

**AUE1601**

October/November 2014

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	Audit committees, Audit requirement, Directors' personal financial Interest	36
2	Sale of the greater part of assets, Business rescue proceedings, Motion to dismiss a director, Standards of directors' conduct, Directors' remuneration; Reckless trading	44
3	Financial assistance, Rights associated with shares	<u>20</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.

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

[TURN OVER]

QUESTION 1**36 marks**

You are an expert in the area of company law. Cola-Cola Ltd ("Cola") is an established company in the business of manufacturing and distributing soft drinks in South Africa.

The company has recently appointed Funta Auditors Inc ("Funta") as its new auditor after a vacancy in the position has arisen. The audit committee of Cola nominated Funta for appointment, after being satisfied with the independence of Funta and, after determining and pre-approving the proposed agreement stating that the only non-audit service that Funta will provide, will be the completion and submission of Cola's annual income tax return from records provided by Cola. The audit committee further determined the fees to be paid to the auditor as well as the auditor's terms of engagement.

The audit committee of Cola consists of three directors, namely Mr Sparlotta, who is the managing director of Cola, Mr Pipsi CA (SA) who has recently resigned from the position as accounting officer of Cola and is now a non-executive director of Cola, and Mrs Swchappes who is a non-executive director of Cola. Mrs Swchappes has never been otherwise involved in any aspects relating to the company, and she has no relationship with the company.

Cola has recently purchased a 50% shareholding in a company called Lupton (Pty) Ltd ("Lupton"). Mr Pipsi is a director of Lupton, and he also draws up the financial statements of Lupton. Before the purchase of the 50% interest by Cola, Mr Pipsi was the only shareholder of Lupton. At the end of the 2014 financial year, Lupton's public interest score was calculated at 167 points.

REQUIRED**Marks**

1.1 Comment on the composition and duties of the audit committee of Cola-Cola Ltd as follows

(i) Discuss the composition of the audit committee by evaluating whether each of the three members is a suitable member in terms of the Companies Act and taking the general composition requirements into account.

(7)

(ii) List five other duties of the audit committee provided for in the Companies Act that are not mentioned in the scenario.

(5)**[TURN OVER]**

- 1.2 Complete the table below by indicating whether the company listed in the first column should have its annual financial statements audited or independently reviewed, or neither of the two. Select one of the three options in each case "Audit"/"Review"/"Neither" and provide a reason for your answer

Company	Audit/Review/Neither	Reason
Company owned by the state	(i)	
Company with a public interest score of more than 350, and financial statements externally compiled	(ii)	
Company with a public interest score of less than 100, and all shareholders are also directors	(iii)	
Public company (Ltd) not listed on the JSE	(iv)	
	½ mark each	1 mark each

(6)

- 1.3 Discuss whether the annual financial statements of Lupton (Pty) Ltd will be subject to an audit for the 2014 year under review. Formulate your answer by first listing the Companies Act requirements and then applying it to the scenario (10)
- 1.4 Discuss the Companies Act requirements that should have been complied with regarding the purchase of the shares in Lupton (Pty) Ltd by Cola-Cola Ltd relating to the interest that Mr Pipsi has in this transaction. Do not include any notice or quorum requirements in your answer. (8)

QUESTION 2**44 marks**

You are a chartered accountant and an expert on the Companies Act.

Oscars Ltd ("Oscars") is a company conducting business in the entertainment industry. The company produces television programmes, and the majority of its assets consist of several production studios that it owns in the Gauteng province.

During the 2014 financial year, Oscars experienced severe financial difficulties owing to major power disruptions that occurred during filming of two of its most popular television series, "Sesde Straat" and "Usidingo". This in return resulted in deadlines set by the television broadcaster not being met, and the broadcaster imposing large fines on Oscars.

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Below is an extract of the minutes of a meeting of the board of directors of Oscars

**OSCARS LTD
MINUTES OF MEETING OF THE BOARD OF DIRECTORS HELD ON
28 JANUARY 2014**

Present

Ms Angeline Jolly, chairman and independent non-executive director
Mr Brett Pitt, non-executive director
Mr Leonard DiCapri, non-executive director
Ms Marilyn Streep, finance director
Mr Jonathon Depp, managing director
Ms Jennifer Laurens, company secretary

Apologies

Ms Lupeeta Nyong'o, production and marketing director

Matters for discussion

1. Financial distress of the company

It was suggested by Mr Depp that all the production studios owned by the company be sold, and the cash used to pay outstanding creditors. Ms Jolly agreed, and pointed out that the company is currently in a net loss position on the face of its financial statements. Mr Pitt, however, disagreed and stated that he was sure that there were other options available for the company to turn its current financial position around, such as business rescue proceedings.

Ms Streep subsequently mentioned that even though load shedding was to blame for the power cuts that caused the financial problems, better planning, and perhaps the purchase of a generator, could have prevented the current financial dilemma. She suggested that it was in fact the person responsible for production, Ms Nyong'o, who was to blame and that Ms. Nyong'o should be dismissed as a result of her not acting in the best interest of the company.

The matter of dismissing Ms Nyong'o was subsequently put to vote, and the majority of the directors voted against her dismissal.

2. Directors' remuneration

Mr Depp proposed that even though the company faced financial difficulties, the introduction of e-tolling on Gauteng's roads warranted an increase in directors' remuneration.

The directors agreed, and it was unanimously accepted that a 21% salary increase for all directors will be effective immediately.

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REQUIRED**Marks**

- 2.1 Refer only to the first point on the agenda: Financial distress of the company**
- (i) Discuss the requirements that should be met if the board wishes to proceed with the sale of the production studios as suggested by Mr Depp, assuming that the company is not under business rescue **(10)**
- (ii) Complete the following sentence by writing down the answers for (a), (b) and (c)
In order to initiate business rescue proceedings, the board of a company should have reasonable grounds to believe that the company is (a) .. and there appears to be a (b) . . of (c) . . the company **(3)**
- (iii) Discuss the motion to remove Mrs Nyong'o as a director of Oscars by stating the requirements of the Companies Act and applying it to the scenario. **(8)**
- (iv) Mrs Nyong'o subsequently approached you for advice. You are required to do the following
- (a) Explain to her what the standards of conduct are with which she must comply as a director of Oscars **(12)**
- (b) Explain to her to whom in the company she should officially direct queries if she requires assistance in understanding her duties and responsibilities as a director. **(4)**
- 2.2 Keeping the first agenda point in mind, refer to the second point on the agenda: Directors' remuneration**
- Discuss the following
- (i) Whether Oscars is trading recklessly **(5)**
- (ii) The authority required to approve the salary increase **(2)**

QUESTION 3**20 marks**

You are the auditor in charge of the audit of LasVegas (Pty) Ltd ("LasVegas"), a company that consists of a chain of travel agencies. The board of LasVegas approved interest-free, unsecured loans in the amount of R800 000 each to two of its directors, Mr Bellagio and Mr Caesar, to enable them to purchase shares in LasVegas. The loans were approved at a board meeting by a majority vote of the directors of LasVegas. The board considered the solvency and liquidity requirements, and was satisfied that these requirements were met.

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Mr Bellagio and Mr Caesar have subsequently been informed that the shares they now hold will entitle them to receive dividends in LasVegas, but that these shares will have no voting rights LasVegas only has one class of share.

REQUIRED

- | | Marks |
|--|--------------|
| 3.1 Discuss the legality of the loans granted to Mr Bellagio and Mr Caesar as well as the possible consequences for the company and the directors who authorised these loans in terms of the Companies Act. | (10) |
| 3.2 Comment on the rights associated with the shares issued to Mr Bellagio and Mr Caesar in terms of the Companies Act | (10) |