

Tutorial letter 203/3/2015

Legal aspects in Accountancy

AUE1601

Semesters 1 & 2

Department of Auditing

IMPORTANT INFORMATION

This tutorial letter contains the solution to the self-evaluation assessment included in Tutorial letter 101

BAR CODE

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1 KEY AND COMMENTS ON THE SELF-EVALUATION ASSESSMENT IN TUTORIAL LETTER 101

1.1 GENERAL COMMENTS

This assessment 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 SUGGESTED SOLUTION AND COMMENTS ON THE SELF-EVALUATION ASSESSMENT

QUESTION 1

32 marks

Specific comments

Question 1.1

A list of examples where a special resolution is required appears on page 50 of your study guide. Take note of (c) and (f) which specifically relates to transactions with directors or prescribed officers. Note that you would not obtain marks if this fact was not noted.

Also note the examples listed in (f) – note that it refer to the **greater** part of assets. Thus, merely stating 'sale of assets' would be incorrect.

Question 1.2

Refer to the table on page 58 of your study guide which relates to section 66 of the Companies Act. No further explanation is required.

Question 1.3

This question deals with section 69 of the Companies Act. Refer to the diagram on page 60 of your study guide.

Question 1.4

Note that the required related to persons who may form part of the **quorum**, and thus, you should not have discussed whether the persons are allowed to **attend** meetings.

Question 1.5

This question is straight forward and requires no further explanation. It is dealt with in study unit 5.4 of your study guide and relates to section 76 of the Companies Act.

Question 1.6

This question is straight forward, but required careful reading. It relates to section 93 of the Companies Act.

Question 1.7

This question required you to list the Companies Act requirements relating to the sale of the greater part of a company's assets. This is dealt with in study unit 7.3 of your study guide and relates to section 112 of the Companies Act.

Question 1.8

As all public companies are required to have their AFS audited, the PIS of a public company will be irrelevant in determining the audit requirement of the company.

Question 1.9

Study unit 8.1 deals with the winding up of a company as per sections 79 – 83 of the Companies Act.

Suggested solution

1.1 Any four examples:

- (a) To amend the company's memorandum of incorporation (section 16(1)(c) and section 36(2)(a)). (1)
- (b) To ratify actions by the company or directors in excess of their authority, as contemplated in section 20(2). (1)
- (c) To approve an issue of shares/securities or grant of rights to directors, prescribed officers, or future directors or prescribed officers (section 41(1)). (1)
- (d) To approve an issue of shares or securities as contemplated in section 41(3). (1)
- (e) To authorise the board to grant financial assistance in the circumstances contemplated in section 44(3)(a)(ii) or 45(3)(a)(ii). (1)
- (f) To approve a decision of the board for re-acquisition of shares in the circumstances contemplated in section 48(8) (from directors/prescribed officers etc.). (1)
- (g) To authorise the basis for compensation to directors of a profit company, as required by section 66(9). (1)
- (h) To approve any proposed fundamental transaction (e.g. selling of the greater part of a company's assets/amalgamation/mergers). (1)

Maximum (4)

Although not examinable, marks will also be awarded for:

- Ratifying a consolidated revision of a company's MOI
- Voluntary winding-up of a company
- Approve application to transfer the registration to another jurisdiction
- To revoke a resolution In terms of section 164

1.2 Requirements for number of directors:

Type of company (as explained in topic 7.3 of this study guide)	Minimum number of directors	
Private company ((Pty) Ltd))	(i) 1	(½)
Personal liability company (Inc)	(ii) 1	(½)
Public company (Ltd)	(iii) 3	(½)
Not-for-profit company (NPC)	(iv) 3	(½)

Maximum (2)

1.3 Ineligible [sec 69(7)]

- A juristic person. (1)
- An unemancipated minor (or under a similar legal disability). (1)
- A person not meeting the requirements of the MOI. (1)

Disqualified [sec 69(8)]

- Prohibited by a court. (1)
- Declared delinquent by a court. (1)
- Unrehabilitated insolvent. (1)
- Prohibited in terms of public regulation. (1)
- Removed from office of trust due to misconduct that involved dishonesty. (1)
- Convicted and imprisoned without option of a fine for theft, fraud, forgery, perjury or other offences. (1)

Maximum (4)

- 1.4** (i) No: the company secretary is not a director. (2)
- (ii) No: the auditor of the company cannot be a director. (2)
- (iii) Yes: all directors can form part of the quorum. (2)

Maximum (6)**1.5 Where the director:**

- believes the information is immaterial to the company (1)
- believes the information is generally known to the public or other directors (1)
- would be breaching a legal or ethical obligation of confidentiality. (1)

Maximum (1)

- 1.6** (i) False: The auditor, in terms of section 93(1)(a), has right of access at all times to ...
- accounting records
 - all books
 - documents.
- OR
- The auditor does not have right of access to storage warehouses at all times. (2)
- (ii) False: In terms of section 93(1)(c), the auditor is entitled to attend any general shareholders' meeting (including the AGM). (2)
- OR
- The auditor has no right to attend directors meetings. (2)
- (iii) False: In terms of the Act, the auditor is entitled to receive all notices of and other communications relating to any shareholder meeting. (2)

Maximum (6)**1.7 Disposal of the greater part of the assets**

1. The directors may not dispose of the greater part of the assets without a special resolution taken by the shareholders. (1)
2. The directors need to give **10 business days'** notice of the meeting to the **shareholders**. (2)
3. The notice must include a written summary of the terms of the transactions (selling the assets). (1)
4. To form a quorum, sufficient persons (shareholders/proxies) must attend the meeting to exercise at least 25% of the voting rights that are entitled to be exercised on the matter. (1)
5. Unless the MOI stipulates a different percentage, the resolution must be passed by 75% of the voting rights (exercisable on the matter) present in person or by proxy. (1)

Maximum (5)

- 1.8** No: In accordance with the Companies Act, all public companies, such as Elementary Ltd, must have their AFS audited regardless of the public interest score. (2)

Maximum (2)

1.9 Section 79 provides that a solvent company may be dissolved by:

- **Voluntary winding-up** initiated by the company as contemplated in section 80, and conducted either by the company or its creditors, as determined by a special resolution adopted by the company; or (1)
- **Winding-up and liquidation by a court order**, as contemplated in section 81. (1)

Maximum (2)

QUESTION 2

55 marks

Specific comments

Question 2.1

This question required you to discuss whether or not the company was trading recklessly in terms of section 22. You therefore had to list the theory regarding reckless trading, and thereafter you had to apply it to the scenario. You also had to draw a conclusion.

Question 2.2

This question dealt with financial assistance granted to a director, and was broken up into three parts. Part (i) required you to list the theory regarding financial assistance in terms of the Companies Act. This is dealt with in section 45 of the Companies Act, as well as topic 5 of your study guide. Part (ii) required you to apply the theory which you have listed in part (i), to the given scenario. You therefore had to evaluate each of the Companies Act requirements that you have listed to the information in the scenario. Part (iii) required you to conclude on whether or not the specific actions of the company were legal.

Question 2.3

This question dealt with various aspects pertaining to the auditor of a company (topic 6 of the study guide). Part (i) of the required dealt with the eligibility to be appointed as an auditor of the company (section 90). You had to list the theory and apply it to the scenario. Part (ii) dealt with the vacancy in the position as auditor (section 91). You only had to list the theory. Part (iii) dealt with the auditor's independence, and you once again only had to list the theory in terms of the Companies Act.

Question 2.4

This was a straight forward theoretical question, and you merely had to list the duties of the audit committee in terms of section 94 of the Companies Act.

Question 2.5

This question deals with the removal of a director. This is dealt with in great detail in topic 5 of your study guide (also see the summary in the table on page 60 of your study guide). Note how the procedure to remove a director may differ where the director was found to be negligent as opposed to a normal removal of a director.

Suggested solution

2.1 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, 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 prohibited conduct or that it is able to pay its debts as they become due and payable in the normal course of business, (1)

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 **Rocknroll Limited will not be able to satisfy the Commission** if it receives the notice indicated above, as:

- **Rocknroll Limited does not satisfy the solvency test**, since considering all reasonable foreseeable financial circumstances of the company, **the assets (R8 000 000) of the company fairly valued, do not exceed the liabilities (R10 000 000) of the company fairly valued;** and (1½)
- **Rocknroll Limited is not liquid**, since the current liabilities (R5 000 000) exceed the current assets (R2 000 000). (1½)

In addition, as Rocknroll Limited is not liquid it will probably not be able to pay its debts as they fall due. (1)

Rocknroll Limited is therefore trading recklessly and is therefore contravening the Companies Act 2008, as amended. (1)

Maximum marks (6)

2.2

(i) The loan will result in the granting of financial assistance to a director, which is permissible, having regard to the following: (1)

- Any conditions set out in the MOI in this regard should be met *[sec 45(4)]*. (1)
- The liquidity/solvency test should be satisfied immediately after the financial assistance has been granted *[sec 45(3)(b)]*. (1)
- The terms should be fair and just. (1)
- A special resolution should be obtained (must have been passed within previous two years) *[sec 45(3)(a)(ii)]* (except if the financial assistance is pursuant to an employee share scheme). (1)
- Written notice of the meeting and the intended assistance should be given to all shareholders (unless all shareholders are directors) *[sec 45(5)]*. (1)
- Written notice of the meeting and the intended assistance should be given to any trade union that is representing the employees of the company *[sec 45(5)]*. (1)
- Meeting notice and meeting/voting quorum requirements should be adhered to. (1)

Maximum (6)

(ii) Ms Monroe approved the loan without having regard to any conditions in the MOI. (1½)

- It would also seem that no the rest of the board was not involved in this decision, as she approved it on her own. (1½)
- Ms Monroe did not consider the solvency and liquidity situation of the company and from the calculation in 2.1 above, the company is not solvent or liquid. (1½)
- The terms and conditions do not seem fair and reasonable towards the company, as
 - The company is already struggling financially and will now be placed under further financial strain. (1)
 - There are no fixed repayment terms, as Mr John will be allowed to repay the loan only when his new business venture becomes profitable. (1)

- At this stage it is not yet determinable whether or not his business will be profitable. (1)
- No special resolution was obtained within the previous two years, as the company has never before granted such a loan. (1½)
- No written notice was given regarding a meeting about this decision (Ms Monroe approved it on her own). (1½)

Maximum (8)

(iii) Conclusion: Based on the information given, the financial assistance provided is illegal, since it does not satisfy the requirements of the Act.

Maximum (1)

2.3

(i) **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

Ms Presley, the proposed designated auditor for the audit of Rocknroll Limited, is the **wife of the managing director** of Rocknroll Limited and therefore will **not be seen as independent** by the audit committee. (1)

Mr Presley is a director of Rocknroll Limited, and Ms Presley is **a person related to him.** (1)

Ms Presley may therefore not be appointed as designated auditor; another registered auditor from Blues Incorporated may however be acceptable. (1)

Maximum (7)

(ii) 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 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) **if, within five business days after delivering the proposal, the audit committee does not give notice** in writing to the board **rejecting the**

proposed auditor, the board may **proceed to make the appointment**. (2)

Maximum (3)

(iii) Considerations to be 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)

(iii) **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)

Maximum (5)

2.4 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 the **auditor's terms of engagement**; (1)
- (c) To **determine**, subject to the provisions of Chapter 3 of the Companies Act regarding enhanced accountability, **the nature and extent of any non-audit services** that the auditor may or may not provide to the company or 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 (11)**

2.5 If the MOI contained a clause that designated an individual such as Mr Presley, in his capacity as CEO, the power to remove a director (like Ms Monroe) from the board of the company, that power could be exercised. (1)

Ms Monroe can also be removed by an **ordinary resolution** of the shareholders at any general meeting. (1)

Ms Monroe may also be removed if a shareholder or fellow director (for example, Mr Presley) alleges, inter alia, that she has been negligent or derelict in her duties as a director. (1)

- The **board** must consider the allegation and vote on her removal. (1)
- If the board has to remove Ms Monroe, she **may not vote** on her removal. (1)
- For the removal resolution to be accepted, the **majority** of directors voting would need to vote in favour. (1)

Irrespective of the "method" used to remove Ms Monroe, she must be afforded the chance to defend herself, and (1)

- she must be given notice of the meeting (10 business days) and a copy of the resolution to remove her (1)
- she must be afforded a reasonable opportunity to make a presentation (in person or through a representative) before voting takes place. (1)

- Within 20 **business** days ... (1)
- Ms Monroe may go to court for a review regarding her removal. (1)
 - if she is **not** removed, any director or shareholder who voted to have her removed, may go to court for a review. (1)
- Maximum (8)**

QUESTION 3**13 marks****Specific comments****Question 3.1**

Take note that this specific share issue were granted to **directors**, therefore a **special resolution** of shareholders were required. Note that you have to link the special resolution requirement to the correct reason, i.e. shares being issued to directors.

Question 3.2

This question dealt specifically with notices and the conduct of meetings. Take careful notice of the fact that the shareholders are to be provided with **written** notice. Also take notice of the reference to "**business days**". Merely referring to "days" may cost you marks in the exam.

Suggested solution**3.1 Share issue to the directors**

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

Shares are going to be issued to the directors of Designers Limited and therefore a special resolution of the shareholders will be required. (1½)
Maximum (2)

3.2 As there is a need to hold a shareholders' meeting, the board will have to provide all shareholders with **written notice** ... (1)

- of the date, time and place of the meeting
 - of the specific purpose of the meeting (to issue shares)
(A copy of the resolution must be provided.)
 - of the percentage of voting rights required for the resolution
(special resolution)
 - that a shareholder, who is entitled to vote, may appoint a proxy
(this must be reasonably prominently displayed on the notice)
 - that satisfactory identification will be required from shareholders
participating in the meeting.
- } Maximum (3)

This notice must be given at least **15 business days** (as this is a public company) before the meeting will be held. (1)
(The MOI may stipulate a longer or shorter notice period.) (½)

The meeting to pass this resolution may only begin if **25%** of the voting rights entitled to be voted in respect of at least one matter to be decided at the meeting, are present. (1)

For the debate to commence on the share issue resolution, holders of at least **25%** of the shares entitled to vote in respect of the share issue must be present when the matter is called on the agenda. (1)

(Note: The MOI may stipulate lower percentages.) (½)
In addition, as Designers Ltd has more than two shareholders, the meeting may not begin and no matters may be debated, unless **at least three shareholders** are present at the meeting. (1½)

At the commencement of the meeting, shareholder **identities** as well as their rights to attend or participate must be **verified**. The person presiding over the meeting must be satisfied with the validity of the shareholders' identity. (1)

The proposed resolution must be sufficiently clear and specific. It must also be accompanied by sufficient information to enable a shareholder to decide whether or not to participate in the meeting and "influence the outcome" of the vote on the resolution. (1)

For the (special) resolution on the share issue to be passed, at least **75%** of the voting rights exercised on the resolution must support it. (1)

Note: The MOI may stipulate a lower or higher percentage, but the difference between the percentage for an ordinary and a special resolution must be at least 10%. (½)

Voting should take place by poll (not by a show of hands). (1)
Maximum (11)

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 the self-evaluation assessment. 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!