



AUE1601

May/June 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.

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THIS PAPER CONSISTS OF SIX (6) PAGES

This paper consists of the following questions and main topics:

| QUESTION | MAIN TOPIC | MARKS |
|----------|--|-------------------|
| 1. | Sundry Companies Act issues | 36 |
| 2. | Board meetings, Share buy-backs, Distributions; Recovering losses from a director, Resignation of a director, Resignation of the company secretary, Loans to directors | 40 |
| 3. | Public interest score; Requirement to be audited; Rotation of auditors | <u>24</u> |
| | | <u>100</u> |

LET WEL:

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

36 marks

You are an audit partner at Chess Incorporated, a medium-sized audit firm in Gauteng. You received the queries listed below via e-mail from your various clients.

Client name: King Ltd

Please explain how the solvency and liquidity tests of a company is calculated. Taking the extract of our balance sheet below into account, would our company satisfy these tests? (5)

| | R |
|-------------------------------|-------------------|
| Assets | |
| Total non-current assets | 17 000 000 |
| Total current assets | <u>28 000 000</u> |
| | <u>45 000 000</u> |
| Liabilities | |
| Total non-current liabilities | 10 000 000 |
| Total current liabilities | <u>21 000 000</u> |
| | <u>31 000 000</u> |

Client name: Queen Ltd

We are considering incorporating a new company, but we only anticipate our new company to start generating profits in approximately five years' time, as our initial expenses will exceed the company's profits. Once our company starts to generate profits, these profits will be distributed to our shareholders.

Please explain to us, on the hand of an example, what is meant by a non-profit company. (3)

Will we be able to register this company as a non-profit company? (1)

Client name: Rook Ltd

We are struggling to understand all the requirements of the memorandum of incorporation of a company. Our understanding is that the Companies Act permits a company's memorandum of incorporation to, *inter alia*, alter the effect of any provision of the Companies Act. Is this true or false? Please supply us with a reason for your answer. (4)

Client name: Bishop Ltd

We are in the process of incorporating a new company, Knight (Pty) Ltd. It is however our understanding that it is possible to execute certain transactions, such as signing a lease agreement in the name of the company, even before the company has been incorporated.

Please explain to us the requirements and possible consequences of such an agreement. (7)

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Furthermore, we would like to enquire whether, as this new company will not require an audit, it will be necessary for this company to produce annual financial statements or keep any other records. If so, please supply us with a list of the records that we should keep. (8)

Lastly, we are contemplating a share issue, and would like some explanation as to what is meant by existing shareholders having a pre-emptive right to subscribe for shares. Please explain this to us by means of an example (4)

Is this provision applicable to our company? Please give a reason for your answer. (1)

Pawn (Pty) Ltd

We would like to know, besides from determining whether a company is to be audited or reviewed, does the public interest score of a company serve any other purpose? (2)

REQUIRED

Marks

1. Respond to the queries of each of the clients, taking into account the mark allocation of each query. (35)

Communication skills. Clarity of expression (1)

QUESTION 2

40 marks

Zodiac Ltd (Zodiac) is a company trading in paintball guns and paintball supplies. Zodiac has a net asset value of R25 million and a current net asset value of R8 million. Zodiac has two classes of shares, namely 1 500 000 authorised and issued class A shares and 100 000 authorised and issued class B shares. All the class B shareholders are also directors of the company. Zodiac has 12 directors.

The Memorandum of Incorporation of Zodiac requires that a special resolution be obtained in order to approve distributions made to directors.

Below is an extract of the minutes of the meeting of the board of directors of Zodiac, held on 1 February 2015. This meeting was called by the managing director, after four of Zodiac's directors required for the meeting to be called.

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| |
|--|
| ZODIAC LTD MINUTES OF MEETING OF THE BOARD OF DIRECTORS HELD ON 1 February 2015 |
|--|

Present:

Mr Charles Manson, chairman and independent non-executive director
Mr Jeffrey Dahmar, non-executive director
Mr Ted Bundy, marketing director
Ms Bonnie Parker, finance director
Mr Clyde Barrow, managing director
Mr John Gacy, company secretary and sales director
Mr Moses Sithole, non-executive director

Present via electronic communication:

Ms Daisy de Melker, non-executive director

Matters for discussion:

1. Share buy-back

Mr Barrow suggested a share buy-back of 1 000 000 of Zodiac's class A shares from the general public at a fair market value of R1 per share. The matter was put to vote and the buy-back was unanimously approved by the directors

2. Dividend declaration

Ms Parker proposed the declaration of a dividend of 50c per share to all the class B shareholders of Zodiac. The matter was put to vote and the dividend declaration was unanimously approved by the directors

3. Resignation of Mr Gacy

At the board meeting, Mr Gacy announced his resignation from the board and from his position as company secretary. Mr Barrow noted that this came as a surprise to the board. The board opposed his resignation, and it was noted that they were unsure if the appropriate procedure was followed regarding his resignation as company secretary, and whether the remaining directors number of directors on the board would be a sufficient number of directors as required by the Companies Act.

4. Loan to director

Mr Bundy requested a loan to the amount of R3 million be made available to him in order to cover the following costs: R1,2 million in legal expenses relating to his pending divorce case; and R1,8 million for funding an advertising campaign that he is undertaking on behalf of Zodiac. Mr Bundy stated that he will make all relevant invoices and statements available to the company. The board approved his request.

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| REQUIRED | Marks |
|---|--------------|
| 2.1 Discuss in general the conduct of the board meeting of Zodiac held on 1 February 2015, having regard to only the following matters. | |
| i. Calling a directors' meeting. | (2) |
| ii. Conducting a meeting via electronic communication | (2) |
| iii. Approving a directors' resolution | (2) |
| iv. Determining the quorum for a directors' meeting | (2) |
| 2.2 Refer only to matter 1 on the agenda: List the Companies Act's requirements that should be met in order for a company to legally repurchase its own shares (share buy-back) Do not include notice or quorum requirements in your answer, and do not deal with shares bought back by subsidiary companies. No application is required | (3) |
| 2.3 Taking the background information into account, refer only to matter 2 on the agenda: | |
| i. Discuss the legality of the dividend declaration to the class B shareholders of Zodiac by first listing the requirements of the Companies Act and then applying it to the scenario. | (8) |
| ii. What are the steps that Zodiac can take if the directors participated in a resolution to approve the declaration of a dividend, which subsequently caused losses to the company, despite knowing that it was contrary to the Companies Act? | (3) |
| 2.4 Refer only to matter 3 on the agenda: | |
| i. Discuss whether the correct procedure was followed by Mr Gacy in order to resign as company secretary and director of Zodiac | (4) |
| ii. What is the minimum number of directors that Zodiac can have in terms of the Companies Act, and why? | (2) |
| 2.5 Taking the background information into account, refer only to matter 4 on the agenda: | |
| i. Discuss whether the R3 million loan to Mr Bundy meets the definition of financial assistance as per section 45 of the Companies Act. | (3) |
| ii. Discuss the Companies Act's requirements to be met in order for Zodiac to legally grant the proposed loan to Mr Bundy. Ignore any notice and quorum requirements | (7) |
| Communication skills Clarity of expression: | (2) |

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QUESTION 3

24 marks

You are a first-year audit trainee at GOT Incorporated, a small audit firm. The audit partner in charge of the firm has given you the task of calculating the public interest scores of all the firm's clients and to indicate, with reasons, whether each of the clients should be audited or independently reviewed for the 2015 financial year. Below is an extract of the list after you have completed all the public interest score calculations.

| Client name | Additional information | Public interest score | Marks |
|---------------------|--|-----------------------|-------|
| Lannister (SOC) Ltd | Financial statements externally compiled; does not hold any assets in fiduciary capacity | 105 | (2) |
| Snow NPC | Financial statements internally compiled; does not hold any assets in fiduciary capacity | 312 | (4) |
| Seaworth (Pty) Ltd | Financial statements externally compiled; does not hold any assets in fiduciary capacity | 345 | (4) |
| Baratheon (Pty) Ltd | Financial statements externally compiled, does not hold any assets in fiduciary capacity | 368 | (3) |
| Melisandre Ltd | Financial statements externally compiled; does not hold any assets in fiduciary capacity | 75 | (2) |

REQUIRED

Marks

- 3.1** Name the four factors that are used in calculating the public interest score of a company. (6)
- 3.2** Having regard to the mark allocation in the table above, for each of the clients on the list, state whether the financial statements of the client would be subject to an audit or an independent review for the 2015 financial year. Give detailed reasons for your answers. (15)
- 3.3** May GOT Incorporated be appointed as auditor of any of its clients for more than five consecutive years? Give a reason for your answer (3)