

**AUE1601**

October/November 2015

LEGAL ASPECTS IN ACCOUNTANCY

Duration 2 Hours

100 Marks

EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT

Use of a non-programmable pocket calculator is permissible

Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue

THIS PAPER CONSISTS OF **EIGHT (8)** PAGES

This paper consists of the following questions and main topics

QUESTION	MAIN TOPIC	MARKS
1.	Share issue, Share purchase, Director's interest in a contract, Public interest score, Requirement to be audited, Sale of the greater part of assets, Reckless trading, Protection for whistle-blowers	50
2.	Appointment of directors, Loan to director, Rotation of auditors, Independence of auditors, Pre-incorporation contracts	<u>50</u>
		<u>100</u>

NOTE:

The main objective of the examination is to test a candidate's knowledge and ability to apply the study material, although the examiners will also take into account the candidate's ability to organise and present that knowledge in writing and according to an acceptable standard

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In this paper, references to the Companies Act are to the Companies Act 71 of 2008, as amended and the Companies Regulations, of the Republic of South Africa.

QUESTION 1

50 marks

You are a trainee auditor at Middle Incorporated (Middle), a medium-sized audit firm in Gauteng. Middle has been the auditors of Heck (Pty) Ltd (Heck) since 2013 and Ernie Bloom is the engagement partner responsible for the audit.

Heck owns several book stores located throughout South Africa and it also has a subsidiary company Axl (Pty) Ltd (Axl). Due to the growing popularity of electronic book readers (*e-readers*) and electronic books Heck is currently facing financial difficulties as book sales have dropped significantly.

Legal matters

Ernie Bloom is currently dealing with the following legal matters pertaining to Heck.

Matter 1

Heck has 100 000 authorised shares and 70 000 of these shares have been issued. The directors are planning to issue a further 10 000 shares to an unrelated company, Brick (Pty) Ltd (Brick).

Matter 2

Axl currently holds 10 000 shares in Heck. The directors of Heck plan to issue a further 10 000 shares to Axl. After the share issue, Axl will own 20 000 shares. Thus, Axl will own 22.2% of Heck's shares.

Matter 3

Heck plans to purchase all the shares in a company called Orson (Pty) Ltd (Orson). A directors meeting has been scheduled to consider the proposed acquisition. Sue Heck is a director of Heck and her father, Mike Heck, is currently the only shareholder of Orson.

Matter 4

Below is an extract of the statement of financial position of Axl, for the financial year ended 30 June 2015. The financial statements have been prepared by an **external third party**.

	R
Assets	
Total non-current assets	33 000 000
Total current assets	<u>17 000 000</u>
	<u>50 000 000</u>

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Liabilities

Total non-current liabilities	10 000 000
Total current liabilities	<u>21 000 000</u>
	<u>31 000 000</u>

Current liabilities include the following, R18 million owed to third party creditors and R3 million owed to the directors of Axl

Non-current liabilities include the following, a R10 million mortgage bond, owed to a third party, Ellert Bank

Other information:

Axl employs 200 employees on average and has two shareholders. Axl has a turnover of R44 million for the year under review

Matter 5

Jasmin Rowling, a director of Heck, advised Ernie Bloom that the board of directors are planning to sell property to the value of R104 million and equipment to the value of R89 million

The reason for the planned sale was that several of the stores are no longer profitable. Heck owns assets with a book value of R321 million (before the planned sale of property and equipment)

Jasmin also mentioned that she was certain that Heck was trading recklessly and was uncertain as to whether it was legal or not

Matter 6

Jasmin Rowling, the director of Heck, enquired from Ernie Bloom as to whether she would be offered protection as a whistle-blower, should she become aware of and decide to report any illegal actions by the board members of Heck

REQUIRED

Marks

- 1.1 **Refer only to matter 1 of the scenario:**
Describe what authorisation is needed to approve the share issue to Brick and **discuss** whether the share issue is acceptable, in terms of the Companies Act (3)
- 1.2 **Refer to the background information and matter 2 of the scenario:**
Discuss, in terms of the Companies Act, whether it is legal for Axl to hold 20 000 shares in Heck (3)
- 1.3 **Refer only to matter 3 of the scenario:**
Describe the requirements that must be fulfilled by Sue Heck, in terms of section 75 of the Companies Act, with regard to the directors meeting for the proposed acquisition (5)

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REQUIRED (continued)

Marks

1.4 Refer only to matter 4 of the scenario:
Based on the available information for Axl for the financial year ended 30 June 2015

1.4.1 List the factors that need to be taken into account when calculating the public interest score **(4)**

1.4.2 Calculate the number of public interest score points of Axl for each factor and **calculate the total** public interest score for the financial year **(7)**

Structure your answer in the following format

1.4.1 Factor to be taken into account	1.4.2 Public interest score
1.	
2	
3.	
4	
	Total score:

Communication skills: Answer presented in correct tabular format **(2)**

1.4.3 State whether or not Axl should have its financial statements audited for the financial year ended 30 June 2015, **give reasons** for your answer taking into account the public interest score and information supplied in matter 4 **(6)**

Communication skills: Application to theory **(1)**

1.5 Refer only to matter 5 of the scenario:

1.5.1 Explain the Companies Act requirements to be met in order for Heck to sell the greater part of its assets **(6)**

Communication skills: Clarity of expression **(1)**

1.5.2 Explain whether or not the proposed sale of the property and equipment constitute the sale of the greater part of Heck's assets **(3)**

1.5.3 Describe in terms of the Companies Act, what is meant by the term "reckless trading" **(2)**

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REQUIRED (continued)	Marks
1.6 Refer only to matter 6 of the scenario:	
1.6.1 List six (6) persons and/or entities that may be offered protection as a whistle-blower, in terms of Section 159 of the Companies Act	(6)
1.6.2 State whether or not Jasmin will be offered protection if she decides to become a whistle-blower	(1)

QUESTION 2

28 marks

Background information

The auditing firm, Pritchett Incorporated (Pritchett), at which you are a trainee auditor, are specialists in the area of company law

Modern Fashion Ltd (Modern) is a newly formed company in the fashion industry Donny Ressler, is the founder and managing director of the company

Board meeting minutes

Below is an extract of the minutes of the last board meeting held by the directors of Modern

MODERN
MINUTES OF MEETING OF THE BOARD OF DIRECTORS HELD ON
1 August 2015

Present:

Mr Ray Reddington, chairman and independent non-executive director
Mr Thomas Keen, non-executive director
Mr Bernie Berlin, marketing director
Ms Eliza Keen, finance director
Mr Donny Ressler, managing director
Mr Harry Cooper, sales director
Ms Samara Navabi, non-executive director

Apologies:

Ms Demi Zuma, non-executive director

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Matters for discussion:

1. Appointment of directors

Donny Ressler presented a list of candidates to be considered for positions as directors of Modern. The following possible candidates were short listed:

- Ms Donita Ressler, Donny Ressler's 16 year old daughter
- Redlist Ltd, a company specialising in the field of information technology
- Mrs Amy Motjabai. She used to be a Chartered Accountant (SA) before she was convicted and imprisoned due to involvement with money laundering.

The board resolved that all three candidates be appointed.

2. Loan (financial assistance) to Bernie Berlin

Bernie Berlin requested a loan to the amount of R 2,8 million be made available to him in order to cover the following costs: R1,4 million as an advance for travelling expenses relating to Modern and R1,4 million which will be used to renovate his personal residence.

Other matters:

(a) Possible appointment as auditor

Donny Ressler informed you that the directors of Modern are considering the appointment of Pritchett as the auditors of the company.

(b) Pre-incorporation contract entered into by Donny Ressler

Donny Ressler further informed you that he had entered into a written contract on behalf of Modern, before Modern was formally incorporated. The contract was for the supply of sewing equipment.

He has requested advice on the requirements of the Companies Act regarding this contract.

REQUIRED

Marks

2.1 Refer only to matter 1 on the agenda: Appointment of directors.

- 2.1.1** Supply the board members in terms of the Companies Act, of persons who will be **ineligible or disqualified** from being **appointed as a director of a company**

(10)

[TURN OVER]

REQUIRED (continued)

Marks

- 2.1.2 State whether or not each of the candidates short listed will be permissible** in terms of the requirements of the Companies Act, to be **appointed as a director** of Modern. **Give a reason** for each person being permissible or not **(5)**

Present your answer in the following format:

Candidate	Reason

Communication skills: Answer presented in tabular format **(1)**

2.2 Refer only to matter 2 on the agenda: Loan to Bennie Berlin.

- 2.2.1 Explain** what is defined as financial assistance to directors per section 45 of the Companies Act **(3)**

- 2.2.2 Explain** what is **not** defined as financial assistance to directors per section 45 of the Companies Act **(3)**

- 2.2.3 Discuss whether or not** the loan to Bennie Berlin meets the definition of financial assistance **(4)**

Communication skills: Clarity of expression **(1)**

2.3 Refer to the background information and matter (a) of other matters: Possible appointment as auditor.

- 2.3.1 Describe** the requirements of the Companies Act, regarding the rotation of auditors **(3)**

- 2.3.2 Describe four (4)** considerations that will be taken into account by the audit committee in determining the independence of Pritchett **(4)**

2.4 Refer to background information and matter (b) of other matters: Pre-incorporation contract entered into by Donny Ressler.

- 2.4.1 Describe** the Companies Act requirements that need to be considered when advising Donny Ressler on the pre-incorporation contract **(6)**

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REQUIRED (continued)

Marks

- 2.4.2** For each requirement, **discuss** the information that will be considered in determining the possible consequences relating to the contract **(9)**

Present your answer in the following format.

Note: The following is provided as an example of what is required and no marks will be awarded for repeating the information in the example

2.4.1 Requirement per the Companies Act (1 mark each)	2.4.2 Information to be considered (1.5 marks each)
A person will be liable if the entity is not subsequently incorporated	Modern was incorporated so this requirement will not apply
2	
Etc	

- Communication skills:** Answer presented in tabular format **(1)**