

# **Tutorial letter 203/3/2013**

**Legal aspects in Accountancy**

**AUE1601**

**Semesters 1 & 2**

**Department of Auditing**

**IMPORTANT INFORMATION:**

This tutorial letter contains the solution to assignment 03 included in Tutorial letter 101

BAR CODE

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# 1 KEY AND COMMENTS ON ASSIGNMENT 03/2013 IN TUTORIAL LETTER 101

## 1.1 GENERAL COMMENTS

This assignment is a previous examination paper. We are of the opinion that it would be advantageous to you as a student to take note of the difficulties experienced by students when they wrote this examination as well as common mistakes that were made by students. We have therefore included specific comments related to those questions where problems were experienced.

## 1.2 KEY AND COMMENTS ON ASSIGNMENT 03/2013

### QUESTION 1

**30 marks**

#### Specific 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. Note that theory usually weighs one mark, whilst the application thereof will account for one and a half mark.

### 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 2008, 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

- 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 (issue shares) (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**

## QUESTION 2

**30 marks**

### Specific 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.

### 2.1

2.1.1 In terms of the Companies Act 2008 (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 2008, 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 2008, as they are within two degrees of consanguinity. (1½)

2.1.5 In terms of section 76(2)(b) the information need only be disclosed if it is material. A R7.5 million contract would probably be regarded as material. (1½)  
**Maximum of (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 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, 2008, as amended. (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)**

### QUESTION 3

**40 marks**

#### Specific 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.

#### 3.1

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)
2. A special resolution to amend the MOI is required. (2)
3. If the resolution is passed, a Notice of Amendment (with the prescribed fee) must be filed with CIPC. (1½)

**Maximum marks (5)**



## 3.2

1. **The requirements applicable to appointing an audit committee in terms of the Companies Act 2008**

- 1.1 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)
- 1.2 Shareholders must appoint the audit committee at each annual general meeting. (11)
- 1.3 The audit committee must consist of at least three members. (1½)
- 1.4 Each member must be a director of the company. (1½)
- 1.5 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)

- 1.6 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 for this section (10)**

2. **The duties of the audit committee in terms of the Companies Act 2008 are to ...**

- 2.1 nominate a registered auditor for appointment as auditor by the share-holders (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 & 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 2 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 3.2 (20)**

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

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)
2. Ryan Hansen can also be removed by an ordinary resolution of the shareholders at any general meeting. (1½)
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)
4. Whatever “method” of removing Ryan Hansen is attempted, he must be afforded the chance to defend himself; (1½)
  - 4.1 he must be given notice of the meeting (10 business days) and a copy of the resolution to remove him. (1½)
  - 4.2 he must be afforded a reasonable opportunity to make a presentation (in person or through a representative) before voting takes place. (1½)
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)
6. If Ryan Hansen is removed by the board, he has 20 business days to go to court for a review. Bonus (1½)
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)**

**3.4 Advise John Smit as to which, if any, of the two 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.

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).

The reason that 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)

**(3)**

## **2 EXAMINATION PAPER**

You must be well prepared to pass the paper. The standard will be similar to the examination papers that are available on *myUnisa* as well as assignment 3. Be on the lookout for additional information regarding the exam that will be made available on *myUnisa*. The Close Corporation Act will not be examined.

## **3 CONCLUDING REMARKS**

Avail yourself of all the opportunities created and should you experience any problem or difficulty with the content of this module, please do not hesitate to contact us via email or telephonically.

We wish you only the best and for successful completion of the module!

**LECTURERS: AUE1601**

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