactory identification will be required from shareholders to attend.
- One mark each to a maximum of (3)

1.6.2 This written notice must be given at least 10 business days before the meeting is to begin. (The MOI may stipulate a longer or shorter notice period). (1½)  
**Maximum marks (3)**

## **1.7 QUORUM REQUIREMENTS FOR THE MEETING REFERRED TO ABOVE AND RELATED MATTERS IN DETERMINATION OF THE VALIDITY OF THE PERSONS MAKING UP THE QUORUM**

1.7.1 The meeting to pass this resolution may only begin if 25% of the voting rights entitled to be voted on at least one matter to be decided at the meeting (there will be other matters to be covered at this meeting) are present (s64(1)(a)).

1.7.1.1 for the debate to commence on the share issue resolution there must be holders of at least 25% of the shares entitled to vote on the share issue present when the matter is called on the agenda. For Computer Services (Pty) Ltd this means holders of at least 25% of the (existing) ordinary shares. (Note: the MOI may stipulate lower percentages). (1½)

1.7.2 As Computer Services (Pty) Ltd has more than two shareholders, the meeting may not begin or a matter begin to be debated, unless at least three shareholders are present at the meeting (s64(3)(a)). Bonus (1½)

1.7.3 At the commencement of the meeting, shareholders' identities must be verified and their right to attend or participate verified. The person presiding over the meeting must be satisfied with the validity of the shareholders' identities (s63(1) (a)). (1½)  
**Maximum marks (3)**

## **1.8 REQUIREMENTS REGARDING THE CONTENT OF THE RESOLUTION TO BE VOTED UPON**

1.8.1 The proposed resolution must be sufficiently clear and specific, and must be accompanied by sufficient information to enable a shareholder to decide whether to participate in the meeting and "influence the outcome" of the vote on the resolution. (1½)  
(1½)

## **1.9 VOTING RIGHTS REQUIRED TO BE EXERCISED FOR A VALID RESOLUTION**

1.9.1 For the special resolution on the share issue to be passed, it must be supported by at least 75% of the voting rights exercised on the resolution. (Note: the MOI may stipulate a lower (or higher) percentage but the difference between the percentage for an ordinary and special resolution, must be at least 10%). (1½)

1.9.2 Voting should be by poll (not on a show of hands). Voting by poll enables those shareholders with larger shareholdings to have more influence on the vote. (1½)  
**(3)**

## **1.10 SECRETARIAL REQUIREMENTS AFTER RECEIVING THE CONSIDERATION FOR THE SHARES**

1.10.1 When Computer Services (Pty) Ltd has received the consideration for the shares (s40(4)) ...  
1.10.1.1 the shares are regarded as fully paid up; and

- 1.10.1.2 the company must issue share certificates in the name of the new shareholder, and
- 1.10.1.3 enter the details of new shareholders/shareholdings in the company's share (securities) register, e.g. name, address and number of shares.

One mark each to maximum of (3)

(3)

**Total marks 30**

## Comments

In the examination, many students did not address sub-sections 1.1 to 1.10 separately. Instead it was discussed as one very long "essay". This is not the correct approach to follow. Each sub-section should be addressed separately, and if you are merely required to give the Companies Act requirements, you should list the theory in point format. If you are required to discuss a certain matter with regards to the Companies Act, you should firstly state the theory of the Act (in point format) and then apply the theory to the scenario. The application should also be done in point format ( in same sequence as the points under theory). Note that theory usually weighs one mark, whilst the application thereof will account for one and a half marks.

## QUESTION 6

**30 marks**

### Solution

#### 2.1

**2.1.1** In terms of the Companies Act (section 76):

2.1.1.1 Greg O'Reilly should have communicated to the board of Shipping Engineers (Pty) Ltd at the earliest practicable opportunity, any information which was material to Technical Systems (Pty) Ltd, e.g. it would be important for the board to know that Greg and Brian are related as a R7.5 million deal could be influenced by the relationship. (1½)

2.1.1.2 Greg O'Reilly must at all times perform his function and exercise his powers as a director:

2.1.1.3.1 in good faith

2.1.1.3.2 in the best interests of the company. (1½)

**2.1.2** In effect Greg O'Reilly had a conflict of interest – the company or his brother. (1½)

**2.1.3** In terms of section 75 of the Companies Act, if Greg O'Reilly had a personal financial interest in the matter to be considered at a meeting of the board (sale of the radar systems), or had known that a **related** person had a personal financial interest, he should have: Any one of the two for (1½)

2.1.3.1 disclosed the interest and its general nature before the matter was considered at the meeting.

2.1.3.2 disclosed to the meeting any material information relating to the sale which was known to him.

2.1.3.3 disclosed any observations or pertinent insights into the matter if he had been requested to do so by the other directors.

2.1.3.4 left the meeting (if he was present) immediately after making the disclosures to the meeting, and

2.1.3.5 have taken no further part in the meeting, and

2.1.3.6 would not have voted on the decision. Any 4 for maximum of (6)

- 2.1.4 As Greg and Brian O'Reilly are brothers, they are regarded as related for the purposes of the Companies Act, as they are within two degrees of consanguinity. (1½)
- 2.1.5 In terms of section 76(2)(b) this information need only be disclosed if it is material. A R7.5 million contract would probably be regarded as material. (1½)
- Maximum marks (12)**

## 2.2

- 2.2.1 The meeting of shareholders to ratify the contract can be held by electronic communication provided
- 2.2.1.1 the company is not prohibited by its MOI from conducting the meeting by electronic communication. (1½)
- 2.2.2 In terms of section 63, one or more shareholders (or their proxies) may participate in an electronic meeting, provided (1)
- 2.2.2.1 the electronic communication employed ordinarily enables all persons participating in that meeting, to communicate concurrently with each other without an intermediary (1)
- and to participate reasonably effectively in the meeting. (1)
- 2.2.3 The notice of the meeting must inform shareholders of the availability of that form of participation (1½)
- and provide the necessary information to enable shareholders (proxies) to access the available medium (cost to be borne by the shareholder). (1½)
- Maximum marks (5)**

## 2.3

- Voting by a show of hands - *each shareholder (or proxy) has one vote* irrespective of number of shares held by the shareholder. (1½)
- Voting by a poll - shareholder (or proxy) must be allowed to exercise all the voting rights attached to the shares held by the shareholder. (1½)
- (3)**

## 2.4

- In terms of section 46, Shipping Engineers (Pty) Ltd must not make any proposed distribution, unless ...
- (a) the distribution ...
- (i) is pursuant to an existing legal obligation (not applicable) of the company, Bonus (1)
- or a court order (not applicable); or Bonus (1)
- (ii) the board of the company, by resolution, has authorised the distribution (this did happen according to the given information); (1½)
- (b) it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution; and (1)
- (c) the board of Shipping Engineers (Pty) Ltd, by resolution, has acknowledged that it has applied the solvency and liquidity test, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution. (1)

Shipping Engineers (Pty) Ltd does not satisfy the solvency requirements after making the dividend distribution, considering all reasonable foreseeable financial circumstances of the company, (1½)

the liabilities (R5 000 000) of the company fairly valued, exceed the assets (R4 000 000) of the company fairly valued. (1½)

Shipping Engineers (Pty) Ltd is not liquid, since the current liabilities (R3 000 000) exceed the current assets (R1 000 000). (1½)

Based on the information provided the dividend distribution will be illegal, since it does not satisfy the solvency and liquidity requirement, thereby constituting a breach of section 46 of the Companies Act. (1½)

Any director of Shipping Engineers (Pty) Ltd is liable to the extent set out in section 77(3)(e)(vi) if that director was present at the meeting when the board approved a distribution and failed to vote against the distribution, despite knowing that the distribution was contrary to section 46 – which is the case here. The directors also did not apply their duties regarding the application of the solvency and liquidity test properly; otherwise the distribution would never have been approved. (1½)

**Maximum marks (10)**

## Comments

This question dealt with a director who had an interest in a contract that the company entered into. It also dealt specifically with shareholders' meetings and distributions. We noted that students tend to get confused between shareholders' and directors' meetings and resolutions. Note that the shareholders are the "owners" of the company, whilst the directors are the persons who manage the company. Study the definitions of ordinary and special resolutions in section 1 of the Act, as well as section 73 on board meetings, in this regard.

## QUESTION 7

**40 marks**

### Solution

#### 1. Requirement to have annual financial statements audited

1.1 If John Smit is to have the audit requirement included in the company's memorandum of Incorporation (MOI), the MOI will have to be amended in terms of the Act. (1½)

1.2 A special resolution to amend the MOI is required. (2)

1.3 If the resolution is passed, a Notice of Amendment (with the prescribed fee) must be filed with CIPC. (1½)

**Maximum marks (5)**

#### 2.A The requirements applicable to appointing an audit committee in terms of the Companies Act

2.1 The Companies Act does not require of a private company to appoint an audit committee, but according to the information Painters (Pty) Ltd's MOI does require such an appointment. (1½)

- 2.2 Shareholders must appoint the audit committee at each annual general meeting. (1½)
- 2.3 The audit committee must consist of at least three members. (1½)
- 2.4 Each member must be a director of the company. (1½)
- 2.5 Each member must satisfy the minimum qualifications prescribed by the Minister to ensure that the audit committee taken as a whole, comprises persons with adequate financial knowledge and experience. (1½)

Regulation 42 requires that at least one third of the members of the audit committee have academic qualifications or experience in economics, law, accounting, corporate governance, etc. Bonus (1½)

- 2.6 Members of the audit committee **must not** be ...
- involved in the day to day running of the company or have been so involved at any time during the previous financial year; or (1½)
  - a prescribed officer, or full time executive employee of Painters (Pty) Ltd (or any related or inter-related company) or have held such post at any time during the previous three financial years; or (1½)
  - a material supplier or customer of the company, such that a reasonable and informed third party would conclude that, in the circumstances, the integrity, impartiality or objectivity of that member of the audit committee would be compromised; or (1½)
  - a “related person” to any person subject to these prohibitions e.g. the wife of a full time executive employee of Painters (Pty) Ltd. (1½)

**Maximum marks (10)**

**2.B The duties of the audit committee in terms of the Companies Act are to ...**

- 2.1 nominate a registered auditor for appointment as auditor by the shareholders (must be satisfied nominated person/firm is independent of Painters (Pty) Ltd). (3)
- 2.2 determine the auditors’ fees and terms of engagement. (1½)
- 2.3 ensure the appointment of the auditor complies with the Companies Act and the Auditing Profession Act. (1½)
- 2.4 determine the nature and extent of any non-audit services the auditor may provide to Painters (Pty) Ltd; and (1½)  
pre-approve any agreement with the auditor for the provision of these services. (1½)
- 2.5 prepare a report to be included in the AFS which ...
- describes how the audit committee carried out its function. (1½)
  - states whether the auditor was independent of the company. (1½)
  - comments in any way the committee considers appropriate of the financial statements, the accounting practices and internal controls of the company. (1½)
- 2.6 receive and deal with appropriately, any concerns or complaints relating to ...
- the accounting practices and internal audit of the company;



- the content or audit of the AFS;
- internal financial controls; or
- any related matters. Any two for maximum of (3)

2.7 make submissions to the board on any matters dealt with in (2.6) above. (1½)

2.8 perform other functions determined by the board. (1½)

**Maximum marks for this section (10)**

**Maximum marks for question (20)**

**3. Advise John Smit on whether Ryan Hansen could be removed from his position as a director of Painters (Pty) Ltd**

**3.1** If the MOI contained a clause which designated an individual e.g. John Smit in his capacity as CEO, the power to remove Ryan Hansen from the board, that power could be exercised. (1½)

**3.2** Ryan Hansen can also be removed by an ordinary resolution of the shareholders at any general meeting. (1½)

**3.3** Ryan Hansen may also be removed if a shareholder or fellow director (e.g. John Smit) alleges, *inter alia*, that he has been negligent or derelict in his duties as a director. (1½)  
The board must consider the allegation and vote on his removal. (1½)

**3.4** Whatever “method” of removing Ryan Hansen is attempted, he must be afforded the chance to defend himself; (1½)

**3.4.1** he must be given notice of the meeting (10 business days) and a copy of the resolution to remove him. (1½)

**3.4.2** he must be afforded a reasonable opportunity to make a presentation (in person or through a representative) before voting takes place. (1½)

**3.5** Where Ryan Hansen is to be removed by the board, he may not vote on his removal. (1½)  
For the removal resolution to be accepted, the majority of directors voting would need to vote in favour. (1½)

**3.6** If Ryan Hansen is removed by the board, he has 20 business days to go to court for a review. Bonus (1½)

**3.7** If he is **not** removed, any director or shareholder who voted to have him removed, may go to court for a review (20 business days). Bonus (1½)

**Maximum marks (12)**

**4. Advise John Smit as to which, if any, of the two audit firms/individuals listed for appointment as auditor for the voluntary audit, would be suitable for appointment**

**Lee Westwood:** not suitable for appointment as he is, in terms of the IRBA Code of Professional Conduct (CPC), not independent as he is the brother of one of the major shareholders of Painters (Pty) Ltd.

In terms of section 90(2)(c) of the Companies Act an auditor must be acceptable to the company's audit committee as being independent of the company and according to the above and the given information, he is not independent. (1½)

This relationship is likely to be a threat to his independence, (primarily familiarity) and would certainly be seen to impinge upon the independence of the opinion given by Lee Westwood in his capacity of auditor. (1½)

**Fin Advisors Inc:** not suitable for appointment as the company could not be registered with the IRBA and therefore cannot conduct audits (section 90(2)(a) of the Companies Act). (1½)

The reason why the company could not be registered with the IRBA is that for any incorporated practice to register as an audit company, all shareholders must be registered auditors. Anne Naidoo is a lawyer and obviously not qualified for registration with the IRBA. (1½)

**Maximum marks (3)**

## Comments

This question dealt with audits, auditors and audit committees. Students performed fairly well in this question however we did pick up that students did not study section 90(2) very well, as they struggled with question 3.4. It is also important to note that the audit committee does not **appoint** the auditor, but merely **nominates** the auditor for appointment by the shareholders.

## QUESTION 8

**6 marks**

### Solution

#### PRE-INCORPORATION CONTRACTS

A person may enter into a **written agreement in the name of or on behalf of, an entity** that is contemplated to be incorporated, but **does not yet exist at the time.** (1)

**A person** who does anything as explained above, **is jointly and severally liable** with any other such person **for liabilities created as provided for in the pre-incorporation contract** while so acting, **if ...** (1)

**(a) the contemplated entity is not subsequently incorporated;** or (1)

**(b) after being incorporated, the company rejects any part of such an agreement.** (1)

**If, after its incorporation, a company enters into an agreement on the same terms as,** or in substitution for, an agreement contemplated above, the **liability of the person** in respect of the substituted agreement **is discharged.** (1)

**Within three months after the date on which a company was incorporated the board** of that company **may** completely, partially or conditionally **ratify or reject any pre-incorporation contract** purported to have been made in its name or on its behalf. (1)

**If, within three months after the date on which a company was incorporated, the board has neither ratified nor rejected a particular pre-incorporation contract, the company will be regarded as having ratified that agreement.** (1)

To the **extent** that a **pre-incorporation contract has been ratified ...**

- (a) the **agreement is enforceable against the company as if the company had been a party to the agreement when it was made**; and (1)
- (b) the **liability of a person who entered** into the pre-incorporation contract in respect of the ratified agreement **is discharged**. (1)

If a company **rejects the agreement before the incorporation** of the company, a **person who bears any liability for that rejected agreement may assert a claim against the company** for any benefit it has received, or is entitled to receive, in terms of the agreement. (1)

**Maximum marks (6)**

### Comments

This question was self-explanatory and you merely had to write down the requirement of section 21 of the Companies Act.

### QUESTION 9

**12 marks**

#### Solution

**ABC** has a public interest score of: 400 (165 + 7 + 186 + 42) (½)

1 point for every one of the average number of employees employed during the year (165). (1½)

1 point for every R1 million (or portion thereof) in third party liability of the company at the financial year-end (7). (1½)

1 point for every R1 million (**or portion thereof**) in turnover during the financial year (186). (1½)

1 point for every individual who at the end of the financial year, is known by the company to directly or indirectly have a beneficial interest in the company's issued securities (42- note that you have to count Mr X and Mr Y as well). (1½)

ABC is therefore subject to a 'public interest audit' as the company has a public interest score of more than 350, and needs to be audited by a registered auditor.

**XYZ** has a public interest score of 153 (70 + 0 + 80 + 3). (½)

1 point for every one of the average number of employees employed during the year (70). (1½)

1 point for every R1 million (or portion thereof) in third party liability of the company at the financial year-end (0). (1½)

1 point for every R1 million (or portion thereof) in turnover during the financial year (80). (1½)

1 point for every individual who at the end of the financial year, is known by the company to directly or indirectly have a beneficial interest in the company's issued securities (3). (1½)

XYZ is therefore subject to a 'public interest audit' as the company has a public interest score of more than 100 but less than 350, and their financial statements are **internally compiled**. Thus, the company needs to be audited by a registered auditor. (1½)

**Maximum marks (12)**

### Comments

In the case of ABC, it is irrelevant that their financials are compiled externally, as the public interest score is above 350. Consider how your answer would have been different if the public interest score was below 350.

In the case of XYZ, consider how your answer would have been different if the financial statements were compiled externally.

## 4 CONCLUSION

If you find, when comparing your answers with this key, that your answer in respect of any specific topic is less than satisfactory, then you should go back to that topic and study it again.