

Tutorial Letter 202/2/2018

LEGAL ASPECTS IN ACCOUNTANCY

AUE1601

Semester 2

Department of Auditing

IMPORTANT INFORMATION

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

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

SUGGESTED SOLUTION AND COMMENTS ON ASSIGNMENT 02/2018

QUESTION 1

40 marks

Specific comments

- 1.1** Question 1.1 tests your knowledge of sections 2 and 3 of the Companies Act and your ability to **motivate** whether or not the parties involved are **related**. Detailed reasons should be provided.
- 1.2** Question 1.2 deals with **financial assistance provided to directors** as per section 45 of the Companies Act. Students should know the statutory requirements (in terms of the Companies Act) very well and discuss both **theory** and **application** under the respective headings. You should be guided by the mark allocation when structuring your answer to avoid writing too much or too little.
- 1.3** Question 1.3 requires students to describe the relevant requirements as per sections 69 and 71 of the Companies Act with regard to the **removal of directors**. In this question, **only theory** was required. 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.

Suggested solution

1.1 RELATED PARTY TO I-ROLL

- References:**
- Learning unit: 1.1.1
 - Companies Act: sections 2 and 3

In terms of section 2 of the Companies Act, an individual is related to another individual if the two individuals are separated by no more than two degrees of natural or adopted consanguinity (relationship by blood) or affinity (relationship by marriage). (1)

Minnesh Crossing is the son of Wasseem Crossing, the financial director of I-Roll, and they are not separated by more than two degrees of consanguinity. (1)

Therefore, Minnesh Crossing is a related party of Wasseem Crossing. (1)

Total (3)

1.2 COMPANIES ACT REQUIREMENTS FOR GRANTING OF THE LOAN TO MINNESH CROSSING

- References:** Learning unit 6.2, Companies Act: sections 45 and 62

1.2.1 Granting of a loan to a person related to a director

In terms of section 45, except to the extent that the Memorandum of Incorporation (MOI) provides otherwise (1)

the board may authorise the company (1)

any conditions or restrictions in respect of the granting of financial assistance set out in the MOI are satisfied (1)

The board is satisfied that immediately after providing the financial assistance the company will satisfy the solvency and (1)

liquidity test. (1)

The terms of the loan should be fair and just. (1)

Total (6)

Max (4)

1.2.2 Authorisation to approve loans to directors or related parties

The following authorisation is required in order for the board to grant the loan:

A special resolution by shareholders (1)

adopted within the previous two years, approving the loan to a specific recipient or generally for a category of potential recipients. (1)

Total (2)

1.2.3 Requirements to give notice to approve loans to related parties

Prior approval by shareholders within the previous two years in terms of section 45(3)(a)(ii)

Written notice of the resolution by the board of directors of the company to grant a loan to a related party must be given to (section 45(5)): (1)

all shareholders of the company or (1)

unless every shareholder is also a director of the company, and to (1)

to any trade union representing the company's employees; (1)

within 10 business days after adoption of the resolution by the board of I-Roll; (1)

if the value of the financial assistance exceeds one-tenth of 0.1% of the net worth of I-Roll's at the time of the resolution; (1)

or else the notice must be given within 30 business days after the end of the company's financial year. (1)

Total (7)

Max (6)

1.3 Whether the granting of the loan was legal or not

Loan to a related person

Minnesh Crossing is the son of Waseem Crossing (financial director) and is therefore a person related to a director. (1)

The loan was granted after the board evaluated whether all the conditions and restrictions in respect of the granting of financial assistance set out in the MOI have been satisfied. (1)

I-Roll does satisfy the solvency requirements after granting the loan (1)

the assets of the company fairly valued, exceed the liabilities of the company fairly valued, since the net asset value is R5 million. (1)

I-Roll meets the liquidity requirements after granting the loan, (1)

since the current assets (R5 million) exceed the current liabilities (R2.5 million). (1)

It is not possible to conclude whether or not the terms of the loan was fair and just due to limited information provided in the scenario. (1)

Approval of the loan

This is the first time this type of loan was approved and granted by the board of I-Roll, thus a special resolution of shareholders was not obtained within the previous two years, approving loans to directors and related parties (recipient/category of potential recipients). (1)

Notice of the resolution taken by the board

A notice of the resolution was sent to all the shareholders on 20 July 2018, (1)

more than 10 business days after the adoption of the resolution by the board. (1)

It should have been sent out within 10 business days after adoption of the resolution, as the loan of R1 million to Minnesh Crossing exceeds one-tenth of 0.1% of the net worth of I-Roll of R5000 (R5 million x 0.1x1%). (1)

Conclusion

Based on the information provided, the loan to Minnesh was made in contravention of section 45 of the Companies Act and it is therefore illegal. The requisite approval was not obtained from the shareholders (approved and granted by the board). (1)

Total (12)

Max (10)

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

Grand Total (23)

1.4 REMOVAL OF DIRECTOR

References: - Learning unit 4.1.2
- Companies Act: sections 69 and 71

In terms of section 71, despite anything to the contrary in the MOI; (1)

A director may be removed by an ordinary resolution at a shareholders' meeting by the persons entitled to exercise voting rights in the election of a director. (1)

- Before the shareholders of a company may consider such a resolution: (1)
 The director must be given notice of the meeting and the resolution to remove him. (1)
- The notice period must be at least equivalent to that which a shareholder is entitled to receive: (1)
- 15 business days for public companies (I-Roll Limited), or any longer notice per MOI; and (1)
- the director must be afforded a reasonable opportunity to make a presentation (in person or through a representative) to the meeting before voting takes place. (1)
- If a company has more than two directors, (1)
- and a shareholder or director has alleged that a director of the company has become ineligible or disqualified in terms of section 69, other than on the grounds contemplated in section 69 (8) (a); or (1)
- become incapacitated to the extent that the director is unable to perform the functions of a director, and is unlikely to regain that capacity within a reasonable time; or (1)
- has neglected, or been derelict in the performance of, the functions of director. (1)
- The board, other than the director concerned, must determine the matter by resolution and may remove that director. (1)
- Before the board of a company may consider a resolution, the director concerned must be given notice of the meeting, (1)
- including a copy of the proposed resolution and a statement setting out reasons for the resolution, with sufficient specificity to reasonably permit the director to prepare and present a response; and (1)
- a reasonable opportunity to make a presentation, in person or through a representative, to the meeting before the resolution is put to a vote. (1)
- Total (14)
Max (15)

QUESTION 2

50 marks

Specific comments

- 2.1** Question 2.1 tests various Companies Act requirements relating to shares in general and the **share issue** of 30 000 shares to Anamalia (Proprietary) Limited, a **company that is related to a director**. It is very important for students to structure their answers under the respective headings provided in the question. Students should know the statutory requirements (in terms of the Companies Act) very well and understand how to apply the theory to the information in the scenario. You should be guided by the **mark allocation** when structuring your answer to avoid writing too much or too little.
- 2.2** Question 2.2.1 and 2.2.2 deal with a **share buyback** transaction as the company buys back its own shares. Question 2.2.1 only requires **theory** in respect of sections 46 and 48 of the

Companies Act. Question 2.2.2 requires students to **apply** their knowledge to the theory to be able to conclude on the legality of the share buyback transaction.

2.3 Question 2.3 only requires **theory** with regard to **pre-incorporation contracts**. 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.

Suggested solution

2.1 MATTER 1: SHARE ISSUE OF 30 000 SHARES

References:

- Learning units 3.1.2, 3.1.4, 3.3.2, 3.3.3, 4.4.1, 4.4.2 and 6.2.1
- Companies Act: sections 16, 36, 38, 40, 41, 62, 64, 65, 76 and 77

Authority of the board to issue shares

In terms of section 38(1), the board of Barking Mad may resolve to issue shares of the company at any time, (1)

but only within the classes and to the extent that the shares have been authorised by or in terms of Barking Mad's MOI, in accordance with section 36. (1)

Total (2)

Authorised shares available for issue

Barking Mad Limited has an authorised share capital of 100 000 ordinary shares, 80 000 of which are issued (1)

and therefore 10 000 of the 30 000 shares are in excess of the number of authorised share capital. (1)

The MOI needs to be amended to increase the authorised share capital to allow for the intended share issue. (1)

The amendment of the MOI should be approved by a special resolution of shareholders in terms of section 36(2) or (1)

the board may resolve to increase the authorised shares of the company (section 36(3)) provided that (1)

the board files a Notice of Amendment of the MOI, setting out the changes effected by the board. (1)

If the board issues shares which have not been authorised or are in excess of the number of authorised share capital, the issue has to be retroactively ratified by a special resolution of shareholders (section 38(2)). (1)

The scenario does not indicate any amendments to the MOI in terms of the increase of the authorised share capital. (1)

Total (8)

Total (7)

Consideration for the shares

In terms of 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 (prescribing specific standards of directors' conduct, which directors need to abide by), read with section 77(2) (liability of directors and prescribed officers). (1)

The shares will be issued at the current market value of the shares, which can be regarded as adequate consideration as determined by the board. (1)

Total (4)

Share issue to Anamalia

In terms of section 41(1)(b), an issue of shares must be approved by a special resolution of the shareholders of a company, if (1)

the shares are issued to a person or company related to a director of the company. (1)

Shares are going to be issued to Anamalia, a company controlled by the managing director, Rinus Terrier of Barking Mad. Rinus Terrier owns 75% of the shares in Anamalia. (1)

Therefore Anamalia is related to a director of Barking Mad and is therefore a related party. (1)

The scenario does not refer to a special resolution to be taken by shareholders or a shareholder's meeting to be held. (1)

The share issue will therefore be in contravention with the Companies Act (section 36). (1)

Total (6)

Max (4)

Voting requirements for a special resolution to be approved by shareholders

In terms of section 65, for a special resolution to be approved by shareholders, it must be supported by at least 75% of the voting rights exercised on the resolution. (1)

Total (1)

Notice of shareholders' meeting

In terms of section 62, the company must deliver a notice of each shareholders' meeting in the prescribed manner and form to all of the shareholders of the company as of the record date for the meeting, (1)

at least 15 business days before the meeting is to begin, in the case of a public company or a non-profit company that has voting members. (1)

Total (2)

Requirements for a shareholders' meeting quorum

In terms of section 64, a shareholders' meeting may not begin until sufficient persons are present at the meeting to exercise, in aggregate, at least 25% of all of the voting rights that are entitled to be exercised in respect of at least one matter to be decided at the meeting; and (1)

a matter to be decided at the meeting may not begin to be considered unless sufficient persons are present at the meeting to exercise, in aggregate, at least 25% of all of the voting rights that are entitled to be exercised on that matter at the time the matter is called on the agenda. (1)

If a company has more than two shareholders, a meeting may not begin, or a matter begin to be debated, unless at least three shareholders are present at the meeting. (1)

Total (3)

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

Grand Total (24)

2.2.1 MATTER 2: COMPANY ACQUIRING ITS OWN SHARES IN A SHARE BUYBACK

References: - Learning unit 3.1.8
- Companies Act: sections 46 and 48

In terms of section 48,

(a) the board of a company may determine that the company will acquire a number of its own shares; and (1)

(b) the board of a subsidiary company may acquire shares of its holding company provided that (1)

- not more than 10% in aggregate (together with other subsidiaries) of the number of issues shares of any class of shares, (1)

- no voting rights attached to those shares may be exercised while shares are held by the subsidiary. (1)

Despite any provision of any law, agreement, order or the MOI of a company, (1)

the company may not acquire its own shares, if, as a result of that acquisition, there would no longer be any shares of the company in issue other than (1)

(a) shares held by one or more subsidiaries of the company; or (1)

(b) convertible or redeemable shares. (1)

A board decision must be approved by a special resolution of the shareholders of the company if the company is to buy back any shares from a director or prescribed officer of the company, or a person related to a director or prescribed officer of the company. (1)

The decision for a company to acquire its own shares must satisfy the following requirements of section 46:

- (a) A company must not acquire any of the company's own shares unless
- pursuant to an existing legal obligation of the company, or (1)
 - pursuant to a court order; or (1)
 - the board of the company, by resolution, has authorised the transaction; (1)
- (b) it reasonably appears that the company will satisfy the solvency and (1)
- (c) liquidity test immediately after completing the proposed transaction; and (1)
- (d) 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 transaction. (1)
- Total (15)
Max (10)

2.2.2 SHARE BUYBACK IS LEGAL OR NOT

- References:**
- Learning unit 3.1.8
 - Companies Act: sections 46 and 48

Solvency and liquidity requirements

Barking Mad does not satisfy the solvency requirements after acquiring the company's own shares, (1)

since the total liabilities (R15 000 000), exceed the total assets (R9 000 000). (1)

Barking Mad does not satisfy the liquidity requirements, (1)

since the current liabilities (R9 000 000) exceed the current assets (R5 000 000). (1)

Based on the information provided, the acquisition of the company's own shares will be illegal, since it does not satisfy the solvency and liquidity requirement, thereby constituting a breach of section 48 of the Companies Act 71 of 2008. (1)

Total (5)
Max (3)

Number of Barking Mad shares acquired in the share buyback

Barking Mad will acquire 80 000 issued shares in the share buyback, which will result in no shares of Barking Mad in issue. (1)

Therefore the acquisition of all 80 000 shares in issue by Barking Mad will be in contravention of the section 48(3) of the Companies Act. (1)

Total (2)
Grand Total (5)

2.3 MATTER 3: PRE-INCORPORATION CONTRACTS

- References:**
- Learning unit 1.2.2
 - Companies Act: section 21 and Companies Regulation 35

A person may enter (1)

into a written agreement in the name of or on behalf of, an entity that is contemplated to be incorporated, but does not yet exist at the time. (1)

A person who does anything as explained above, is jointly and severally liable with any other such person for liabilities created as provided for in the pre-incorporation contract while so acting, if (1)

(a) the contemplated entity is not subsequently incorporated; or (1)

(b) after being incorporated, the company rejects any part of such an agreement. (1)

If, after its incorporation, a company enters into an agreement on the same terms as, or in substitution for, an agreement contemplated above, the liability of the person in respect of the substituted agreement is discharged. (1)

Within three months after the date on which a company was incorporated, the board of that company may completely, partially or conditionally ratify or reject any pre-incorporation contract purported to have been made in its name or on its behalf. (1)

If, within three months after the date on which a company was incorporated, the board has neither ratified nor rejected a particular pre-incorporation contract, the company will be regarded as having ratified that agreement. (1)

To the extent that a pre-incorporation contract has been ratified (1)

(a) the agreement is enforceable against the company as if the company had been a party to the agreement when it was made; and (1)

(b) the liability of a person who entered into the pre-incorporation contract in respect of the ratified agreement is discharged. (1)

If a company rejects the agreement before the incorporation of the company, a person who bears any liability for that rejected agreement may assert a claim against the company for any benefit it has received, or is entitled to receive, in terms of the agreement. (1)

Total (12)

Max (11)

OTHER ASSESSMENT METHODS

QUESTION 1

50 Marks

1.1 Gold Products (Pty) Ltd

References: - Learning unit: 1.1.1
- Companies Act: sections 2 & 3

1.1.1 Susan related to Gold Products (Pty) Ltd (GP)

- **Yes[^]**, Susan is related to GP. (½)
- **David** directly **controls GP** (100% shareholding) ✓[^]. (1½)
- **David** is **related** to **Susan**, his mother ✓[^], **within** the **second degree of consanguinity** (by blood) ✓[^]. (Award mark if student states that they are related in the first degree.) (3)

- It does not matter that David is adopted; in terms of the law, **his relationship with his mother is the same, whether he has been adopted or not** ✓^ (1½)
Available (6.5)
Max (4)

1.1.2 David and Kevin related to each other

- **Kevin and Katy** are brother and sister and are therefore **related** ✓^ **within the second degree of consanguinity** (by blood) ✓^ (3)
- **David**, Katy's husband, **is related to Kevin** within the second degree by marriage (by affinity) ✓^ (1½)
Available (4½)
Max (3)

1.2 Giving Hope NPC

- References:
- Learning unit: 1.1.3
 - Companies Act: sections 8, 10, 66(4) & 68(2)
 - Companies Regulation 27

1.2.1 Does Giving Hope NPC (GH) qualify to be a non-profit company?

- Yes. ^ (½)
- Giving Hope NPC (GH) has been formed for a **public benefit purpose** ✓^ (1½)
- Except for **reasonable compensation for services rendered**, the income and property of GH **are not distributable to incorporators, members, directors or officers** ✓^ (1½)
- GH **applies its assets and income** to advance **its objectives** ✓^ (1½)
- GH has a minimum of **three incorporators** ✓^ (1½)
- GH has a minimum of **three directors** ✓^ (1½)
Available (8)
Max (6)

1.2.2 Appointment of directors

Debbie Stone seems to have been removed from her previous position owing to misconduct that involved dishonesty ✓ and is thus disqualified to be appointed ✓. (2)
Available (2)
Max (2)

1.3 Wine time (Pty) Ltd (Wine time)

- References:
- Learning units: 1.2.2, 2.1.1, 2.1.2, 5.2.1
 - Companies Act: sections 21, 24, 27, 28, 86–89
 - Companies Regulation 25(3)–(6) & 26(1) (b) & (c)

1.3.1 Legality of the pre-incorporation contract

- A person **may enter** ✓ into a **written agreement** ✓ in the name of, or on behalf of, an entity not yet incorporated at the time. (2)
- A person is **jointly and severally liable** ✓ with any other such persons for liabilities created as provided for in the pre-incorporation contract while so acting, if (1)

- (i) the contemplated entity is not **subsequently incorporated** ✓ (1)
 - (ii) the company **rejects any part of such an agreement** or action ✓ (1)
 - If, after its incorporation, a company enters into an agreement on the same terms as this agreement, the liability of a person in respect of the substituted **agreement is discharged** ✓. (1)
 - **Within three months** after the date on which a company was incorporated, the board of that company may **completely, partially or conditionally ratify or reject any pre-incorporation contract** ✓. (1)
 - If, within three months after the date on which a company was incorporated, the board has neither ratified nor rejected a particular pre-incorporation contract, the company will be regarded to have ratified that agreement or action ✓. (1)
 - If a company **rejects an agreement** or action contemplated in section 21(8), a person who bears any liability in terms of the rejected agreement may assert a **claim against the company for any benefit it has received**, or is entitled to receive, in terms of the agreement or action ✓. (1)
- Available (9)**
Max (8)

Application and consequences of the pre-incorporation contract

- Bernie Els (on behalf of Wine Time) **entered** into an agreement with foreign wine merchants before Wine Time had been incorporated ✓[^]. (1½)
- The agreement was in **writing** ✓[^]. (1½)
- Even though Wine Time had **subsequently** been incorporated, the company **rejected** the agreement as a whole ✓[^]. (1½)
- The board's decision was approved on 2 March 2016, which was **within the three months period** after the incorporation of Wine Time ✓[^]. (1½)
- The **rejection** of the contract by Wine Time is **legal** ✓[^], but (1½)
Bernie Els will be **liable** for any liabilities arising from the contract ✓[^]. (1½)
However, he will be able to **claim against** Wine Time for any benefit it has received in terms of the contract ✓[^]. (1½)

Available (10½)

Max (6)

Communication skills: Clarity of expression

(1)

1.3.2 Public interest score

Wine Time's public interest score for the year ended 30 April 2016 is calculated as the sum of the following:

- Wine Time employed an average of 25 employees, which equals 25 ✓ points, as each employee earns one point ✓. (2)
- Wine Time has eight shareholders which equals eight ✓ points. Each security holder of the company earns one point ✓. (2)
- Wine Time had third-party liabilities totalling R6 million, which is equal to six ✓ points. Each R1 million or part thereof equals one point ✓. (2)
- Wine Time had turnover of R10 million, which equals ten ✓ points. Each R1 million in turnover equals one point ✓. (2)

Calculation:

$$25 + 8 + 6 + 10 = 49 ✓$$

(1)

Available (9)

Max (8)

Communication skills: Clarity of expression

(1)

1.3.3 Audit or review required

Wine Time should be **reviewed**✓. The **public interest score is below 100**✓ and an **audit is therefore not required**✓.

(3)

Available (3)**Max (2)**

1.3.4 Company records

- **Yes**^, all companies must keep accurate and complete accounting records (1/2)
- for seven years✓^ (1 1/2)

Available (2)**Max (2)**

1.3.5 Company secretary

- Wine Time (Pty) Ltd **does not need to appoint a company secretary**✓ as it is a **private company**✓, **unless its MOI contains a requirement**✓ that a company secretary must be appointed. (3)
- In terms of section 86(2), a company's Memorandum of Incorporation (MOI) can require any company, including private companies, to appoint a company secretary✓. (1)

Available (4)**Max (2)**

1.3.6 Duties of the company secretary

A company secretary's duties in terms of the Companies Act include, but are not restricted to ...

- providing the directors of the company collectively and individually with guidance as to their duties, responsibilities and powers✓ (1)
- making the directors aware of any law relevant to or affecting the company✓ (1)
- reporting to the company's board any failure on the part of the company or a director to comply with the Memorandum of Incorporation or rules of the company or this Act✓ (1)
- ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee, are properly recorded in accordance with this Act✓ (1)
- certifying in the company's annual financial statements whether the company has filed required returns and notices in terms of this Act, and whether all such returns and notices appear to be true, correct and up to date✓; (1)
- ensuring that a copy of the company's annual financial statements is sent, in accordance with this Act, to every person who is entitled to it✓; and (1)
- carrying out the functions of a person designated in terms of section 33(3) of the Companies Act.✓ (1)
- In terms of section 33(3) of the Companies Act, a designated director or another employee must be responsible for submitting annual returns. (1)

Available (8)**Max (5)**

QUESTION 2**50 Marks****2.1 Financial assistance to a director to acquire shares****2.1.1 Financial assistance to a director**

- References:**
- Learning unit: 6.2
 - Companies Act: section 45

The loan is granted to Mr Solomon, the marketing **director** of Babula ✓^ (1½)

The board successfully determined that all the **conditions and restrictions** in respect of the granting of financial assistance set out in the **MOI** will be satisfied if the loan is granted ✓^ (The board must ensure that any conditions or restrictions in respect of the granting of financial assistance set out in the MOI will be satisfied – award **1.5** marks.) (1½)

Babula does satisfy the liquidity and solvency test after granting the loan **as total assets exceed total liabilities by R25 million** (R80 million minus R55 million) ✓^, and **current assets exceed current liabilities by R2 million** (R25 million minus R23 million) ✓^ (The board should be satisfied that after granting financial assistance, the company satisfies the solvency and liquidity tests – award **1.5** marks.) (3)

The **terms** under which the financial assistance is proposed to be given are **fair and reasonable** to the company ✓^ (1½)

The board may not authorise any financial assistance unless the particular provision of financial assistance is:

- (i) Pursuant to an employee share scheme that satisfies the requirements of section 97 ✓^; or (1½)
- (ii) pursuant to a **special resolution** of the **shareholders**, adopted within the previous two years ✓^ (1½)

The financial assistance granted to Mr Solomon will not be pursuant to an employee share scheme ✓^ (1½)

In terms of section 64, for a special resolution to be taken at a shareholders' meeting, a shareholders' meeting may not begin until sufficient persons are **present** at the meeting to exercise, in aggregate, **at least 25%** of all of the voting rights that are entitled to be exercised in respect of at least one matter to be decided at the meeting ✓^ (1½)

In terms of section 65, for a special resolution to be **approved** by shareholders, it must be supported by **at least 75%** of the voting rights exercised on the resolution ✓^ (1½)

This is the first time this type of loan will be approved and granted since the incorporation of Babula and therefore a **special resolution** would **not** have been obtained within the previous **two years** approving the loan to the recipient or the category of potential recipients ✓^ (1½)

A **notice** of the resolution was sent to all the shareholders within 18 business days and not within ten business days after adoption of the resolution ✓^ (The company must

provide written notice of the special resolution within ten business days to all shareholders – award **1.5** marks.) (1½)

The notice of the resolution should indicate the **summary of the transaction**, namely to provide **financial assistance** to a **director** to **acquire shares** in the company✓^ (1½)

It should have been sent out within ten business days after the adoption of the resolution, as the loan of R1 million to Mr Solomon exceeds one-tenth of 1% of the net worth of Babula or R25 000 (R25 million x 0.1 x 1%)✓^ (1½)

Based on the information provided, a loan was granted illegally to Mr Solomon as the requisite approval had not been obtained, thereby constituting a breach of section 45 of the Companies Act✓^ (1½)

Available (22½)
Max (8)

2.1.2 Issuing shares to a director

References: - Learning units: 3.1.5, 3.3.3
- Companies Act: section 41

In terms of section 41, the issue of shares to Mr Solomon must be **approved by a special resolution** of the **shareholders** because it is intended that Babula will issue shares to a **director**✓^ (1½)

The **board of directors** approved the resolution to issue shares to Mr Solomon✓^ (The board of directors **incorrectly** approved the resolution – award **1.5** marks). (1½)

A special resolution as required by the Companies Act was **not taken** by Babula's shareholders ✓^ (1½)

This resulted in a contravention of the Companies Act✓^ (1½)

Available (6)
Max (6)
(1)

Communication skills: Application to theory

2.2 Disposal of greater part of a company's assets

References: - Learning unit: 6.3.1
- Companies Act: sections 112, 115 & 164

2.2.1 The legality of the disposal of Babula'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 R50 million of the game lodge properties that will be sold, is **more than 50%** of the **book value** of the total assets (**R80 million**)✓^ (1½)

The assets to be disposed of must be **fairly valued**, as calculated in the prescribed manner✓^ (1½)

The directors sent a **notice** to Babula's shareholders to **inform them of the proposed disposal**✓^ (Notice to be sent before the meeting is held.) (1½)

The **notice** should provide a **summary and prescribed terms of the transaction**, namely the disposal of the greater part of the company's assets✓^ (1½)

The **disposal** of the game lodge properties **required a special resolution by the shareholders**✓^ (1½)

A **quorum of 32% (at least 25%)** of shareholders entitled to exercise voting rights was present at the shareholders' meeting✓^ (1½)

The special resolution was adopted by **80% (at least 75%)** of the shareholders✓^ (1½)

Based on the information, **the disposal of the game lodge properties is in compliance** of the Companies Act of 2008✓^ (1½)

Available (1.5)

Max (9)

Communication skills: Application to theory (1)

2.3 Director's personal financial interest in a contract and director's conduct

2.3.1 The legality of the contract in terms of the Companies Act

References: - Learning unit: 4.3
- Companies Act: section 75

Mr Wilson, the financial director, has a **personal financial interest** in the contract entered into between Babula (Pty) Ltd and Cleaning Supplies (Pty) Ltd✓^ (1½)

His daughter, Ms Samuel, is the **managing director** of Cleaning Supplies (Pty) Ltd✓^ (1½)

Mr Wilson and his daughter, Ms Samuel, are regarded as **related**✓^ for the purposes of the Companies Act as they are within two degrees of consanguinity. (1½)

Mr Wilson did **not disclose** his interest and its general nature **before** the matter was considered at the meeting✓^ (1½)

Mr Wilson did disclose his interest and its general nature to the meeting✓^ (1½)

Nobody required any **further information**; therefore, the requirement that any insights may be disclosed if requested by the other directors was complied with✓^ (1½)

Mr Wilson did **not leave** the meeting immediately after making the disclosures because the voting proceeded with him still in the meeting✓^ [section 75(5)(d)]. (1½)

Mr Wilson **voted** at the meeting and therefore took part in the consideration of this matter [section 75(5)(e) & (f)(ii)]✓^ (1½)

The declaration made by Mr Wilson was included in the **minutes** of the board meeting✓^, as clearly indicated. (1½)

Based on the information provided, the requirements in terms of sections 75(5)(d), (e) & (f)(ii) were not met, therefore the decision of the board constitutes a **breach** of the Companies Act✓^.

(1½)

Available (15)**Max (10)****Communication skills: Application to theory (1)**

2.3.2 Standards of director's conduct

- References:**
- Learning unit: 4.4
 - Companies Act: section 76

In terms of section 76, a director of a company **must not use the position of director**, or any information obtained while acting in the capacity of a director, to:

- (a) **Gain an advantage for the director**, or for another person other than the company or a wholly-owned subsidiary of the company; or (act fraudulently)✓ (1)
- (b) Knowingly cause **harm** to the company or a subsidiary of the company (e.g. cause financial distress to the company)✓; and (1)

the **director** must **communicate to the board** at the earliest practicable opportunity any information that comes to the **director's attention**✓, unless the director (1)

- (a) reasonably believes that the information is **immaterial** (insignificant)✓ to the company; or (1)
- (b) **generally available** to the public✓, or known to the other directors; or (1)
- (c) is **bound not to disclose** that information by a legal or ethical obligation of confidentiality✓. (1)

A director of a company, when acting in that capacity, must exercise the powers and perform the functions of director

- (a) in **good faith** and for a proper purpose✓; (1)
- (b) in the **best interests** of the company✓; and (1)
- (c) with the **degree of care, skill and diligence** that may reasonably be expected of a person✓ (1)
 - (i) carrying out the **same functions** in relation to the company as those carried out by that director✓; and (1)
 - (ii) having the **general knowledge, skill and experience** of that director (e.g. strong leadership skills)✓. (1)

Available (12)**Max (9)**

2.4.1 Explain whether or not Babula can voluntarily begin with business rescue proceedings

References: - Learning unit: 7.2.1
- Companies Act: sections 128 & 129

No[^], it cannot be concluded that Babula is financially distressed[✓], as Babula is solvent. Its total assets exceed its total liabilities by R25 million (R80 million minus R55 million) ^{✓^}. (1½)

Babula is liquid, as its current assets exceed its current liabilities by R2 million (R25 million minus R23 million) ^{✓^}. (1½)

**Available (4½)
Max (3)**

2.5.1 List two instances where “Protection for whistle-blowers” in terms of section 159 of the Companies Act, will be applicable

References: - Learning unit: 7.3.1
- Companies Act: section 159

- Contravened the Companies Act or another Act enforced by the Commission[✓] (1)
- Failed (or is failing) to comply with any legal obligation to which the company is subject (e.g. dishonesty by directors) [✓] (1)
- Engaged in conduct that poses a health or safety risk to any individual, or a risk of environmental damage [✓] (1)
- Discriminated unfairly against any person [✓] (1)
- Contravened any legislation that could expose the company to risk or liability [section 159(3)(b)] [✓] (1)

**Available (5)
Max (2)**