

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT

Corporate Law

SESSION

Final Examination - Winter 2007

General :

The overall performance in this Paper was rather unsatisfactory as only 21 per cent of the students were able to obtain passing grades. Once again, the inability of the students to comprehend the precise requirements of the questions and inadequate preparations were observed in a large number of the replies.

Q.1 (a) Issuance of shares to an individual shareholder.

The candidates were required to mention the procedure for issue of further capital in a situation when the present shareholders were not interested in obtaining further shares. Many candidates ignored this fact and narrated the normal procedure for issuance of right shares which was not required. In the given situation two steps were required to be mentioned i.e. (i) a general resolution has to be passed by the Board of Directors and (ii) approval of SECP/Registrar should be obtained for issuance of unsubscribed share capital to an existing shareholder.

(b) Shareholdings of Mr. Majeed are in excess of 10% of the Company's paid up capital.

In this Question reference was required to be made to section 4(1) and (2) of the Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance 2002, according to which Mr. Majeed is obligated to inform the company and also the relevant stock exchange(s) of the status of his holdings within two days of receipt of intimation of allotment of shares.

Furthermore, Mr. Majeed is required to submit particulars of his shareholdings on Form 31 to SECP/Registrar in compliance with section 222 of the Companies Ordinance 1984 within a period of 30 days.

Q.2 Registration of Charge with the Registrar of Companies.

A considerable number of students stated that a charge is void if it is not registered within 21 days of its creation. This premise is not absolutely correct because there is an exception. It is stated in section 131, that SECP may grant extension, if it is convinced that the grounds for omission were incidental or due to inadvertence or for any other justifiable reason and would not prejudice the interests of the creditors or the shareholders of the company. The extension may be granted on such terms and conditions as may be considered appropriate by SECP and would be valid for registration of the documents within the next 21 days. Many of the candidates failed to mention the exception or to mention the conditions associated with it.

Q.3 Appointment of Alternate Director (sections 192 and 184).

Most of the students mentioned only one condition for the appointment of an alternate director, viz the absence of incumbent director for a period of at least 3 months. The other pre-requisites and formalities to be complied with are:

- Necessary provision in the Articles of Association or an agreement between the company and the concerned director proceeding on leave;
- Grant of leave of absence to the director proceeding on leave and approval of appointment of alternate director by the Board of Directors, and
- Filing of completed Form 29 with the Registrar along with the consent of incoming director.

Q.4 Filing of petition against the management in a Court

Only few students were able to state the various conditions mentioned in section 290 at least one of which is required to be met if a petition has to be filed against the management. The conditions are:

- Conduct of the company's business in an unlawful or in a fraudulent manner.
- Conduct of business of the company in a manner which is in contravention of its memorandum of association.
- Conduct of the business in a manner which is oppressive to the interests of any creditor(s).
- Conduct of the business in a manner which is prejudicial to public interest.

According to the decisions in a number of adjudicated cases, petitions cannot be filed in a court on the grounds of loss of confidence in the management, or continuous losses incurred by the company, or the management's failure to pay dividends.

In case the management indulges in insider trading, members may approach SECP under section 224 for remedy, instead of filing a petition in the Court.

Most of the answers were not specific and to the point. Instead, they were based on the general understanding of the examinees.

Q.5 Declaration of solvency (section 362(2)(b)).

In most of the replies, the following shortcomings were noted:

- Many students failed to mention that a declaration of solvency should also include a statement of the company's assets and liabilities made up to the latest practicable date before declaration.
- A number of students failed to mention that if the declaration is subsequently found to be incorrect the directors would be liable to a fine and/or imprisonment, if the declaration was made without obtaining reasonable grounds for belief.

Q.6 Amendment in the Object Clause of Memorandum of Association.

The question was based on Section 21 and Rule 3 of the Companies (General Provisions and Forms) Rules 1985

- (a) Most of the students did not mention that an application for confirmation of amendment in the Object Clause of Memorandum of Association must be filed with the Registrar/SECP within 60 days of the passing of the special resolution seeking the amendment in the Memorandum of Association.
- (b) The information required to be submitted in the application for amendment in the Memorandum of Association must include, name and address of the company, date of incorporation, particulars of paid-up and redeemable capital, actual business of the company in the context of its memorandum of association and reasons for the proposed amendment. Besides, a copy each of the Memorandum and Articles of Association, special resolution, minutes of the meeting in which the special resolution was passed and dissenting votes, if any along with the copy of the latest audited financial statements must be submitted along with the application for amendment in the Memorandum of Association.

Generally, the students were able to mention only a few of the aforesaid requirements and therefore, could not score high marks in this rather simple question.

Q.7 Issuance of bonus shares out of general reserves and share premium account.

- (a) **Rules 5 and 6 of the Companies (Issue of Capital) Rules 1996.**

Share premium was often treated as a part of free reserves. Intangible assets were not deducted while calculating free reserves. Both these errors resulted in loss of valuable marks.

- (b) **Sections 83 and 96 and rules as in part (a) above.**

Although several students mentioned that bonus shares can be issued out of share premium account, they failed to state the important point that such an appropriation should be specifically authorized in the Articles of Association. Moreover, bonus issue can only be made if the free reserves after issuance of bonus shares exceed 25% of the paid up capital and that too, after the issuance of bonus shares. Many students did not know that the condition of 25% has to be applied on the balances, after issuance of bonus shares.

Q.8 Business activities carried out by NBFCs (section 282A and NBFC Rules 2003).

- (a) This part of the Question was answered reasonably well by most students as they were able to identify the investment-related businesses i.e. investment financing, housing finance, discounting, investment advisory and asset management services, as well as lease financing as referred to in section 282A.
- (b) This part of the question required identification of various types of business activities which can be pursued within the ambit of each of the above broad investment-related businesses.

Under investment finance services, money and capital market operations, project and corporate finance services may be provided. Leasing includes both finance and operating leases, whereas investment advisory services encompass management of closed-end funds and rendering advice on valuation of securities and purchase and sale of securities. The activities under asset management services include management of open-end mutual funds, offering of investment schemes under trust deeds and issuance of redeemable securities.

Some of the students went a step further and started describing the operational issues involved in these investment-related services, which was not required.

Q.9 Drafting of a Resolution of the Board of Directors to give effect to a corporate merger

A large number of the students were not aware of the specific narrative requirements of drafting of special resolutions and consequently offered vague summaries of the merger transaction. The students are advised to carefully study the examples of board resolutions which appear in the annual reports of leading listed companies and also in the standard corporate law text books to develop an insight in the precise terminology, format and presentation of the various types of resolutions passed in the meetings of the Board of Directors.

Q.10 Winding up a Modaraba (Rule 23(1) of Modaraba Companies and Modaraba Ordinance 1980.

Generally, the replies to this question were satisfactory. However, several students did not clarify that a modaraba can be wound-up, if it is unable to discharge its liabilities and/or if its accumulated losses exceed 50 per cent of the total amount subscribed by the holders of the modaraba certificates.

The application for winding-up of a modaraba can be filed by the Registrar Modaraba to a Tribunal constituted by the Federal Government under the Modaraba Companies and Modaraba Ordinance 1980.

Q.11 Committees formed under Code of Corporate Governance of an unquoted insurance company

- (a) Only a few students were able to list the four committees formed under the Code of Corporate Governance viz. (i) Underwriting Committee, (ii) Claims Settlement Committee, (iii) Reinsurance and Co-insurance Committee and (iv) Audit Committee. A number of students were able to identify only the audit committee and its functions. It was evident that most students had resorted to selective studies and were not aware of the Code of Corporate Governance applicable to insurance companies.
- (b) Each of the above Committees comprises of a minimum of three members, including one director and meets at least once in every quarter. The Secretary of each committee is responsible for recording the proceedings of the meetings and their circulations among the recipients within a period of 15 days of the convening of the meeting. The Secretary also ensures that the records of the affairs of the Committee are retained at the Head Office. Here again, very few of the students were able to perform well.

Q.12 Preferential Payments to be made by a company in the process of winding –up.

Although many students mentioned that in the event of shortfall of funds in the event of winding-up of a company, proportionate payments were to be made to the creditors, they were not aware of the priority of the creditors listed in the question. The students were expected to list the preferential payments in the following order:

- Salaries and wages of 97 employees at Rs 2000 per employee.
- Fuel expenses to employees, property taxes, sales tax, income tax penalty, contribution to employees provident fund, leave encashment and disability insurance to be paid in full, as these payments including the salary would amount to Rs 1.594 million.
- The outstanding amounts of utility bills, legal and professional fees, NBP loans including interest, and both secured and unsecured creditors would be paid on a pro rata basis from the balance amount of Rs 156,000.

Some students incorrectly declared that priority of payments shall be according to clauses (a), (b), (c) and so on of Section 405 of the Companies Ordinance.

Many students did not know that priority payments against salary were to be restricted to Rs. 2000 per employee.

(THE END)