



**AUE302Q  
RAE322W  
RAU3226**

May/June 2011

**LEGAL ASPECTS CONCERNING AUDIT PRACTICE  
(AUDITING 302)**

Duration 2 Hours

100 Marks

**EXAMINERS :**

FIRST :

SECOND

EXTERNAL

MR FN VAN NIEKERK  
PROF EM ODENDAAL  
MS C STEYN

PROF JM VAN STADEN

Use of a non-programmable pocket calculator is permissible.

THIS PAPER CONSISTS OF **SEVEN (7)** PAGES.

This paper consists of the following questions and main topics:

QUESTION	MAIN TOPIC	MARKS
1	International Standard on Auditing. engagement letter	15
2	The Auditing Profession Act and the Code of Professional Conduct reportable irregularity	20
3	The Companies Act share buy-back, audit of private companies, independent reviews and enhanced accountability and transparency	20
4	The Companies Act directors - standards of conduct, removal by the board, probation and indemnification of a director	25
5	The Close Corporations Act changes in membership	20
		<u>100</u>

**NOTE:**

The main objective of the examination is to test a candidate's knowledge and ability to apply the study material, although the examiners will also take into account the candidate's ability to organise and present that knowledge in writing, and according to an acceptable standard

[TURN OVER]

In this paper, references to the Companies Act, the Close Corporations Act and the Auditing Profession Act apply to the Companies Act 71 of 2008, the Close Corporations Act 69 of 1984, as amended, and the Auditing Profession Act 26 of 2005, as amended, respectively of the Republic of South Africa

## QUESTION 1

**15 marks**

Excel Spares Limited recently appointed your audit firm, Auditors Inc, as their new auditor. You are assigned to be the partner in charge of this new audit in Pretoria. After an initial meeting with the financial director of the company, you sent an engagement letter to the company. You received a letter from Mr Miller, the chief executive officer (CEO) of the company, and the following are extracts from that letter:

### Marks

- |            |  |             |
|------------|--|-------------|
| <b>1.1</b> | Our company has been audited for many years and this is the first time we have ever been required to sign an "engagement letter". Why are we now required to sign such a letter?   | <b>(4½)</b> |
| <b>1.2</b> | From your engagement letter it would appear that you do not accept any responsibility for the detection or reporting of fraudulent activity in my company. If you conduct your audit properly all fraudulent activity should be identified and reported to us. | <b>(6)</b>  |
| <b>1.3</b> | In the engagement letter it is indicated that you require written confirmations of oral representations made by ourselves during the course of the audit. Is our "word" not sufficient for you?  | <b>(4½)</b> |

## REQUIRED

Write a letter to the CEO responding to the three matters above.

[TURN OVER]

## QUESTION 2

20 marks

You are the auditor in charge of the year-end audit of Ceres (Pty) Limited, a fruit canning factory. Although Ceres (Pty) Limited is a private company, and therefore not required to be externally audited, the terms and conditions of its major long-term finance agreement require that the company's annual financial statements be audited by a registered auditor.

During the course of the audit you discover that the financial director and managing director (the two executive directors on the board), both of whom own shares in the company, have been falsifying the monthly value added tax (VAT) returns by claiming considerable amounts of VAT on salaries and wages to which the company is not entitled. You are satisfied that a reportable irregularity (RI), in terms of the Auditing Profession Act, has taken place and reported it to the Independent Regulatory Board for Auditors (IRBA).

After playing a round of golf recently, you could not resist telling your friend about the problems you encountered at Ceres (Pty) Limited, since he is a shareholder of the company.

You are also the auditor of Tzaneen Fruit Cannery Limited, a company in the same industry as Ceres (Pty) Limited.

### REQUIRED

Marks

- |     |   |     |
|-----|---|-----|
| 2.1 | Use the definition of a RI and the information in the question to show your evaluation of whether a RI took place or not  | (6) |
| 2.2 | State and substantiate whether you would still have to report the RI to IRBA if   |     |
|     | 2.2.1 the financial director and managing director realised, before you made your report to IRBA, that you suspected what was going on, and offered to notify the South African Revenue Services and pay all VAT and penalties owed | (2) |
|     | 2.2.2 you had discovered the RI whilst conducting other work (not audit work) for Ceres (Pty) Limited   | (2) |
| 2.3 | Explain how you would respond to the argument that as this is not an audit required by the Companies Act, you have no duty to report the RI   | (2) |
| 2.4 | Taking into account the information in the question, explain your concerns regarding compliance with the Code of Professional Conduct of the South African Institute of Chartered Accountants (SAICA)                               | (8) |

[TURN OVER]

### QUESTION 3

20 marks

Holding Limited is an unlisted public company with an authorised and issued share capital of 50 million ordinary shares. The stated capital reflected in the previous year's annual financial statements amounted to R100 million. The directors plan to buy back all shares from shareholders that individually own less than ten thousand shares in order to decrease the administrative burden. This will involve 5 million shares in total.

The directors are willing to pay a price per share that will be more than acceptable to every shareholder involved in the buy back, and therefore do not expect any opposition to the offer from any shareholders.

Holding Limited is the holding company in a group of companies. It is expected that most of the companies in the group would not be legally required to be audited in the future although the Minister of Finance has, in terms of section 37(7) of the Companies Act, not yet made any regulations as to which private companies must have their financial statements audited. The directors, after consultation with the auditors, decided that it will be in the best interest of the group that all companies be audited in future, in spite of any possible exemption from the audit requirement.

Holding Limited's memorandum of incorporation does not have any different requirements with respect to amendments to its memorandum of incorporation than the requirements prescribed by the Companies Act.

REQUIRED	Marks
3.1 List the requirements that Holding Limited must meet in terms of the Companies Act in order to buy back the five (5) million shares. In your answer indicate the amount by which the stated capital must be reduced and show your calculations.	(13)
3.2 Taking into account the specific circumstances above, explain under which circumstances all the companies in the group will be obliged to be audited.	(2)
3.3 Explain under which circumstances a company would be exempted from both the audit requirement and the requirement to have an independent review performed.	(2)
3.4 What three appointments must be made by Holding Limited in order to comply with the enhanced accountability and transparency requirements in terms of the Companies Act?	(3)

[TURN OVER]

## QUESTION 4

25 marks

A friend of yours, Maria Bueno, has recently been appointed by the shareholders as a director of GPS Limited, an electronics company which specialises in the development and manufacturing of global positioning systems (GPSs) for vehicles and motorcycles. The company is not listed. Maria is considered to be an important individual with regard to the future of the company, particularly its research and development programmes.

However, Maria has not filled the role of a company director before, and whilst excited about her promotion, is concerned about her responsibilities as a director, particularly those arising from the Companies Act. She tells you that she has heard that the Companies Act has sections dealing with standards of directors' conduct and that if she doesn't perform, she can be removed from the board and dismissed from the company. She also tells you that she has heard that she can be placed on probation as a director by the chairman of the board or declared delinquent.

Maria's husband has a financial interest in Electronic Importers Limited, a company that, from time to time, tenders for large contracts to supply GPS Limited with certain electronic parts that the latter requires in order to manufacture GPSs. Electronic Importers Limited is one of four companies that put in tenders to be considered at the upcoming board meeting.

The following actions have already taken place at the time Maria asked your advice:

Before a recent board meeting, Maria requested various GPS sales figures from the sales manager, since she had to report to the board thereon. Maria spoke to various persons in the company about matters on the agenda in order to be able to intelligently take part in discussions at the meeting. Maria informed her husband about new projects that are being pursued and certain confidential information about tenders that will be put out in the coming month. Maria was silent about her husband's financial interest when the tenders were voted on at the board meeting. Her husband informed her that an American company is on the verge of taking over GPS Limited's largest competitor in order to make inroads into the South African market. Maria immediately informed the chief executive officer of GPS Limited of this after it came to her attention.

Maria signed a contract on behalf of GPS Limited after her appointment as director of GPS Limited and subsequently indicated to the other party to the contract that she acted without authority at the time of signing the contract. Maria was under the impression that she had the necessary authority. She is now being sued for damages by the other party.

[TURN OVER]

GPS Limited's memorandum of incorporation is silent on the indemnification of its directors in respect of any liability

**Marks**

She has put the following questions to you

1. Can I be removed from the board and dismissed from the company if I do not perform as a director, and if so, what requirements must be met in terms of the Companies Act? (9)
2. Considering my actions above, explain the standards of conduct for directors, (limited to **four**) provided for by the Companies Act, and whether or not I have complied with the standards described?

Your answer should be in the following format

Standard of conduct (1 mark each)	Whether or not the standard has been complied with (1½ marks each)	(10)

3. Can I be placed on probation by the chairman or any other party, and what requirements must be met in this regard in terms of the Companies Act? (3)
4. Discuss whether or not GPS Limited may indemnify me as director in respect of the liability flowing from the signed contract? (3)

**REQUIRED**

Respond to each of Maria Bueno's questions and substantiate your answers, where applicable

[TURN OVER]

## QUESTION 5

20 marks

You are a chartered accountant and the financial advisor of Toys CC, a profitable business which manufactures a range of construction toys which it sells through a chain of toy shops across the country. The close corporation currently has nine members but the members feel that to keep the business successful, it is necessary to introduce new members to replace members who wish to sell their interests and to offer membership to a number of employees who have served the close corporation well. Toys CC has an association agreement.

### Marks

The existing members have asked you to comment on the following nonrelated proposals:

1. Mr Rodgers, the production manager who has been with the close corporation since it was formed in 1990, but has never been a member, will be offered the member's interest of one of the members willing to sell his interest. As Mr Rodgers has no financial backing, the close corporation intends lending him the money to purchase the member's interest. (14)
2. Toy Agencies (Pty) Limited, the company which distributes Toys CC's toy range, will become a member of the close corporation. The members believe that this will secure the distribution network. (You are to comment only on the membership.) (1½)
3. The financial accountant and administrative manager of Toys CC, neither of whom are currently members, will be offered a joint member's interest in the close corporation to give them a stake in the close corporation. (You are to comment only on the joint member's interest.) (1½)
4. Toys CC will purchase the member's interest from another member who wants to sell his interest, as no current member is interested in purchasing that interest. (3)

### REQUIRED

Comment fully, in terms of the Close Corporations Act, on each of the proposals presented to you.