

LEARNING UNIT 5 COMPANIES ACT 71 OF 2008

Duration: 156 minutes



LEARNING OUTCOME AND ASSESSMENT CRITERIA

The content of this sub learning unit is based on the following learning outcome and assessment criteria:

Learning outcome	Assessment criteria
Exercise statutory requirements in practical situations.	<ul style="list-style-type: none"> Review, apply and discuss how could affect the auditor and the audit work that he/she needs to perform.

ASSUMED PRIOR LEARNING



If you wish to refresh your knowledge, you may refer to your undergraduate material, prescribed textbook and the SAICA Handbooks. For your convenience, we provide textbook references, **but it is your responsibility to revise and work through (if needed) the content of this learning unit as it will not be repeated in this learning unit.**

Learning outcomes assumed to have been attained during prior learning	<i>Auditing Notes for South African Students (Auditing Notes) (12 th edition)</i>	<i>SAICA Handbook 2024/2025</i>
<ul style="list-style-type: none"> Analyse, assess and evaluate compliance with laws and regulations that governs activities and decisions taken by the board/shareholders and the auditor in any practical scenario. good corporate governance in any practical scenario. 	Chapter 3, section 3.1 to 3.4	<i>SAICA student handbook 2024/2025, volume 2B,</i> <ul style="list-style-type: none"> Section 4: Companies Act No.71 of 2008 – Chapter 1 to 9, Companies Regulations



The table above provided you with the learning outcomes for this learning unit as well as references to your undergraduate material should you need to refer to it.

However, the table below provides a breakdown relating to the of the content mentioned above relating to the SAICA Student Handbook 2024/2025. The table below provides the sub-content for the references mentioned above which will assist you when working through questions. You should then flag and underline all the important sections and/or information in the SAICA Student Handbook 2024/2025, so that you can easily refer to the related sections and pages. The SAICA Student Handbooks 2024/2025 are also the only book that you can take into the exam venue, so it will just be to your benefit to use these books during your studies and when working through the questions. This can also assist you when formulating your answers for all your formative(tests)- and summative assessments (examinations) in future.

SAICA Student Handbook, 2024/2025	Chapter
Volume 2B - Section 4	
Companies Act No. 71 of 2008 and Companies Regulations	Chapter 1 to 9



5.1 INTRODUCTION

As a future accountant and auditor, it is of the utmost importance that you have sound knowledge of the legal environment you will be operating in. Your knowledge of the Companies Act will therefore be enhanced and tested in this learning unit.



EXAMINATION TECHNIQUE

1. We find that students do not work through enough questions in Auditing. Remember that you must train yourself to be "test-fit" and "examination-fit", and you need to work through enough questions during the year to achieve this.
2. **Please note** that it is your responsibility to study the Act and to be familiar with important aspects contained therein. The textbook provides good guidance in this regard. The Act also forms part of the documents you are allowed to have with you during tests and examinations in terms of the open book policy.
3. **Additional tip:** Pay attention to the wording of the requirements. If asked about concerns, you should only discuss non-compliance. The best way to deal with a concern is to start your sentence with "It is a concern that..." Some questions require discussion of both compliance and non-compliance, in which case you should not limit your answers just to non-compliance.
4. **VERY IMPORTANT:** In the examination and in the test, the Companies Act may be integrated with the rest of your auditing syllabus as well as with other statutory, regulatory and ethical matters, such as the King IV Report on Corporate Governance. Certain sections of the Companies Act have a direct link with the King IV Report, therefore you should not study them in isolation.
5. Your knowledge of the relevant legislation may be tested in one or more of the following ways:
 - A question may provide a scenario and you may be required to evaluate the legality of any transactions or schemes that are contemplated or were implemented. You may also need to advise about alternatives and/or further requirements that have to be met.
 - A question may set out certain transactions or schemes that are contemplated or were implemented and you may be required to describe the audit procedures that should be performed to obtain sufficient appropriate audit evidence on them.

We suggest that you approach questions as follows:

A. Questions that require advice on or the evaluation of a given situation

- Identify **all** transactions/events.

- Determine which requirements of the relevant Acts relate to each transaction or event. These requirements may relate to the following:
 - the powers of the entity (memorandum; sections of the Act);
 - specific authorisation required (e.g. a special or ordinary resolution); and/or
 - special preconditions (liquidity and solvency).
- Reproduce the theory applicable to each transaction or event.
- Apply the theory to the facts given in question.
- Conclude on the legality of each transaction or event.
- Make recommendations or discuss alternatives (if required by the question).

B. Questions requiring audit procedures

Normally, only substantive procedures will be possible since transactions affected by specific legal requirements usually occur sporadically and no or limited internal controls will be present to mitigate the risks related to them.

- Identify **all** transactions or events.
- Determine which requirements of the Act relate to each transaction or event (see list given above of aspects that requirements may relate to).
- Visualise and note the accounting journal entry underlying each transaction described in the question.
- Identify source(s) of audit evidence.
- Develop audit procedures, using the following audit assertions:
 - occurrence (power, authorisation, special requirements)
 - accuracy (amount or calculation, all aspects of each transaction)
 - completeness (all transactions)
 - cut-off (correct period)
 - classification (as current or non-current asset or liability, or income or expense)
 - disclosure (based on statements of IFRS/GAAP)

Remember that the purpose of performing audit procedures is to obtain sufficient appropriate evidence that the financial statements are fair. Possible **sources of evidence** include the following:

- | | |
|--|--|
| • memorandum of incorporation | • notes to the annual financial statements |
| • notices of meetings | • deposit slips |
| • minutes (always be specific as to those of directors' meetings or members' meetings) | • general ledger account(s) |
| • statutory registers | • paid cheques |

Due to the extensive documentary evidence available with regard to statutory matters, the term **inspect** is of great importance when formulating procedures.

In the examination and in the test, the Companies Act may be integrated with the rest of your auditing syllabus, as well as with other statutory, regulatory and ethical matters, such as the King IV Report on Corporate Governance. Certain sections of the Companies Act have a direct link with the King IV Report; therefore you should not study them in isolation.



SELF DEVELOPMENT

In compliance with the 2021 SAICA Competency Framework; there are other legislations that you should be aware of and be able to identify and describe the implication of applicable laws and regulations to the organisation. These include:

- Overview of the SA legal system
- Contract law
- Property rights
- Consumer Protection Act
- National Credit Act
- Protection of Personal Information Act
- Promotion of Access to Information Act
- Labour Law
- Broad-Based Black Economic Empowerment Act
- Money laundering legislation

Other public sector specific legislations are:

- Public Finance Management Act (Chapter 1,4,5,6 and 9)
- Municipal Finance Management Act (Chapter 1,4,8,9,11,12 and 14)
- Municipal Systems Act (Chapter 5,6 and 7)

5.2 LEARNING ACTIVITY

After you have read the sections set out above, complete the following comprehensive activity:



Activity 5.2.1 ~ 52 marks (duration 156 minutes)

Activity 5.2.1 marks	Estimated time		
	Writing	Marking and review	Total
52 marks	104 minutes	52 minutes	156 minutes

You are a senior trainee accountant in your audit firm's technical department. Your responsibility is to advise fellow staff members, who are conducting an audit, on statutory and corporate governance matters. One of the firm's clients is the Hello-Dolly Group. All companies in the group manufacture retail or wholesale dolls and doll accessories.

The group is structured as follows: Hello-Dolly Ltd holds 60% of Doll-Face Ltd, 80% of Doll-Prms (Pty) Ltd and 70% of Doll-Fashions (Pty) Ltd. Doll-Prms (Pty) Ltd holds 100% of the shares in Pram-Wheels Ltd.

Your firm holds the appointment as auditors of all companies in the group, and the various audit teams are currently engaged in the 30 September year-end audit.

You have received the following queries from fellow trainees:

1. From Fred Astaire, on the audit of Doll-Fashions (Pty) Ltd

We identified an amount of R4,6 million in trade creditors owed to Silky-Sewing (Pty) Ltd. This represents the purchase during August of a machine that is used to manufacture dresses for the different doll ranges. The machine has been installed. However, it appears that **Silky-Sewing (Pty) Ltd is fully owned by Barbie Sibaya and Ken Booth, two of the four directors of Doll-Fashions (Pty) Ltd (concern 1)**. Neither of them is a shareholder of Doll-Fashions (Pty) Ltd. The purchase documentation, for example, purchase order, delivery note, invoice and entries in the records, is correct and **R4,6 million is the fair price for such machines (concern 2)**. Do I have any further responsibilities arising from this transaction? (8)

2. From Marlon Brando, on the audit of Doll-Prams (Pty) Ltd

The company has made a number of loans during the past year. I considered each of the loans, but I would like to raise queries with you in respect of one of them.

A loan of R150 000 to **John Bratz, the managing director of Pram-Wheels Ltd (concern 3)**, who also serves on the board of Doll-Prams (Pty) Ltd and who intends using the loan to make a private investment. Is this loan acceptable, and if so, what are the requirements of the Companies Act 2008? (3)

3. From John Lennon, on the audit of Hello-Dolly Ltd

During the year under audit, **the company undertook a buyback of its own shares (concern 4)**. Prior to this buyback, the company had one million no par value shares, all of which had been issued at R5 a share. A total of **250 000 shares (concern 5)** were repurchased at **R7 a share (concern 6)**, and the buyback was effected by Isaak Angel, the company secretary to the Hello-Dolly group. Advise me on the procedures I should conduct to audit the buyback. (18)

4. From Charlie Chaplin, on the audit of Doll-Face Ltd

Mr Plastic, the managing director of Doll-Face Ltd has approached a trainee for advice on what authority and conditions must be met so that each of the following can be executed legally. (Doll-Face Ltd has an authorised **share capital of 100 000 shares, of which 80 000 shares have been issued (concern 7)**. The balance of the stated capital account is R140 000.)

- Equipment is to be purchased from a director, Ms Pink, for R900 000 (**Ms Pink purchased the equipment one month previously for R785 000) (concern 8)**). The purchase price will be settled by obtaining a loan of R800 000 from the company's bankers.
- A total of 60 000 shares will be issued to Ms Pink, at their fair market value of R1,67 per share, to settle the balance of the purchase price. (5)
- Ms Skinny was requested to resign as a director. She refused and was dismissed by the other directors. **She will be paid an amount of R80 000 to compensate her for the loss of office (concern 9)**. (6)

5. From Frank Sinatra, on the audit of Pram-Wheels Ltd

During the financial year, interest-free loans of R500 000 and R750 000, respectively, were granted to Mr Firestone (Director: Operations) and Mr Continental (Director: Human resources), respectively (**concern 10**). These loans were granted in terms of a directors' resolution and were not granted to cover business expenses. By examining the MOI it was determined that the MOI does not prohibit such loans. No repayment terms for these loans are known. (12)

REQUIRED	Marks
(a) Respond to queries/requests 1 to 4 from the audit teams by giving reasons for your responses.	40
(b) Refer to audit query 5 and formulate the audit procedures that you would perform for the loans granted to the board members of Pram-Wheels Ltd during the year. Assume that the company gave sufficient notice in an appropriate manner before all meetings. You do <u>not</u> need to include audit procedures in respect of notices in your answer.	12

(Adapted from Gowar & Jackson 2011; Prinsloo 2011; and Stellenbosch University)

SUGGESTED SOLUTION

(a) To Fred Astaire

1. Yes, you should conduct further procedures. (1)
2. This purchase appears to result in a contract in which two of the directors of Doll-Fashions (Pty) Ltd have a personal financial interest because Barbie Sibaya and Ken Booth own Silky-Sewing (Pty) Ltd (**sec 75**). (**This is indicated in concern 1 of the scenario.**) (1)
3. Firstly, you should inspect the company's MOI to determine whether any conditions or restrictions are applicable to directors with personal financial interests in contracts into which their company enters. If there were conditions or restrictions, you would have to confirm whether they had been complied with. (1)
4. In terms of **section 76(2)(b)**, directors must communicate to the board, at the earliest opportunity, any information that comes to their attention (pertaining to the affairs of the company). (1)
5. It is also required by **section 76(3)(a) and (b)** that directors exercise their powers and perform their functions
 - in good faith and for a proper purpose; and (1)
 - in the best interest of the company. (1)
6. Barbie Sibaya and Ken Booth should have notified the other directors of their personal financial interest in the contract to buy a R4,6m machine, prior to the decision taken by the board to purchase the machine [**sec 75(4)**] (**indicated by concern 2 in the scenario.**) (1)
7. Therefore, you should inspect the minutes of the meeting at which the decision was taken to purchase the machine, to confirm/determine that
 - 7.1 the meeting was properly constituted (e.g. a quorum); (1)
 - 7.2 the interest and its general nature (e.g. ownership of the company supplying the machine) was disclosed before being considered at the meeting [**sec 75(5)(a)**]; (1)
 - 7.3 the two directors made any other disclosure that may have significance (may be nothing) [**sec 75(5)(b)**]; (1)
 - 7.4 the two directors left the meeting after making the disclosures (this should be recorded) [**sec 75(5)(d)**] (i.e. did not form part of the quorum for this purpose of this resolution); (1)
 - 7.5 the two did not vote on the decision to purchase [**sec 75(5)(e)**] [**sec 75(5)(f)**]; and (1)
 - 7.6 the resolution to purchase was approved by the other directors (the two should not have voted for the resolution to be passed). (1)

Available 13
Maximum 8

To Marlon Brando

1. John Bratz is a director of a wholly owned subsidiary of the company making the loan, that is, a related company (**indicated by concern 3 in the scenario**). (1)
2. In terms of **section 45(2)**, a company may make a loan to a director of a related company (directly or indirectly). The company (board) must comply with the Companies Act and any requirements/restrictions of the MOI of Doll-Prans (Pty) Ltd [**sec 45(2)**]. (1)
3. However, despite anything the MOI may state, the board may not authorise the loan unless
 - 3.1 it is pursuant to a special resolution of the shareholders who approved the specific loan (i.e. to John Bratz) and was adopted within the previous two years, or generally for a category of recipients, for example the directors [**sec 45(3)(a)**]; and (1)
 - 3.2 the board is satisfied that, immediately after providing the financial assistance, the company would satisfy the liquidity/solvency test [**sec 45(3)(b)**]. (1)
4. There is of course the general rule that in making the loan, the directors must act in good faith and in the interests of the company [**sec 76(3)(a) and (b)**]; therefore, the terms of the loan should be fair and reasonable to the company. (1)

Available 5
Maximum 3

To John Lennon

1. The purchase by Hello-Dolly Ltd of its own shares (**indicated by concern 4 in the scenario**) amounts to a “distribution” as defined in the Act.
 - 1.1 It is a transfer by a company of money to the holders of shares of that company as consideration for the acquisition of any of its shares (**sec 46**). (1)
2. The “distribution” must only be made if it is pursuant to an existing legal obligation or court order [**sec 46(a)**]. You may establish this by doing one of the following:
 - 2.1 Inspect the minutes of the directors' meeting and the enquiry of Isaak Angel, the company secretary. (1)
 - 2.2 Inspect the minutes of board meetings to ensure that it is authorised by the board of the company [**sec 46(1)(a)**]. (1)
 - 2.3 The court order may also be inspected to ensure that it exists and relates to the matter in question. (1)
3. You should inspect the minutes of the meeting of directors (obtain the relevant date from Isaak Angel) to determine that
 - 3.1 the meeting was quorate – the decision will be a majority decision and therefore at least half of the directors must have been present; (1)
 - 3.2 the directors applied the liquidity/solvency test [**sec 46(1)(b)**], that is, after the distribution the company (1)
 - will be able to pay its debts (and has been able to do so) in the normal course of business for the 12 months after the distribution; and (1)
 - the company's assets, fairly valued, exceeded its liabilities; (1)
 - 3.3 the directors acknowledged in the minutes that they had applied the liquidity/solvency test and had concluded that the test was satisfied [**sec 46(1)(c)**]. (1)
4. Obtain the working schedules used by the directors and confirm by inspection, recalculation, analytical review, and the like, that the test was conducted based on
 - 4.1 accurate and complete accounting records; and (1)
 - 4.2 financial statements that comply with the financial reporting standards regarding form and content (as we are conducting the audit, this should not be difficult to do). (1)

5. You should also inspect the MOI to determine whether any conditions/restrictions must be complied with. (1)
6. Obtain a summary from Isaak Angel detailing the buyback and confirm by inspection that
 - 6.1 the number of shares purchased, was 250 000 (**concern 5**) Hello-Dolly Ltd shares; (1)
 - 6.2 the purchase price was R7 (**concern 6**); (1)
 - 6.3 the transaction took place within the financial year and that these details all agree with the directors' meeting minutes; and (1)
 - 6.4 the buyback price of R7 was fair and reasonable (**concern 6**). (1)
7. Inspect the paid cheques/bank transfers/bank statement to confirm that
 - 7.1 the buyback took place within 120 business days of the resolution, in full (Note: If it did not, the directors must reperform the liquidity/solvency/acknowledgement exercise); (1)
 - 7.2 the amount paid out was R1 750 000 (**250 000 x R7**). (1)
8. Inspect the share register to confirm that the shareholders' details/holding has been amended correctly. (1)
9. Confirm by inspection of the financial statements that
 - 9.1 the buyback has been accurately and completely disclosed; (1)
 - 9.2 issued share capital has been reduced by 250 000 shares; and (1)
 - 9.3 stated capital has been reduced by R1 250 000 (**250 000 x R5**) and reserves by R500 000 (**R1 750 000 – R1 250 000**). (1)

Available 22
Maximum 18

To Charlie Chaplin

Purchase of equipment

1. As Doll-Face Ltd has insufficient authorised ordinary shares available to allow for the fresh issue of 60 000 shares (**indicated by concern 7**) (**100 000 – 80 000 = 20 000**), the authorised shares will have to be increased by at least 40 000 (**20 000 + 40 000 = 60 000**). This increase must be authorised in terms of **section 36**, by
 - 1.1 an amendment to the MOI through a special resolution of shareholders [**sec 36(2)(a)**]; or (1)
 - 1.2 the board of directors, unless the MOI provides otherwise [**sec 36(2)(b)**]. (1)
 - 1.2.1 The company must file a notice of amendment of its MOI, setting out the changes effected to the authorised share capital. (1)
2. If the market value of the equipment appears to be below R900 000 (**the equipment was purchased very recently for R785 000, which is R115 000 less than R900 000, as indicated by concern 8 in the scenario**), it would constitute financial assistance for the purchases of shares in terms of **section 44**, in which case the following applies:
 - 2.1 The financial assistance must have been authorised by a special resolution of the shareholders, adopted within the previous two years [**sec 44 (3)(a)**]. (1)
 - 2.2 The board of directors must be satisfied that
 - 2.2.1 after providing the financial assistance, the company would satisfy the solvency and liquidity test [**sec 44(3)(b)**]; (1)
 - 2.2.2 the terms under which the financial assistance is given are fair and reasonable to the company [**sec 44(3)(b)**]; and (1)
 - 2.2.3 all the related conditions/restrictions set out in the MOI have been satisfied [**sec 45(4)**]. (1)

Available 7
Maximum 5

Dismissal of director

Dismissal

1. Irrespective of anything to the contrary in the company's MOI, a director can be dismissed before the termination of her or his term of office **[sec 71(1)]**. (1)
However, this removal requires an ordinary resolution passed at a shareholders' meeting **[sec 71 (1)]** – the directors' resolution is insufficient. (2)
2. If, however, Ms Skinny is removed because of being ineligible or being disqualified as a director, or she is incapacitated **[sec 71(3)(a)]** or has otherwise neglected **[sec 71(3)(b)]** her duties, the board resolution will suffice, provided that (1)
 - 2.1 due notice of the board meeting and proposed resolution is given to Ms Skinny **[sec 71(4)(a)]**; and (1)
 - 2.2 she was provided with a reasonable opportunity to make a presentation before the vote took place **[sec 71(4)(b)]**. (1)

Compensation for loss of office

3. As it appears that the payment was made to Ms Skinny in her capacity as a director of the company (**concern 9 in the scenario**), the payment thereof must be/have been authorised by the shareholders by way of a special resolution passed within the preceding two years **[sec 66(9)]**. (1)
4. The amount paid in respect of the loss of office must be disclosed in the annual financial statements. (1)

Available 8
Maximum 6

(b) AUDIT PROCEDURES – Loans to directors

[Note: **Section 45** of the Companies Act, 2008 is applicable to loans granted to directors (**indicated by concern 10 in the scenario**). In addition to the resolution at the board meeting, a special resolution to approve such loans should also have been passed during the preceding two years].

- Inspect the minutes of the board meeting **[sec 45(2)]** at which the resolution to approve the loans to the two directors was passed and ensure (1)
 - that a quorum was present at the meeting; (1)
 - that there is an indication that the directors applied the solvency and liquidity test and that they considered, after the loans were granted; whether (1)
 - the company's assets would exceed its liabilities and that the company would be able to pay its debts in the normal course of business for at least 12 months after the loans had been granted **[sec 45(3)(b)]**; (1)
 - that the directors acknowledged in the minutes that they had applied the test and came to the conclusion that they complied with the requirements of the test; and (1)
 - that the majority of directors approved the resolution to grant the loans. (1)
- Examine the cash flows, forecasts, management accounts, and the like used by the directors in respect of the application of the liquidity and solvency test and ensure, through inspection, recalculation and analytical review, that the directors applied the test correctly. (1)
- Examine the MOI for any constraints and conditions, which must be complied with regarding the granting of loans (to directors). If so, confirm that these conditions were met **[sec 45(4)]**. (1)

- Inspect the minutes of the shareholders' meeting [sec 45(3)(a)] for the approval of a special resolution and confirm that
 - a quorum was present at the meeting (unless the MOI states differently, at least three shareholders who hold at least 25% of the voting rights); (1)
 - the resolution was taken within the preceding two years; (1)
 - the resolution approves loans to the two directors specifically, or to directors in general; and (1)
 - the resolution was approved by at least 75% of the voting rights exercised (unless the MOI states differently). (1)

- Inspect the loan agreement with the directors and
 - compare the amount and any conditions applicable to the loans with the minutes of the meetings; and (1)
 - confirm that the agreement was properly signed by the respective directors and an authorised representative of the company. (1)

- Confirm the existence of the loans and the outstanding amounts at year end by obtaining written confirmation from the two directors. (1)

- Confirm through inspection of the financial statements that the loans to the directors were properly disclosed as directors' remuneration. (1)

Available 15
Maximum 12