

# **Tutorial Letter 202/2/2015**

## **LEGAL ASPECTS IN ACCOUNTANCY**

**AUE1601**

**Semester 2**

**Department of Auditing**

**IMPORTANT INFORMATION**

This tutorial letter contains the suggested solution to and comments on Assignment 02

BAR CODE

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

## **SUGGESTED SOLUTION AND COMMENTS ON ASSIGNMENT 02/2015**

### **QUESTION 1**

**50 marks**

#### **Specific comments**

##### **Question 1.1**

This question related to section 91 of the Companies Act, which is dealt with in topic 6 of the study guide.

##### **Question 1.2**

This question required you to discuss whether or not Slytherin Ltd must appoint an audit committee in terms of the Companies Act. You therefore had to state the Companies Act requirement, and apply it to the scenario. This question related to section 94 of the Companies Act, which is dealt with in topic 6 of the study guide.

##### **Question 1.3**

This question had two parts to it. You firstly had to list all the Companies Act requirements relating to the composition of the audit committee and secondly, you had to discuss the legality of the composition of the audit committee as given in the scenario. You therefore had to discuss the appropriateness to appoint each individual suggested member of the audit committee. This question relates to section 94 of the Companies Act, which is dealt with in topic 6 of the study guide.

##### **Question 1.4**

It is important to note that you specifically had to include notice, meeting and quorum requirements in your solution.

##### **Question 1.5**

In this question, you firstly had to give the theory relating to the definition of a related person (as dealt with in topic 2 of the study guide). Thereafter you had to apply this definition to Ms Huffelpuff's relationship with her mother. You then had to identify the existence of a director's (Ms Huffelpuff) interest in a contract, and lastly, you had to list the requirements of section 75, relating to a director's interest in a contract.

### **Suggested solution**

#### **1. 1.1 Rotation of auditors**

In terms of section 91, if a company appoints a firm as its auditor, any change in the composition of the members of that firm does not by itself create a vacancy in the office of auditor for that year, subject to the following: (1)

- If, by comparison with the membership of a firm at the time of its latest appointment, less than one half of the members remain after the change, that change constitutes the resignation of the firm as auditor of the company, giving rise to a vacancy. (1)

Only one of the three audit partners of Potter Incorporated left the audit firm. (1½)

Therefore 66% of the composition of the members of Potter Incorporated remains the same and therefore the change in composition of members does not create a vacancy by itself. (1½)

**Maximum 4**

**1.2 Audit committee required**

In terms of section 94, every public company must appoint an audit committee. (1)

Slytherin is a public company and is therefore required to appoint an audit committee. (1½)

**Maximum 2**

**1.3 Evaluation of audit committee**

At each annual general meeting, a public company must elect an audit committee comprising at least three members. (1)

Mr Snape suggested three members to form part of the audit committee which is sufficient in terms of the requirement of the Companies Act. (1½)

Each member of an audit committee of a company must ...

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

**(b)** not be

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

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

The Minister 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. (2)

*Mr Snape*

Mr Snape is a director of the company. However, he is involved in the day-to-day management of the company's business since he is the managing director of Slytherin and can therefore not form part of the audit committee. (1½)

*The son of Mr Snape*

The son of Mr Snape is related to a person who is involved in the day-to-day management of the company's business, since Mr Snape is the managing director of Slytherin, and he therefore cannot form part of the audit committee. (1½)

*Mr Malfoy*

Mr Malfoy is a director of the company. However, he is one of the major customers of Slytherin and therefore cannot form part of the audit committee since the integrity, impartiality or objectivity is compromised due to this relationship. (1½)

*You*

As the auditor of the company, you are not allowed (in terms of section 90 of the Companies Act), to be a director of an audit client. Section 94 requires all audit committee members to also be directors, and therefore, you cannot form part of the audit committee. (1½)

*Mr Longbottom*

Mr Longbottom is an independent non-executive director of the company and, provided that he meets all the other criteria, may form part of the audit committee of Slytherin. (1½)

*Conclusion*

The composition of the audit committee does not comply with the requirements according to the Companies Act. (½)

**Available 17½**  
**Maximum 15**

#### **1.4 Statutory requirement**

If the director wants to include the audit requirement in the company's MOI, the MOI will have to be amended in terms of the Companies Act to include this requirement. (1)

A special resolution is required to amend the MOI of a company. (1)

The board of the company (or the shareholders) can call a meeting of shareholders to exercise 10% of the votes. (1)

As Gryffindor is a private company, the following will apply to the meeting:

- A notice period of 10 business days must elapse before the meeting is to begin. (1)
- Notices must include the date, time and location of the meeting. (1)
- The specific purpose for which the meeting has been called (to amend the MOI) must be stated. (1)
- A copy of the proposed resolution and the percentage of voting rights required to pass the resolution must be included, that is, the resolution to amend the MOI for an annual audit requirement and 75% of voting rights. (1)
- The notice must also include a reasonably prominent statement that a shareholder may appoint a proxy (who does not have to be a shareholder). (1)
- Personal identification is required to attend the meeting. (1)

To obtain a quorum, the meeting must have ...

- at least three shareholders present (1)

- shareholders holding 25% of the voting rights, which can be exercised on the amendment, in attendance before the meeting can begin or the matter be discussed. (1)

Voting of the matter may be done by a show of hands or by polling those present and entitled to vote. (1)

If the resolution is passed, a notice of amendment (with the prescribed fee) must be filed with the CIPC (the registrar). (1)

### **Voluntary requirement**

Alternatively it may be decided by a shareholders or board resolution that the annual financial statements (AFS) of the company will be audited for the year under review. (2)

**Total 15**

## **1.5 Affinity**

A relationship by marriage is sometimes referred to as being related by affinity. A husband and wife are related in the first degree by marriage. For other relationships by marriage, the degree of the relationship is the same as the degree underlining relationship by blood. For example, Johan and Steve are brothers and are therefore second-degree relatives by blood. John's wife, Linda, is related to Steve in the second degree by marriage. (3)

### *Consanguinity*

Your brothers, sisters, grandparents and grandchildren are related to you in the second degree of consanguinity (second degree of blood relationship). In other words, there is at least one other generation between you and a person related to you in the second degree. The persons who are related to you in the first degree of consanguinity are your children or your parents. (3)

In all of the above cases, the relationship will be **within** the second degree of consanguinity/affinity. (1)

With regard to Ms Huffelpuff's interest in the share purchase, section 75 of the Companies Act applies, as the purchase is from her mother, who is related to her within the second degree of consanguinity. They are thus "related persons" as defined in section 2 of the Companies Act, and for the purposes of section 75(b). (2)

- She may at any time disclose the personal financial interest in advance, by delivering to the board, or shareholders a notice in writing, setting out the nature and extent of the interest. (1)
- She must disclose the interest and its general nature before the matter is considered. (1)
- She must disclose to the meeting any material information relating to the matter, and known by her. (1)
- She may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors. (1)
- If she is present at the meeting, she must leave the meeting immediately after making any such disclosure as above. (1)
- She must not take part in the consideration of the matter. (1)

- While she is absent from the meeting she is to be regarded as being present for the purposes of determining a meeting quorum, and is not to be regarded as being present for the purposes of determining a voters' quorum. (1)
- She 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)

**Available** 17

**Maximum** 14