

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Corporate Laws

Examiners' comments and Suggested answers

Certified Finance and Accounting Professional (CFAP) – Summer 2017

Examinations

Overall General Comments:

The overall performance was slightly better as 20.85% candidates passed as compared to 18.20% in the previous attempt. Very poor performance in question 9 was reflective of selective study as the question pertained to areas which were tested after a long time. Below average performances were witnessed in some of the scenario based questions like Question 5 and 8(a).

Question-wise comments:

Question 1

General comments:

36.72% candidates secured passing marks in this question.

Part (a)

Common errors:

- Candidates knew only one condition i.e. that the offer should consist of 10% or more shares and did not know the other condition i.e. regarding the minimum offer size of 100 million.
- Even among those who knew both the conditions, few could give a comprehensive conclusion.
- Offer size was computed on the basis of par value instead of the offer price.

Suggested answer:

According to Issue of Capital Rules, 1996 a person or group of persons holding more than ten percent shares of a company, may offer such shares for sale to the public. However, the size of offer of the capital to the public shall not be less than Rs. 100 million.

Based on the above rule, none of the three can offer the shares to the public individually based on the size of offer.

However, the three of them together or either Nadeem or Faheem in combination with Saleem can offer the shares to the public as a group.

Part (b)

Common errors:

- Answers revolved around the requirement for issuance of prospectus only.
- Candidates mixed up the requirement with those specified in case of issue of right shares by listed companies.

Suggested answer:

Nadeem, Faheem and Saleem cannot charge any amount of premium unless

- ZML whose shares are offered fulfills the following
 - has commenced commercial operations and based on its latest audited accounts for not less than twelve months, it has-
 - earned profit from its principal operations; and
 - has positive earnings per share;
- the offer is fully underwritten as follows:
 - the issue shall be fully underwritten by at least two underwriters and the underwriters shall not be associated companies or associated undertakings of the issuing company;
 - the sponsors shall not enter into any agreement or arrangements directly or indirectly with the underwriters with respect to the purchase of shares taken up by the underwriters to the issue;
- the offerer shall justify the amount of premium per share and the justification shall be disclosed in the offer for sale document.

Question 2

General comments:

57.05% candidates secured passing marks in this question.

Part (a)

Common errors:

- Students could only specify three or four types of businesses.
- Pension fund management and REIT management services were incorrectly included.

Suggested answer:

Following are the businesses which may be carried out by NBFCs under the provisions of the Companies Ordinance, 1984:

- (i) Investment Finance Services;
- (ii) Leasing;
- (iii) Housing Finance Services;
- (iv) Venture Capital Investment;
- (v) Discounting Services;
- (vi) Investment Advisory Services;

- (vii) Asset Management Services; and
- (viii) Any other form of business which the Federal Government may specify, by notification in the Official Gazette, from time to time.

Part (b)(i)

Common errors:

- Frequent use of guesswork was noted resulting in the use of terms which have not been used in the Ordinance such as involvement in fraudulent activities, any other matter deemed appropriate by the Commission, etc.
- Instead of mentioning about the interest of the shareholders and the NBFC, interest of directors was mentioned.

Suggested answer:

The Commission may remove the chief executive of HIL on any one of the following grounds:

- continued association of the chief executive is or is likely to be detrimental to the interests of NBFC or its shareholders or persons whose interest is likely to be affected; or
- the public interest so demands; or
- to prevent the affairs of NBFC being conducted in a manner detrimental to the interest of its shareholders or in a manner prejudicial to the interests of NBFC; or
- if it is necessary to secure a proper management of the NBFC.

Part (b)(ii)

Common errors:

Students were unable to clarify that any person appointed by the Commission to replace the CEO shall be appointed for a maximum of three years only.

Suggested answer:

If in the opinion of the Commission, any delay in the removal of CEO would be detrimental to the public interest or the interest of the shareholders, the Commission may, at the time of giving the opportunity being heard or at any time thereafter, direct that:

- the chief executive shall not, with effect from the date of the order:
 - as chief executive of the NBFC; or
 - in any way, be concerned with or take part in the management of the NBFC;
- any person authorized by the Commission in this behalf shall act as such chief executive of the NBFC till another person is elected to fill in the vacancy.

Any person appointed as chief executive shall:

- hold office subject to such conditions as may be specified in the order of his appointment and, subject thereto, for such period, not exceeding three years as the Commission may specify; and

Part (c)

Common errors:

- It was stated that siblings are not included in the definition of close relatives.
- Students were of the view that such agreement would require a special resolution.
- Candidates were of the view that there is no bar on such agreement provided the concerned director does not participate in the meeting/discussion/voting.
- Candidates were of the view that agreement can only be entered into if the rentals are based on market value.

Suggested answer:

EHFL cannot enter into the rental agreement with Zyan who is considered as a close relative of one of the director of EHFL. However, this restriction shall not apply to EHFL if it has a policy to this effect duly approved by its board of directors.

Question 3

General comments:

26.56% candidates secured passing marks in this question.

Part (a)

Common errors:

Only the relevant rule was stated. No conclusion was drawn. It must be noted that whenever the requirement is to give advice, the law as well as the conclusion are required to be stated.

Suggested answer:

According to the Companies Ordinance, 1984 any act of a director or a meeting of a director cannot be considered invalid merely on the ground of any defect subsequently discovered in his appointment. Therefore all the acts of Junaid during this period are valid. However, he should not exercise right of his office with immediate effect and any act after this cannot be considered valid.

Part (b)

Common errors:

- Students were of the view that the amount cannot be utilised by the company. Some of them stated that it can only be utilised with the permission of SECP.
- It was stated that the amount of security deposit should be deposited in a special account in a bank instead of a scheduled bank. Some of them mentioned financial institution instead of a scheduled bank.
- Candidates gave totally absurd advices such as:
 - Deposits should not exceed 25% of the paid-up capital.
 - Security deposits can only be utilised for the execution of contracts.
 - Security deposit can only be utilised in case of default by the payer.

Suggested answer:

Duck Limited (DL) can receive or utilize the amount on account of security deposit against a contract in writing only. DL shall deposit all the amount received on account of deposit in a special account with a scheduled bank.

Part (c)

Common errors:

- Candidates were of the view that the consequence of the delay in registration is that the loan becomes payable immediately and did not know the provisions related to the extension of time.
- It was stated that the extension would be granted by the Registrar instead of the Commission.

Suggested answer:

The time limit of 21 days has expired therefore Naeem Limited (NL) will have to apply to the Commission for extension of time for the registration of the charge.

NL must satisfy the Commission:

- (i) That the omission was accidental or due to inadvertence or due to some other sufficient cause, or
- (ii) It would not be of a nature to prejudice the position of creditors or shareholders of the company, or
- (iii) On any other grounds it is just and equitable to grant relief.

The Commission may extend the time for registration of charge on such terms and conditions as seem to the Commission just and expedient.

A certified copy of the order of the Commission, shall be filed by the company with the registrar within twenty-one days of the date of such order.

Question 4

General comments:

25.15% candidates secured passing marks in this question.

Part (a)(i)

Common errors:

- The condition related to submission of returns, notice of meeting and statement of assets and liabilities, to the registrar was missed in most of the cases. Candidates suggested submission to the Commission instead of Registrar.
- Candidates were too careless in the use of words as they mentioned submission of assets and liabilities instead of submission of statement of assets and liabilities.

Suggested answer:

Since Zahid is of the opinion that MSL cannot pay its debts in full within the period as declared by the directors, he shall forthwith summon a meeting of the creditors and shall lay before the meeting a statement of the assets and liabilities of MSL and such other particulars as may be specified.

Zahid shall submit a return of convening the creditors meeting along with notice and minutes of meeting and a statement of assets and liabilities of MSL with the registrar within ten days of the date of the meeting.

Part (a)(ii)

Common errors:

The students were expected to realize that the inability to pay the debts in full may be due to circumstances developing after the submission of declaration of solvency by the directors or due to any other acceptable reason. Consequently, it was necessary that the directors should be given a chance to clarify their position. This aspect was ignored.

Suggested answer:

As MSL is unable to pay its debts in full as declared by the directors in the statement of solvency, it shall be presumed that the directors did not have reasonable grounds for their opinion, therefore, unless the directors can prove otherwise they would be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ten thousand rupees or with both.

Part (b)

Common errors:

Students did not clarify that the power to accept the resignation of the liquidator rests with the Court and not the Board.

Suggested answer:

According to the Companies Ordinance, 1984 the liquidator shall not resign or quit his office as liquidator before conclusion of the winding up proceedings except for reasons of personal disability to the satisfaction of the Court.

Therefore, Zahid cannot resign.

The power of accepting or rejecting the resignation of liquidator before completion of winding up proceedings rests with the Court and not with the management of the company.

Question 5

General comments:

17.95% candidates secured passing marks in this question.

Part (a)

Common errors:

- Candidates did not have comprehensive knowledge of all the relevant rules i.e. limitation with regard to debt securities, shares and combination thereof.
- Candidates were aware of the aggregate limits only and did not say anything with regard to investment in a single entity.

Suggested answer:

The fund has already made investment in the listed securities equal to 44% of the size of the funds i.e. 24% in listed equity securities and 20% in listed debt securities. Under the EPF Rules:

- (i) The maximum limit of investment in listed debt securities is 50% of the fund. The additional investment of Rs. 20 million would increase the funds investment in debt securities to 24% which is within the allowable limit.
- (ii) The maximum limit of investment in listed equity securities is 30% of the fund. The additional investment of Rs. 40 million would increase its investment in equity securities to 32% which is above the allowable limit. The fund can make investment in BTL up to Rs. 30 million only ($500 \times 30\% - 120$).
- (iii) The maximum aggregate investment in listed securities is 50% of the fund. The additional investment of Rs. 60 million (i.e. Rs. 20 million in debt securities and Rs. 40 million in equity securities) would increase its investment in listed securities to 56% which is above the allowable limit.
- (iv) The aggregate investment in listed equity securities of a particular company shall be restricted to ten per cent of the size of the employees' provident fund i.e. (Rs. 50 million) or five per cent of the paid up capital of the investee company i.e. (Rs. 30 million) whichever is lower, therefore investment in BTL shares under this rule is allowed up to Rs. 30 million.
- (v) The aggregate investment in listed debt securities of a particular company shall be restricted to ten per cent of the size of the employees' provident fund i.e. (Rs. 50 million) or five per cent of debt issue of the investee company i.e. (Rs. 10 million) whichever is lower, therefore investment in FL under this rule is allowed up to Rs. 10 million.

Therefore, the maximum aggregate investment should also not exceed Rs. 30 million $\{(500 \times 50\%) - (100 + 120)\}$. Therefore, it may invest the entire amount of Rs. 30 million in BTL **OR** Rs. 20 million in BTL and Rs. 10 million in FL.

Part (b)

Common errors:

- Incorrect rating was mentioned whereas the correct rating was AA or above.
- Candidates mentioned the required rating as AA but did not mention that it was the minimum required rating.
- The rules related to default on financial obligation and not being on the defaulters' counter were mostly missed.

Suggested answer:

Other conditions to be met

for listed debt securities i.e. FL

- (i) The securities must have been assigned a minimum rating of "AA" with at least a stable outlook at the time of investment.

for listed equity securities i.e. BTL

- (i) BTL should have a minimum operational record of three years.
- (ii) BTL must have exhibited average total return on investments, not less than prevailing risk free rate i.e., the rate on which 6 months T-Bill are issued+50 basis point, at the time of investment.
- (iii) BTL must not have defaulted on any of its financial obligations.
- (iv) Its listed securities must not be on the defaulter segment of Pakistan Stock Exchange.

Question 6

General comments:

26.56% candidates secured passing marks in this question.

Part (a)

Common errors:

- Many incorrect measures were specified such as removal of CEO and the management, winding-up of the company, etc.
- The power to appoint receiver and fix his/her remuneration and regarding purchase of shares of any member were mostly missed.
- The question was not attempted.

Suggested answer:

The Court may order the following:

- (i) make an order restraining the carrying out the act or conduct;
- (ii) order that GTL shall proceed against the persons involved in such manner and terms as the Court may deem fit;
- (iii) appoint a receiver, specify the powers and duties of the receiver or manager and fix his remuneration; and
- (iv) make any other order it considers fit, whether for regulating the conduct of the GTL's affairs in future or for the purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital or otherwise.

Part (b)

Common errors:

- Candidates mentioned the requirements of section 224 of the Companies Ordinance, 1984.
- Candidates were totally confused and mentioned that the Company Secretary should present the required information to the CEO.
- The secretary's responsibility in case the CEO fails to meet his obligation was not mentioned in majority of the cases.

Suggested answer:

Duties and responsibilities of the Chief Executive and the company secretary in respect of transactions entered into by the Chief Executive are as follows:

- (i) Where the chief executive of a listed company sells or buys shares of the listed company of which he is the chief executive, he shall immediately notify in writing to the Company Secretary of such transaction.
- (ii) He shall also deliver a record of the price, number of shares, form of share certificates, i.e., whether physical or electronic within the Central Depository System, and nature of transaction to the Company Secretary within four days of effecting the transaction.
- (iii) The notice of chief executive shall be presented by the Company Secretary at the meeting of the board of directors immediately subsequent to such transaction.
- (iv) In the event of default by the chief executive to give a written notice or deliver a written record, the Company Secretary shall place the matter before the board of directors in its immediate next meeting.

Part (c)

Common errors:

- Candidates could not mention more than four or five points.
- In many cases, the complete provision was not mentioned, for example, while mentioning the condition of being an employee, employment in subsidiaries and the holding company was not covered.
- Candidates who did not appear to have the requisite knowledge provided lengthy discussion on the term 'independence'.

Suggested answer:

A director shall not be considered as independent, if one or more of the following circumstances exist:

- (i) He/she has been an employee of the company, any of its subsidiaries or holding company within the last three years;
- (ii) He/she is or has been the CEO of subsidiaries, associated company, associated undertaking or holding company in the last three years;
- (iii) He/she has, or has had within the last three years, a material business relationship with the company either directly or indirectly as a partner, major shareholder or director of a body that has such a relationship with the company.

- The major shareholder means a person who, individually or in connection with his family or as part of a group, holds 10% or more shares having voting rights in the paid up capital of the company.
- (iv) He/she has received remuneration in the three years preceding his/her appointment as a director or receives additional remuneration, excluding retirement benefits from the company apart from a director's fee or has participated in the company's share option or a performance-related pay scheme;
 - (v) He/she is a close relative of the company's promoters, directors or major shareholders:
Close relative means spouse(s), lineal ascendants and descendants and siblings;
 - (vi) He/she holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
 - (vii) He/she has served on the board for more than three consecutive terms from the date of his first appointment provided that such person shall be deemed "independent director" after a lapse of one term.
 - (viii) He/she is nominated as director by the company's creditors or other special interest by virtue of contractual agreements.
 - (ix) He/she is nominated as a director by the corporation/company who has made investment or otherwise extended facilities.
 - (x) He/she is nominated as a director by Federal Government, Provincial Government, Commission, foreign equity holders on the board of PICIC or any other company set up under a regional co-operation.

Question 7

General comments:

43.32% candidates secured passing marks in this question.

Part (a)

Common errors:

The transaction was considered as valid on the basis of the fact that paid up capital after the purchase would be Rs. 285 million. The fact that treasury shares cannot be purchased before completion of two years from the date of listing was ignored.

Suggested answer:

According to the Buy back of Shares Regulations 2016, a company shall be eligible to purchase its own shares when it is listed on the stock exchange for a period of not less than two years.

Therefore, Nabil Earth Limited cannot buy back its own shares as the period of two years has not been completed as it was listed on 1 August 2015.

Part (b)

Common errors:

- The transaction was considered as valid on the basis of the fact that the purchase was being made after two years from the date of listing. The fact that paid up capital after the purchase would be less than Rs. 200 million was ignored.

- Many students calculated the paid up capital after purchase as Rs. 200 million instead of Rs. 198 million.

Suggested answer:

According to the Buy back of Shares Regulations 2016, a company shall be eligible to purchase its own shares when it has a paid up capital of not less than Rs. 200 million after the purchase.

Therefore, Nabil Sun Limited cannot buy back its own shares as its paid up capital would be reduced below two hundred million rupees after the purchase.

Part (c)

Common errors:

- Candidates offered comments only on the issue of resale. The fact that treasury shares shall not exceed 10% of the paid up capital was not mentioned.
- The period after which resale was possible was mentioned as 1 year or 3 years instead of six months. Many candidates were of the view that treasury shares cannot be resold altogether.

Suggested answer:

Nabil Moon Limited (NML) can buy back shares provided that:

- (i) Shares held as treasury shares shall not exceed ten percent of the total paid up capital of NML.
- (ii) The treasury shares shall not be sold, transferred or otherwise disposed of within a period of six months from the closure of the purchase period. Therefore, NML cannot re-sell the share in the market after a period of three months.

Question 8

General comments:

19.88% candidates secured passing marks in this question.

Part (a)

Common errors:

- The requirement was to evaluate whether the given transaction falls under the ambit of insider trading. Consequently, it was necessary to briefly mention the meaning of insider and insider trading. Instead, a number of candidates gave concluding remarks without any evaluation.
- Many candidates declared it to be a case of insider trading only on the basis of the fact that share price has risen after the declaration of result or because Mr. Javed had made a substantial profit. However, either or both the above situations do not necessarily lead to insider trading. (Please see the suggested answer for further clarity on this aspect.)

Suggested answer:

According to the Securities Act, 2015, an '**insider**' includes any executive officer of an issuer of listed securities; and '**inside information**' means information which has not been made public relating, directly or indirectly, to listed securities and which if made public, would be likely to have an effect on the prices of listed securities.

From the above definition, it is established that Javed Ahmed is an insider person as he is in employment of the PTL and may possess inside information as he is head of production department and full knowledge of production of FCL.

The transaction will fall in the ambit of insider trading if:

- Mr. Javed Ahmed possessed the above information when he purchased the shares.
- The decision was taken on the basis of such information.

Part (b)

Common errors:

Candidates were not aware of the fact that listed companies are supposed to maintain a list of 'insiders', to keep it updated and to send it to SECP whenever required.

Suggested answer:

Responsibilities of a listed company regarding disclosure of inside information are as follows:

- (i) Whenever a listed company discloses any inside information to any third party in the normal course, effective disclosures of that information must be made simultaneously. However, this rule shall not apply if the person receiving the information owes a duty of confidentiality.
- (ii) A listed company shall maintain a list of persons employed, under contract, or otherwise in the prescribed manner, who have access to inside information and such company shall regularly update this list and send it to the Commission whenever required by the Commission.
- (iii) A listed company shall in the list of persons that have access to insider information state that the persons listed have acknowledged the requirements of this part related to the prohibition to conclude transactions with the use of inside information and to advise the persons to whom they provide insider information.

Question 9

General comments:

08.75% candidates secured passing marks in this question.

Part (a)

Common errors:

- Candidates were of the opinion that all transactions above a certain amount are suspicious transactions and various limits were assigned arbitrarily.

- Majority of the candidates had little knowledge of the relevant provisions and resorted to all sorts of guesswork.

Suggested answer:

- (i) The term suspicious transaction means a transaction or a pattern of transactions of which the transaction is a part which:
 - Involves funds derived from illegal activities or is intended or conducted in order to hide or disguise proceeds of crime.
 - Is designed to evade any requirements of section 7 of Anti Money Laundering Act, 2010.
 - Has no apparent lawful purpose.
 - Involves financing of terrorism.
- (ii) Suspicious transactions are reported to Financial Monitoring Unit (FMU) by
 - Financial institutions
 - Non-financial businesses and professions
 - Government agencies
 - Autonomous bodies
 - Regulatory authorities
 - Any other entity designated by the Federal Government.

Part (b)

Common errors:

- Candidates did not know that shares can only be pledged in favour of an eligible pledgee.
- Candidates resorted to guesswork while specifying the rights of MBL. Their answers included points such as MBL has the right to get the charge registered, MBL shall be informed regarding movement in the sub-account, etc.

Suggested answer:

- (i) Dewan can pledge his shares, deposited in CDC account, provided Marhaba Bank is an eligible pledgee, by giving instructions to the relevant participant as he is a sub-account holder.
- (ii) Rights of MBL are as under
 - MBL shall have all the powers available to it under the Contract Act, 1872.
 - MBL shall have the power, upon the default of Dewan, to transfer the pledged book entry securities.
 - Any other power which may be granted to MBL in writing by Dewan in relation to the pledged book-entry securities.
 - CDC cannot remove the pledge without the consent of MBL.

Question 10

General comments:

22.85% candidates secured passing marks in this question.

Part (a)

Common errors:

- Candidates mentioned the provisions contained in section 226 of the Companies Ordinance, 1984 which had already been tested in Question 3(a) instead of the provisions of Companies (Investment and acceptance of Deposits) Rules, 1987.
- Restrictions applicable to private companies were not mentioned by significant number of candidates.

Suggested answer:

A public and a private company cannot accept any deposit:

- for purposes other than the financing of its own business.
- from another company, except a company which is its holding company.
- which is repayable on demand/notice or repayable earlier than the expiry of six months or later than the expiry of thirty-six months from the date of acceptance or renewal of such deposit.

Provided that in case of short-term requirements of funds, accept deposits for repayment earlier than six months from the date of deposit subject to the conditions that such deposit:

- shall not exceed ten per cent, of the aggregate of the paid-up share capital and free reserves of the company; and
- shall be repayable not earlier than three months from the date of such deposit
- the total amount of deposit accepted shall not exceed twenty-five per cent of the aggregate of the paid-up share capital and free reserves of the company.

Restrictions applicable to private companies only

- No private company shall invite deposits from the public.
- A private company may accept deposits from persons other than its directors or shareholders or their spouses or minor children, provided that the number of such persons shall not exceed twenty at any time.

Part (b)

Common errors:

The question was very poorly attempted and candidates did not provide reasonably correct answers. They mentioned only one correct point i.e. regarding deposit of the amount in a scheduled bank.

Suggested answer:

Every company shall before the 31st day of December of each calendar year deposit or invest, at least ten per cent of the amount of its deposits maturing during the year ending on the 31st day of December next following in any one or more of the following, namely:

- (i) in a National Savings Scheme;
- (ii) in a special account opened for the purpose in a scheduled bank, free from charge or lien;

*Examiners' comments and Suggested answers on Corporate Laws,
CFAP Examination Summer 2017*

- (iii) in Government securities; or
- (iv) in such other securities as are notified by the Authority for the purpose.

(THE END)