Tutorial Letter 202/1/2017

LEGAL ASPECTS IN ACCOUNTANCY

AUE1601

Semester 1

Department of Auditing

IMPORTANT INFORMATION

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

BARCODE

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

SUGGESTED SOLUTION AND COMMENTS ON ASSIGNMENT 02/2017

QUESTION 1 — 26 marks

Specific comments

This question requires you to use all the information in the scenario. It consists of **theory**, (listing requirements of the Companies Act) **as well as** the **application** of the theory to the information in the question.

Please note: You need to know the theory very well, as you are not permitted to take a copy of the Companies Act into the examination room.

You should have noted that any requirements for notice of meetings and quorums **had to be included** in your answer. Marks will be allocated to these requirements. Please pay particular attention to exactly what is required of you. If the question had stipulated that you must ignore meeting and quorum requirements then we would not have allocated any marks for such requirements, which effectively means that you would only have wasted your time by including it in your answer.

The statutory requirements applicable to the proposed share issue had to be discussed. The requirements did not specify how you had to structure your answer. Thus, in order to earn the communication skills mark you had to communicate your answer in such a way that it was easy for the marker to understand and that your points had to flow logically from one to the other.

Suggested solution

1.1 Statutory requirements applicable to the proposed share issue

References: Learning unit: 3.1, Companies Act: sections 36, 38, 39, 40, 41, 58-65

Comment: You had to note the information presented in the table below in the planning of your answer.

Your answer should have included the following:

Authorisation for the shares	•Sec 36 and 38 (theory) •Apply the sections to the information given in the scenario
Subscription of shares	•Sec 39 (theory) •Apply the section to the information given in the scenario
Issue of shares to directors	•Sec 41 (theory) •Apply the section to the information given in the scenario
Consideration for the shares	•Sec 40 (theory) •Apply the section to the information given in the scenario
Shareholders meeting requirements	•Sec 58-66 (theory) •Apply the sections to the information given in the scenario
Securities register	•Sec 40 (theory) •Apply the section to the information given in the scenario

Authorisation for shares

1. The company has 350 000 shares already in issue, and wishes to issue a further 250 000 shares. However, the company has only 400 000 authorised shares✓.

2. The authorised share capital will therefore have to be increased to (at least) 600 000 shares✓.

2.1 The board can increase the number of authorised shares✓.

2.2 This in turn, will require an amendment to the MOI✓.

3. To amend the MOI, the board (or shareholders entitled to exercise at least 10% of the voting rights) must propose a special resolution✓ to authorise the amendment. (This will present no problem in this case as the board wishes to make the amendment.)

Subscription of shares

4. As Med (Pty) Ltd is a private company, all the existing shareholders have a pre-emptive right before any other person who is not a shareholder✓, to be offered to subscribe for a percentage of the shares to be issued.

4.1 The percentage offered must be equal to the voting power of those shareholders' general voting rights immediately before the offer was made✓.

4.2 This may present a problem for Med (Pty) Ltd because the intention was not to offer BioMed (Pty) Ltd✓ and the share scheme trust✓, any of the new shares,

4.3 *but* it was intended to offer shares to the two directors who are *not* existing shareholders✓. **(max 3 for part 4)**

Issue of shares to directors

5. As it is intended to offer shares to the directors, the issue must be approved by a special resolution✓. As the issue is not in proportion to existing holdings, the exemption for obtaining a special resolution does not come into play✓. (There are other exemptions which are not relevant✓.) **(max 2 for part 5)**

Consideration for the shares

6. It will also have to be determinable that the issue price of R40 was "adequate"✓. The board of directors must decide whether the "consideration" of R40 is adequate, and if they have done so, the R40 cannot be challenged on any basis other than the directors not having acted in good faith, or in the best interests of the company and with the degree of skill and diligence reasonably expected of a director✓.

Shareholders meeting requirements

7. As can be seen from the above, two special resolutions✓ are needed for this issue (even after resolving the pre-emptive rights issue). Thus a meeting of shareholders must be called✓.

7.1 *Notice*: 10 business days prior to the meeting✓ (assuming MOI is silent).

7.2 *Notice must include*:

* date, time and location of meeting✓
* general purpose of the meeting✓

* copies of the proposed special resolutions✓ (special resolutions in this case)
* voting percentages required to pass the resolutions✓ (75%)
* a reasonably prominent statement that a shareholder may appoint a proxy and the proxy need not be a shareholder✓
* a reasonably prominent statement that personal identification is required to attend the meeting✓ **(max 2 for part 7.2)**

7.3 *Quorum* : "votes" quorum ─ the meeting may not begin until persons holding 25% of voting rights for at least one matter to be resolved, are present✓ (the attendance of only the three shareholders/directors would satisfy this) *and*
"person" quorum ─ at least three shareholders are present✓

7.4 *Resolution voting*: as these are special resolutions, 75% of the voting rights exercised on the resolution must be in favour✓. (In this case the three shareholders/directors would require the help of other shareholders if all shareholders attended the meeting✓.)

8. If the board makes the issue without increasing the authorised share capital, the issue can be retroactively ratified by special resolution✓.

8.1 If this resolution is not passed, the issue is null and void✓ (money repaid, share certificates and entries in the share register nullified).

Securities register

9. Only once the full consideration (R40 per share) has been received, will the shares be fully paid✓. At this point the shareholders' details must be entered in the share register✓.

Maximum marks (25)

Communication skills: Clarity of expression and logical flow of arguments (1)

(Source: Adapted from Graded questions on Auditing 2014: Question 13.15)

QUESTION 2 57 marks

Specific comments

This is a good example of an integrated question as it covers the **theory** in the Companies Act, as well as the **application** of the requirements as per the Companies Act to the information given in the scenario. In essence, the question consisted of three parts namely, the removal of a director (section 71), a director's personal financial interest (section 75) and loans to directors (section 45).

Please take note of the mark allocation as it is an indication of how much time should be spent on each section of the question. Once again, it was important that your answer be presented clearly and logically for you to earn the communication skills mark.

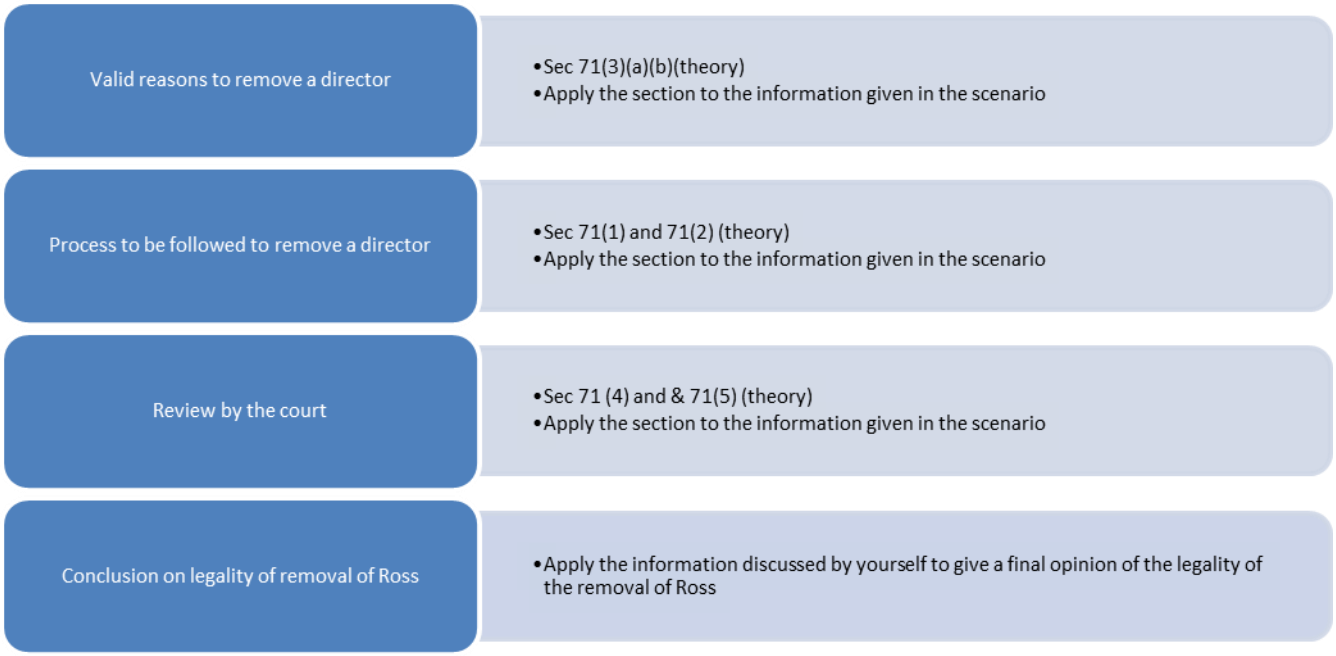
Suggested solution

2.1 Removal of director from the board of directors

References: Learning unit: 4.1.2, Companies Act: section 71

Comment: You had to note the information presented in the table below when you planned your answer.

You had to refer to the information in the first paragraph of the question when you attempted to answer question 2.1.



Valid reasons to remove a director from the board

1. In terms of sec 71, the **board** may remove a director but only if it is alleged by a shareholder or a director and accepted by the board, that the said director is …

1.1 ineligible or disqualified from being a director✓ (in terms of the Act), or

1.2 incapacitated to the extent that the director is unable to perform the functions of a director✓, or

1.3 has neglected, or been derelict in the performance of the functions of a director✓.

Comment: This theory is per the Companies Act, section 71(3) (a), (b).

2. Based on the information given in the question, none of these apply to Ross McKewan✓^; indeed it would appear that he is fulfilling his function very well, despite being unable to prevent Barry Black from acting illegally and probably being derelict in the performance of **his** duties✓^.

Comment: You were required to apply the theory to the information in the scenario.

Process to be followed to remove a director

3. Even if Barry Black was intent on removing Ross McKewan from the board for any of the above reasons, he, Barry Black, would have to call another meeting of the directors at which Ross McKewan's removal would be proposed✓. Ross McKewan would have to be provided with

3.1 Notice of this meeting✓, including a copy of the proposed resolution✓ and a statement setting out the reasons for the resolution with sufficient specificity✓ to reasonably permit Ross McKewan to prepare and present a response✓.

3.2 A reasonable opportunity to make a presentation to the meeting before the resolution is put to the vote✓.

Comment: This is the process which needs to be followed as per the Companies Act.

(max 4 for part 3)

Review by the court

4. In this presentation, Ross McKewan would be fully entitled to disclose Barry Black's contraventions of the Act in his own defence✓. If the directors still vote to remove Ross McKewan, he may apply within 20 business days to a court to review the decision of the board✓.

Conclusion on legality of removal of Ross

5. As it stands, the current resolution to remove Ross McKewan is totally invalid and he remains a director✓. He should notify Barry Black, the other directors, and the shareholders (who would probably have appointed him in the first place) of the situation. If Barry Black still wishes to have Ross McKewan removed, he would either have to

5.1 Proceed as outlined in 1 to 3 above✓.

5.2 Request the shareholders to effect the removal✓. However, this would require the shareholders to pass an ordinary resolution to remove Ross McKewan ***after*** affording him the right to make representations✓.

Maximum marks (16)

2.2 Matter 1: Director's personal financial interest

References: Learning units: 4.3.1 and 4.4.1, Companies Act: sections 75 and 76

Comment: **You had to** note the information presented in the table below when you planned your answer.

Personal financial interest and related person	•Sec 1 & 2 & 75(1)-(4) •Apply the section to the information given in the scenario
Requiremetns of the director in terms of sec 75(5)	•Sec 75(5) (theory) •Apply the section to the information given in the scenario
Standards of directors' conduct	•Sec 76(theory) •Apply the section to the information given in the scenario
Requirements to be fulfilled for the contract to be valid	•Sec 75(7)(theory) •Apply the information discussed by yourself to give a final opinion of the whether or not the contract will be valid.
Conclusion	•Sec 76 (2) & 76(3)

Personal financial interest and related person

1. This is a contract in which Barry Black has a personal financial interest by virtue of the fact that he is "related" (by definition) to the party✓, Singer Designs, with whom Saska (Pty) Ltd has contracted on the strength of a directors' resolution. The owners of Singer Designs are his wife and daughter✓.

Requirements of the director in terms of sec 75(5)

2. Barry Black should therefore have

2.1 Disclosed the interest and its general nature to the meeting before the contract was discussed✓.

2.2 Disclosed any material information he had about the contract✓.

2.3 Disclosed any observations/insights he had about the contract if requested to by the directors✓. No doubt Ross McKewan and the other directors would have wanted Barry Black's opinion on why the Singer Designs contract was more expensive, had they known of his interest✓^.

2.4 Left the meeting immediately after having made the disclosures to the meeting✓.

2.5 Taken no part in the deliberations on the proposal to award the contract✓. He did take part, actually convincing the other directors on which one to vote for✓^.

2.6 Had no right to vote on the decision✓.

Comment: The theory is based on section 75 of the Companies Act and it was necessary to apply it to the information given in the scenario.

(max 7 for part 2)

Standards of directors' conduct

3. As it stands, this contract is invalid as it was approved without disclosure and Ross McKewan is, as a director, entitled (if not obliged in terms of section 76(2)) to communicate this information to the board✓.

Requirements to be fulfilled for the contract to be valid

4. Barry Black would then have the option of

4.1 Having the contract ratified by an ordinary resolution of the shareholders after making full disclosure✓, or (section 75(7) (b))

4.2 Reconvening a directors meeting disclosing his interest and having the directors vote again on the contract✓.

Conclusion

5. As it stands, Barry Black appears to be in breach of sec 76, which deals with the standard applicable to directors' conduct✓. Barry Black has contravened this section in that

5.1 He has ***used his position*** as a director to gain an advantage for himself by having a lucrative contract awarded to his family✓^.

5.2 He did not ***communicate*** information to the board which he should have disclosed – financial interest✓^.

5.3 He has not exercised his ***powers and functions*** as a director …

- in good faith and for a proper purpose✓^
- in the best interests of the company✓^.

Comment: You were required to apply the theory in sections 76(2) and 76(3) to the information in the scenario.

It appears that Barry Black has made a "secret profit" at the expense of the company by getting the directors to accept an expensive (inflated) contract from which he will benefit✓.

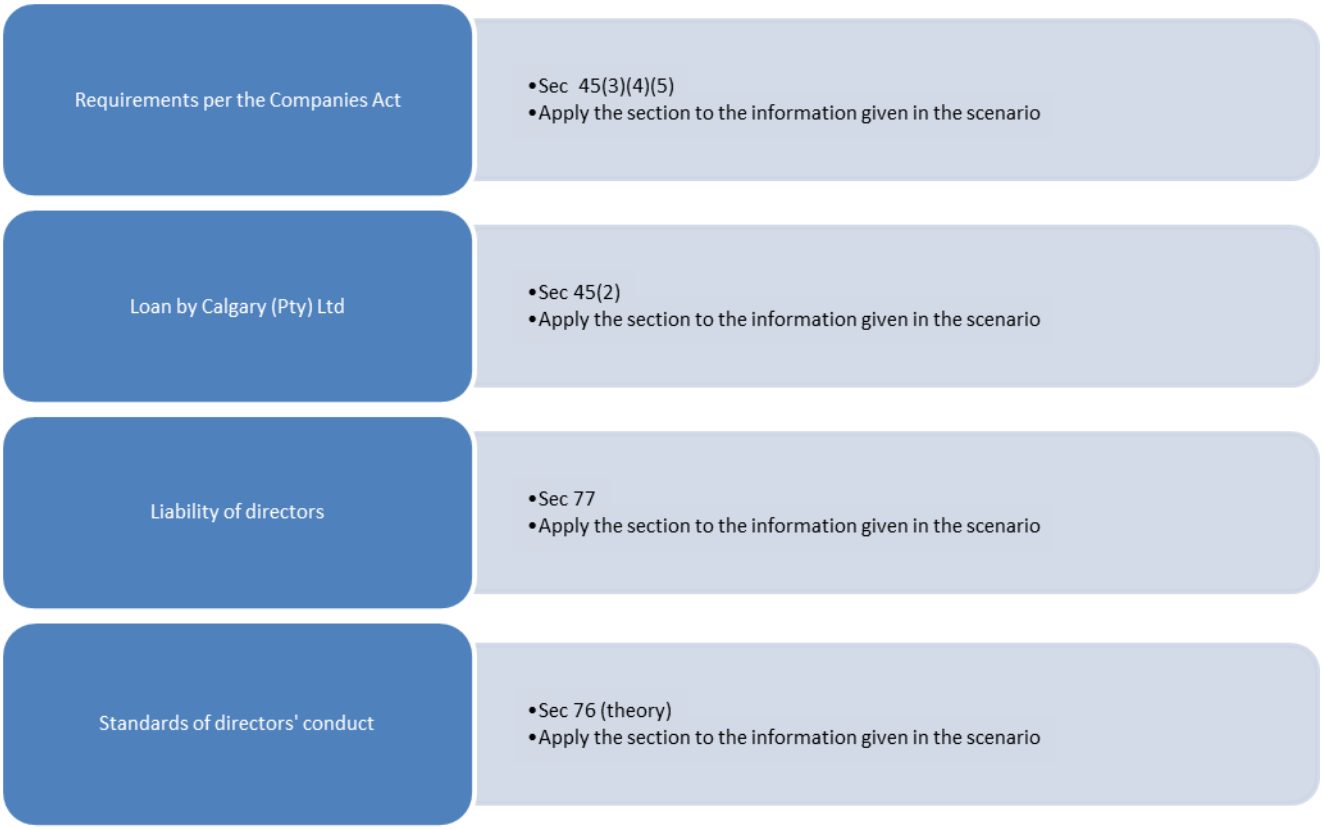
Maximum marks (20)

Communication skills: Clarity of expression and logical flow of arguments (1)

2.3 Matter 2: Loan to director

References: Learning units: 4.4.1, 4.4.2 and 6.2, Companies Act: sections 45, 76 and 77

Comment: You had to note the information presented in the table below when you planned your answer.



Requirements per the Companies Act

1. A company is perfectly entitled to make a loan to one of its directors provided (sec 45)

1.1 Any conditions or restrictions in respect of making the loan contained in the MOI✓`, are adhered to, and

1.2 The board is satisfied that …

- immediately after providing the loan (financial assistance), the company would satisfy the solvency and liquidity test✓ – no consideration seems to have been given to this✓^
- the terms under which the loan is proposed, are fair and reasonable✓ (a R2m interest-free loan is neither fair nor reasonable✓^), and
- a special resolution is obtained✓.

(max 6 for part 1)

2. The special resolution could be one which had been passed within the last two years, giving authority for a loan to a specific recipient✓; (it is obviously not the case here✓^), or it could be one giving general authority to a category of potential recipients✓, for example directors.

2.1 However, it appears that no such authority exists✓^ as the authority for this loan is the "personal authorisation by Barry Black in his capacity as chairman".

2.2 In terms of the Companies Act there is no such thing as the "personal authority of the chairman"✓.

Loan by Calgary (Pty) Ltd

3. Barry Black's intention to have the loan made by Calgary (Pty) Ltd because Ben Johnson is "not a director of Calgary (Pty) Ltd" is strange✓^ as sec 45 makes it perfectly clear that a company can make a loan to the director of a related company✓ [Calgary (Pty) Ltd is a subsidiary of Saska (Pty) Ltd and therefore is related]✓ (by definition), ***provided*** all the same conditions as described above, are met. **(max 2.5 for part 1)**

4. If by his actions, however, Barry Black is trying to hide the loan from the shareholders✓^ of Saska (Pty) Ltd/Calgary (Pty) Ltd, he will not succeed as shareholders must be notified of the granting of this loan within the stipulated time periods depending on the size of the loan✓.

Liability of directors

5. As it stands, this loan is void✓ and in terms of sec 77, the directors who voted in favour of the loan may be jointly and severally liable for any loss, damage or costs arising as a direct or indirect consequence of approving the loan, for example if it is not repaid in full✓.

Standards of directors' conduct

6. Barry Black's actions appear to be in serious contravention of sec 76 ✓(Standards of Conduct).

Comment: It can be seen from the solution that the Companies Act requirements are required to be stated and then the information supplied in the scenario is to be considered when discussing whether or not each of the requirements have been complied with or not.

Maximum marks (20)

(Source: Adapted from Graded questions on Auditing 2014: Question 13.17)

OTHER ASSESSMENT METHODS

QUESTION 1 **50 marks**

1.1 Channing Communications

References: Learning unit: 1.1.3 and Companies Act: sections 8 and 10, and Companies Regulation 27

Company	**1.1.1 Designation** **(1 mark each)**	**1.1.2 Number of directors** **(1 mark each)**	**1.1.3 Is a company secretary required? (Yes or No)** **(1 mark each)**	**1.1.4 Is an audit committee required? (Yes or No)** **(1 mark each)**
JMM Kitchenware	Proprietary limited or (Pty) Ltd✓	1✓	No✓	No✓
Channing Communications	Limited or Ltd✓	3✓	Yes✓	Yes✓

Available (8)
Max (8)

Communication skills: Answer had to be presented in tabular format. **(1)**

1.2 Public interest score, requirement to be audited or reviewed; and company records

References: Learning unit: 2.1.2 and Companies Act: sections 24, 29 and 30, and Companies Regulations 26 and 27

1.2.1 Public Interest score

The public interest score for the year ended 30 June 2016 is calculated as the sum of the following:

- JMM employed an average of 20 employees, which equals 20✓ points. As each employee earns 1 point✓. **(2)**
- JMM had third-party liabilities totalling R3,5 million, which is equal to 4✓ points. Each R1 million or part thereof equals 1 point✓. **(2)**
- JMM had a turnover of R15 million, which equals 15✓ points. Each R1 million in turnover equals 1 point✓. **(2)**
- JMM has 6 shareholders, which equals 6✓ points. Each security holder of the company earns 1 point✓. **(2)**

Calculation:
20+4+15+6=45✓ **(1)**

Available (9)
Max (8)

Communication skills: Clarity of expression **(1)**

1.2.2 **Audit or review required**

JMM's financial statements should be reviewed✓ as the public interest score is below 100✓ (an audit is therefore not required). **(2)**

Available (2)
Max (2)

1.2.3 **Company records**

Every company must maintain the following records:

- a Copy of the Memorandum of Incorporation (MOI)✓ (and any amendments, etc, thereto) **(1)**
- a Record of its directors' details✓ **(1)**
- Copies of all reports presented at an annual general meeting✓ **(1)**
- Copies of annual financial statements✓ **(1)**
- Copies of accounting records as required by the Act✓ **(1)**
- Notices and minutes of all shareholders' meetings✓, including all resolutions adopted **(1)**
- Copies of all communications sent to shareholders✓ **(1)**
- Minutes of all meetings of directors, or directors' committees and of the audit committee✓(max 1)
- Securities register **(1)**

Available (9)
Max (4)

1.3 Worksheet to be completed by trainee auditors

References: Learning units 1.1.1, 1.2.2 and 2.1.2 and Companies Act: sections 2(a), 15 and 30

1.3.1 Consanguinity✓ **(1)**

1.3.2 Second degree✓ **(1)**

1.3.3 In terms of section 15(6), a company's MOI is **binding**:

(a) Between the **company and each shareholder**✓; **(1)**
(b) Between or **among the shareholders**✓ of the company; and **(1)**
(c) Between the **company and**
  (i) **each director**✓ or prescribed officer of the company; or **(1)**
  (ii) **any other person serving the company as a member of a committee of the board**✓, in the exercise of their respective functions within the company. **(1)**

Available (4)
Max (3)

1.3.4 6 months✓ **(1)**

1.4 Appointment of auditors for BB

References: Learning unit 5.3.1 and Companies Act: section 90

1.4.1 Requirements to be appointed as auditors in terms of the Companies Act

In terms of section 90, to be appointed as an auditor of a company, a person or firm must …

(a) be a **registered auditor ✓;** **(1)**

(b) **not be** …

(i) **a director** or prescribed officer **of the company**✓; **(1)**

(ii) **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)**

(iii) a director, officer or employee of **a person appointed as company secretary**✓**;** **(1)**

(iv) **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)**

(v) **a person** who, at **any time during the five financial years immediately preceding the date of appointment**, was a person contemplated in any of the four subparagraphs (i)–(iv) **above**✓; (e.g. must not have been a director for any period during the preceding five years); **(1)**

(vi) or a person **related to a person** contemplated in the subparagraphs **above**✓; and **(1)**

(c) be acceptable to the company's audit committee as being **independent**✓ of the company. **(1)**

Available (8)

Max (5)

1.4.2 Eligibility of individuals/firms to be appointed as auditor of BB

- ***William Fair*** cannot be appointed^. The firm is registered with the IRBA and is not excluded by section 90 of the Companies Act. However, William Fair has a direct financial interest in the firm as he is a shareholder✓^. **(2)**
- **Mark Smith** is ineligible to be appointed as the auditor of BB^. Mark Smith is a partner at Up n Up Incorporated, a registered auditing firm; however, he is the husband of Bev Smith who is a director of BB. Mark is therefore **related** to a director of BB✓^. **(2)**
- ***George Simon*** cannot (at this stage) be appointed^ as he is disqualified by section 90 of the Companies Act. Although he is a registered auditor, he was up until three years ago, a director of BB. Section 90 requires a five-year period to have elapsed before a former director can take up the position of auditor✓^. **(2)**
- ***Lauren Sinclair*** could be appointed ^. She is registered with the IRBA✓^. The holiday work she performed at BB is not seen as threatening her independence and it was also more than five years ago. **(2)**

Available (8)

Max (8)

1.5 Removal of a director from the board

References: Learning unit 4.1.2 and Companies Act: section 71

1.5.1 Reasons for a director to be removed from the board of directors

In terms of sec 71(3), the ***board*** may remove a director but only if it is alleged by a shareholder or a director and accepted by the board, that the said director is …

- ineligible or disqualified from being a director✓ (in terms of the Act), or **(1)**
- incapacitated to the extent that the director is unable to perform the functions of a director ✓, or **(1)**
- has neglected, or been derelict in the performance of the functions of a director ✓. **(1)**

Available (3)
Max (2)

1.5.2 The process that must be followed by the board to remove a director in terms of sec 71(4):

- If the directors intend to remove a director, they must give the director concerned notice of the meeting✓ and a copy of the proposed resolution to remove such director✓. **(2)**
- The director must also be given a statement setting out the reason for the resolution✓, which is sufficiently specified to reasonably permit the director to prepare and present a response✓. **(2)**
- The director concerned should be given a reasonable opportunity to make a presentation in person or through a representative to the meeting before the resolution is put to the vote✓. **(1)**

Available (5)
Max (3)

1.5.3 Indicate whether or not the correct process was followed

No^, no notice of the meeting or the proposed resolution was given to Deviya✓^. No statement setting out the reason for the resolution was given to her✓^ and she was not given a reasonable opportunity to make a presentation to the meeting✓^.

Available (5)
Max (2)

QUESTION 2 — 50 marks

2.1.1 Requirements for directors to issue shares to shareholders

References: Learning units 3.1.4, 3.1.5 and 3.3.3 and Companies Act: sections 36 and 38

In terms of section 38, the **board of a company (directors)** may resolve **to issue shares of the company at any time (board resolution)✓,** **(1)**

but only within the same classes and to the extent that the **shares have been authorised**✓ or **(1)**

in terms of the company's Memorandum of Incorporation (MOI), in accordance with section 36✓. **(1)**

In terms of section 38, **if the board issues shares** which have not been authorised or **are in excess of the number of authorised shares as per the MOI✓,** **(1)**
the **issue can be retroactively ratified by a special resolution** (section 36) within 60 business days after the date on which the shares were issued✓. **(1)**
Available (5)
Max (3)

2.1.2 Impact of additional share issue on authorised share capital

References: Learning units 3.1.2 and 3.3.3 and Companies Act: sections 16 and 36

Frozen-berry has an **authorised share capital of 80 000 ordinary shares, of which 60 000 is issued✓^.** **(1½)**

The **50 000 additional shares** to be issued will be in **excess of the 20 000 authorised shares available for issue** as per the MOI✓^. **(1½)**

Frozen-berry must therefore **increase its authorised share capital by 30 000✓^.** **(1½)**

by amending the MOI✓^. **(1½)**

Frozen-berry's board **must file a Notice of Amendment of its MOI**, setting out the changes effected by the board✓^. **(1½)**
Available (7½)
Max (5)

2.1.3 Authorisation required for additional share issue to shareholders

References: Learning units 3.1.4, 3.1.5 and 3.3.3 and Companies Act: sections 36 and 38

In terms of section 38, the **board of a company (directors)** may resolve **to issue shares of the company at any time (board resolution)✓,** **(1)**

In terms of section 38, **if the board issues shares** which have not been authorised or **are in excess of the number of authorised shares as per the MOI✓,** the **issue can be retroactively ratified by a special resolution** (section 36) within 60 business days after the date on which the shares were issued✓. **(2)**

In terms of section 36, the authorisation and classification of shares, **the number of authorised shares of each class**, and the preferences, rights, limitations and other terms associated with each class of shares, as set out in a company's MOI, **may be changed only by** …✓ **(1)**

- an **amendment of the MOI by special resolution** of the shareholders✓; or **(1)**
- the **board** of the company✓, **except to the extent that the MOI provides otherwise✓**. but take note of **(a)** below: **(2)**

Note **(a) (Max 2)** **(2)**

- The board may increase or decrease the number of authorised shares for any class of shares✓;
- Reclassify any classified authorised but unissued shares✓;
- Classify any unclassified shares✓;
- Determine the preferences, rights and limitations of any shares ✓.

If any of the above actions are carried out by the directors the **MOI must still be amended and** a Notice of Amendment (MOI) should be filed✓.

Available (9)
Max (2)

2.1.4 Authorisation required for issuing shares to directors

References: Learning units 3.1.4, 3.1.5 and 3.3.3 and Companies Act: section 41

In terms of section 41, this issue of shares must be **approved by special resolution**✓ of the **shareholders**✓ because it is intended that Frozen-berry will issue shares to the **directors**. **(2)**

In certain instances a special resolution is **not required**, however, that **does not apply** in this situation since: **(Max 4½)**

- The issue is not under an agreement underwriting the shares✓^. **(1½)**
- The directors do not have a pre-emptive right as they are not shareholders✓^. **(1½)**
- The issue is not in proportion to existing holdings✓^. **(1½)**
- The issue is not pursuant to an employee share scheme or underwriting agreement✓^. **(1½)**
- The issue is not offered to the public (it is offered to the directors)^. **(1½)**

Available (6)
Max (3)

2.1.5 Determination of the consideration for additional shares to be issued

References: Learning units 3.1.1, 3.1.2 and 3.3 and Companies Act: sections 40, 76 and 77

In terms of the Companies Act (section 40) the board **may issue authorised shares only for adequate consideration** as determined by the board✓. **(1)**

Before a company issues any particular shares, the **board must determine the consideration** for which, and the terms on which, those shares will be issued✓. **(1)**

A **determination by the board of a company as to the adequacy of consideration for any shares may not be challenged** on any basis other than in terms of section 76, read with section 77(2)✓. **(1)**

Available (3)
Max (2)

2.1.6 Consideration for issued shares

References: Learning units 3.1.1, 3.1.2 and 3.3 and Companies Act: section 40

Frozen-berry's shares will **be issued at the fair value** of the shares✓^, **(1½)**

which can be **regarded as adequate consideration as determined by the board**✓^. **(1½)**

Available (3)
Max (2)

Communication skills: Application of theory **(1)**

2.2 Disposal of greater part of a company's assets

References: Learning unit 6.3.1 and Companies Act: Sections 112, 115 and 164

2.2.1 Requirements in order to dispose of the greater part of a company's assets

In terms of section 112, **despite any provision of a company's MOI**✓, **(1)**

a company may not dispose of all or the greater part of its assets, unless the disposal **has been approved by a special resolution** (75%) of the shareholders✓; and **(1)**

section 112 also provides that the **notice** convening the meeting of shareholders for considering the **special resolution**✓ **(1)**

must be delivered within the **prescribed time and in the prescribed manner** to each shareholder of the company✓. **(1)**

Each such notice must be accompanied by:

(a) A written summary of the **precise terms of the transaction to be considered** at the meeting✓; and **(1)**

(b) Reference to the provisions of section 115 ─ the **specific approval required**✓; and **(1)**

(c) Reference to section 164 ─ indicating the **shareholders' rights**, **should the special resolution be passed, but where there are dissenting shareholders✓. (1)**

Any part of the assets of a company to be disposed of, as contemplated in this section, must be given its **fair market value** as at the date of the proposal✓, in accordance with **(1)**

the **financial reporting standards✓. (1)**

Available (9)

Max (6)

2.2.2 The legality of the disposal of Frozen-berry's assets in terms of the Companies Act.

The transaction is **in fact** the selling of the **greater part of the company's assets✓^, (1½)**

since the **book value of** the frozen yogurt machines **that will be sold (R12 million)**✓^ **(1½)**

is more than 50% of the book value of the total assets (R20 million)✓^. **(1½)**

The **disposal** of the frozen yogurt machines was **approved by a director's resolution**✓^ **(1½)**

and therefore **no special resolution was obtained** as required✓^. **(1½)**

The directors also **did not deem it necessary to inform the shareholders of the company, therefore no notice has been sent** out to any of Frozen-berry's shareholders✓^. **(1½)**

Based on the information, **the disposal of the frozen yogurt machines will be illegal,** thereby constituting a breach of the Companies Act, 2008✓^. **(1½)**

Available (10½)

Max (6)

Communication skills: Application of theory **(1)**

2.3.1 Requirements for the declaration of a dividend

References: Learning unit 3.1.6 and Companies Act: section 46

In terms of section 46, a company must **not** make any proposed distribution unless the distribution;

a) (i) **is pursuant to an existing legal obligation** of the company✓, **(1)**
or a court order✓; or **(1)**
(ii) **the board of the company, by resolution, has authorised** the distribution✓. **(1)**

b) it reasonably appears that the company will **satisfy** the **solvency and liquidity test** immediately after completing the proposed distribution✓. **(1)**

c) the **board of the company**, 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)**

Available (5)
Max (4)

2.3.2 Discussion whether Frozen-berry complied with the Companies Act in terms of the declaration of a dividend

References: Learning unit 3.1.6 and Companies Act: sections 46, 76 and 77

As total liabilities exceed total assets by R6 million (R26 million minus R20 million)✓^, **(1½)**

therefore Frozen-berry is **not solvent**✓^. **(1½)**

As current liabilities exceed current assets by R9 million (R15 million minus R6 million)✓^**,** **(1½)**

therefore Frozen-berry is **not liquid**✓^. **(1½)**

The **board of Frozen-berry, by resolution, has acknowledged that it did not apply the solvency and liquidity test**, as they did not calculate or consider the impact of the declared dividend on the financial results✓^. **(1½)**

The board of the company resolved at the board meeting to declare the dividend of R300 000 and has therefore authorised the distribution✓^. **(1½)**

During the board meeting, the **directors neglected to apply the solvency and liquidity test✓^.** **(1½)**

The directors will be **jointly and severally liable for losses** sustained by the company in terms of the Companies Act (sections 76 and 77) ✓^ **(1½)**

Therefore the **dividend distribution will not be valid,** since **not** all of the requirements in terms of section 46 of the Companies Act, 2008 have been complied with. **(1½)**

Available (15)
Max (8)

Communication skills: Application of theory **(1)**

2.4.1 Companies Act requirements with regard to business rescue proceedings

References: Learning unit 7.2.1 and Companies Act: sections 128 and 129

The board of a company may resolve that the company voluntarily begin with business rescue proceedings **if the board has reasonable grounds to believe✓ that** **(1)**

The company is **financially distressed✓** **(1)**
There is a **reasonable prospect** that the company can be **rescued** **(1)**
Available (3)
Max (2)

2.4.2 Explain whether or not Frozen-berry can voluntarily begin with business rescue proceedings

References: Learning unit 7.2.1 and Companies Act: sections 128 and 129

Frozen-berry is not solvent as total liabilities exceed total assets by R6 million (R26 million minus R20 million)✓^, and **(1½)**

Frozen-berry is not liquid as current liabilities exceed current assets by R9 million (R15 million minus R6 million)✓^**,** **(1½)**

According to Mr Hans Seagull, there are **reasonable prospects** for the company to be rescued due to a new marketing strategy which will be implemented in the next financial year✓^. **(1½)**
Available (6)
Max (2)

2.5.1 List possible whistle-blowers in respect of section 159

References: Learning unit 7.3.1 and Companies Act: section 159

Shareholders✓ **(1)**
Directors✓ **(1)**
Company secretary✓ **(1)**
Prescribed officers✓ **(1)**
Employees✓ **(1)**
Trade unions✓ **(1)**
Other representatives of employees✓ **(1)**
Suppliers of goods or services✓ **(1)**
Employees of such suppliers✓ **(1)**
Available (9)
Max (2)