



**THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF  
PAKISTAN (ICPAP)**

**(Suggested Solution)**

Stage	<b>Professional</b>	Course Code	<b>P-501</b>
Examination	<b>Summer-2012</b>	Course Name	<b>Corporate Law and Governance</b>
Time Allowed	<b>03 Hours</b>	Maximum Marks	<b>100</b>
<b>NOTES:</b>  1) All questions are to be attempted. 2) Answers are expected to the precise, to the point and well written. 3) Neatness and style will be taken into account in marking the papers.			

**Question No 1:-**

- a) Under the Companies Ordinance, 1984 describe the circumstances in which proceedings of a general meeting may be declared invalid by the court. Who is eligible to make petition in this regard.

**Declaration of general meeting as invalid**

The Court may, on a petition by members having not less than ten percent of the voting power in the company, that the proceedings of a general meeting be declared invalid by reason of any material defect or omission in the notice or irregularity in the proceedings of the meeting which prevented members from using effectively their rights, declare such proceedings or part thereof invalid and direct holding of a fresh general meeting.

- b) MZE Limited, an NBFC engaged in leasing business, is currently facing serious financial crisis. SECP is not satisfied with the financial management of the company and has ordered a special audit of the company. In the light of the relevant provisions of the Companies Ordinance, 1984 relating to NBFCs you are required to explain whether the Commission is empowered to make such an order. Also describe the rights of the Commission in this regard?

**Special Audit**

The commission is required to monitor the general financial condition of a NBFC and at its discretion may order an special audit and appoint an auditor to carry out detailed

scrutiny of the affairs of NBFC, provided that the Commission may, during the pendency of the scrutiny, pass such interim orders and directions as may be deemed appropriate by the Commission.

On receipt of the special audit report, the Commission may direct a NBFC to do or to abstain from doing certain acts and issue directives for immediate compliance which shall forthwith be complied with, or take such other action as it deems fit.

- c) **Describe the conditions applicable to a NBFC relating to the appointment of internal auditor, under the NBFCs (Establishment and Regulation) Rules, 2003.**

**Conditions applicable to a NBFC- Appointment of an Internal Auditor**

A NBFC shall, appoint;

- i. a person having minimum three years' experience as internal auditor who is-
  - a. a chartered accountant; or
  - b. a cost and management accountant; or a certified internal auditor; or
  - c. a certified information system auditor; or
  - d. a member of a recognized foreign accountancy organization; or
  - e. an individual having master's degree in commerce or business administration with specialization in finance; or
- ii. A chartered accountancy firm having satisfactory Quality Control Review (QCR) and not being the statutory auditors to whom this function is outsourced.

**Question No 2:-**

In April 2011, Ilyas was appointed as the chief executive of Noor Sugar Mills Limited ('NSML'), a public unlisted company, by the board of directors of NSML ('Board'). Clause 3 of his contract with NSML ('Contract') provides as follows: 'The appointment shall be for a fixed term of three years starting from April 2011 and shall not be terminated before expiry of the aforementioned three years'. In October 2011, some members of the Board discovered evidence that Ilyas had been withdrawing large sums of money from NSML's bank account and using it for financing his son's new business. They want to seek Ilyas's removal as the chief executive. The Board comprises twelve members, six of whom are currently out of Pakistan. The six directors present in Pakistan want to meet immediately to remove Ilyas. Some Board members are of the view that due to Clause 3 of the Contract, Ilyas cannot be removed before the expiry of his term.

**Required:**

**Under the Companies Ordinance 1984, advise the Board on the possibility of, the procedure for, and the consequences of, Ilyas's removal as the chief executive of NSML.**

**Answer:-**

Section 202 Companies Ordinance, 1984 ('Ordinance') provides that the directors of a company by resolution passed by not less than three-fourths of the total number of directors for the time being, or the company by a special resolution, may remove a chief executive before the expiration of his term of office notwithstanding anything contained in the articles or in any agreement between the company and such chief executive.

On the given facts, Ilyas's term of office has not yet expired. Clause 3 of the Contract would not, of itself, prevent the possible removal of Ilyas because the express wording of s.202 overrides anything to the contrary contained in any agreement between the company and the chief executive.

Under s.202 two possible routes are valuable for Ilyas's removal: removal by the Board or removal by the company in general meeting. Removal by the Board would require a resolution passed by not less than three-fourths of the total number of directors for the time being of NSML, i.e., 3/4th of twelve - nine directors. Since six directors are out of Pakistan, the requisite nine directors are not available to pass the resolution under s.202 to successfully remove Ilyas through this method. If the remaining six directors try to pass a resolution for his removal, even if such resolution is unanimous, it will fall foul of s.202 (*Khawar M. Butt v Abdullah H. Habib* 1985 MLD 1193).

The second method, namely, removal through a special resolution passed by the company may be employed. For this purpose, a general meeting of the members of NSML would have to be convened, provided that due notice of the meeting (of at least 21 days) is given in accordance with ss.158 or 159 of the Ordinance, as the case may be, and the proper quorum is present, a resolution passed by not less than three-fourths of the members entitled to vote as are present in person or through proxy at the general meeting would suffice to remove Ilyas as the chief executive.

The Board may note, however, that although s.202 will enable the Board or the NSML in general meeting, as the case may be, to remove Ilyas, he may still bring a claim for damages for breach of contract citing violation of Clause 3. This risk may be aggravated if the allegations against Ilyas are not substantiated.

Further, by virtue of s.198 read with s.199(1) Ordinance, within 14 days of Ilyas's removal, the Board will have to appoint a new chief executive. Failure to do so may entail penal consequences under s.204 Ordinance.

### **Question No 3:-**

#### **Answer the following:-**

- a) Who out of transferor or transferee can apply for the recording of transfer of shares? What documents need to be attached with such application?**

Both the transferor and the transferee can apply for the recording of transfer of shares. Proper instrument of transfer duly stamped and executed by the transferor and the transferee alongwith scrip should be send for registering the transfer - Sec. 76

- b) Can a transfer of shares by recorded in the absence of a transfer deed? If yes, what is the procedure to be adopted?**

Yes. When transfer deed is lost, destroyed or mutilated before its lodgement, the company may, on the application made by the transferee and bearing the stamps required by the instrument of transfer, transfer it if the transferee proves to the satisfaction of the directors that transfer deed duly executed has been lost, destroyed or mutilated. Sec. 76

- c) Under what circumstances can the directors refuse to transfer the shares? What is time prescribed in the Companies Ordinance, 1984 for notifying to the transferee defects in the instrument of transfer?**

The directors can refuse the transfer of shares if they find the transfer deed as defector or invalid. However the company shall notify the defector invalidity to the transferee within 30 days from the date on which instrument of transfer was lodged (sec. 76) Moreover in case of private company, the articles may contain a clause giving to the directors an absolute discretion to refuse to register a transfer.

- d) During what time the Notice of refusal re-transfer of shares is to be sent by the Company? What are the penalties for not sending such a Notice?**

If a company refuses to register a transfer of any shares, the company shall within 30 days after the date on which the instrument of transfer was lodged with the company, send to the transferee notice of the refusal indicating reasons

for such refusal. In case of default, company and every officer who is a party to default shall be liable to a fine not exceeding two thousand rupees and to a further fine not exceeding Rs. 50 for every day after the first during which the default continues. Sec. 78

- e) **Can a member nominate any person who is not his relative to acquire shares in the case of the death of the member? If yes, can such nomination be varied later on by the member?**

Yes. The nomination is in no way prejudice the right of a member making the nomination during his life time. – sec. 80(4)

- f) **Can a member, having made a nomination, still deal with the shares during his lifetime?**

No. Any person, other than the relatives listed in Sec. 80(3) (spouse, father, mother, brother, sister, son or daughter (including step and adopted), cannot be nominated to acquire shares.

- g) **When the transferee who has been registered as a member on the basis of a forged transfer deed, further sells the shares, what rights the bona-fide purchaser for value will have in respect of the shares?**

A forged transfer is a complete nullity. If, as a result of such a document, the company removes the true owner from the register, it can be compelled to replace him. If on the strength of such a transfer the company issues a certificate, and any innocent person acts on the faith of such certificate and suffers loss, the company is liable. (This is estoppel as the title.) The company can then claim an indemnity for the loss from the person who submitted the forged transfer for registration even though he may have been unaware of the forgery. (There is no estoppel as to title in favor of such a person.) Thus:

A corporation received from B a stock transfer form in respect of a holding in the names of T and H. Unknown to B, H's signature had been forged by T. The transfer was registered into B's name. B then sold and transferred the stock to third parties, to whom certificates were issued. When H discovered the forgery he compelled the corporation to buy him an equivalent amount of stock and to pay him the income he had lost in the interim. The court held that B was bound to indemnify the corporation upon an implied contract that the transfer was genuine (*Sheffield Corporation v Barclay*, 1905).

In practice, in order to limit these risks, a notice of transfer is usually send to the purported transferor; but failure by the latter to object does not estop him from

subsequently denying the validity of the transfer (Barton v London & NW Railway, 1890).

**h) How can the shares of stock registered in the name of a lunatic be transferred? Who can sign the transfer deeds?**

Shares registered in the name of a lunatic are transferred by informing the company that the concerned shareholder has become a lunatic and then employing legal representative or nominee (if any) of the lunatic.

**Question No 4:-**

**Answer the following:-**

- a) **How can investment in associated companies or undertaking be made? Is there any additional requirement in the case of a listed company?**
- b) **How can contracts on behalf of a company be made?**
- c) **What is meant by Disclosure of Interest by directors?**

**When is such disclosure is to be made?**

- d) **What are the restrictions on trading by the directors, officer and principal shareholders?**

**Answer:-**

- a) **Investment in Associated Companies/Undertakings:- (Sec. 208)**

Investment in associated companies or undertakings or in the nature, terms and conditions thereof can be made by passing a resolution which will indicate the nature and amount of investment and terms and conditions attached to it. Resolution should be passed by a majority not less than 60% of the members entitled to vote and are present at a general meeting in person or through proxies. 21 days notice specifying the intention to propose such resolution in essential. In case of a listed company, in addition to its being send in the normal course, the notice should be published in one Urdu & English daily newspaper having circulation in the province in which stock exchange on which company is listed is situated.

This section shall not apply to:-

- a. A banking company.
- b. A financial institution approved by the Federal Government.
- c. A private company which is not a subsidiary of a public company.

**b) Contracts on Behalf of Company:- (Sec. 208)**

1. Contracts on behalf of a company may be made as follows:-

- i. Any contract which, if made between private persons, would be by law required to be in writing, signed by the parties to be charged therewith, may be made on behalf of the company in writing signed by any person acting under its authority, express or implied, and may in the same manner be varied or discharged.
- ii. Any contract which, if made between private persons, would in law be valid although made by parol only, and not reduced into writing, may be made by parol on behalf of the company by any person acting under its authority, express or implied, and may in the same manner be varied or discharged.

2. All contracts made according to sub-section (1) shall be effectual in law and shall bind the company, its successors and all other parties thereto, heirs, or legal representatives, as the case may be.

**c) Disclosure of Interest by Directors:- (SEC. 214):-**

Every director who is directly or indirectly interested in any contract or arrangement entered into or to be entered into by or on behalf of the company shall disclose the nature of his concern or interest at a meeting of the directors. Indeed the rule is so strict that a director is regarded as interested in a contract if he is merely a shareholder in another company which contracts with "his" company (Transvaal Land Co V New Belgium Land Company).

The director shall be deemed to be interested or concerned if any of his relative i.e. spouse or minor children is so interested or concerned. Disclosure will be made at a meeting at which the question of entering into the contract or arrangement is first taken into consideration or if at that time the said director is not interest/concerned, the first meeting after which he becomes so interested or concerned. A general notice of the same should also be given.

**d) Restriction on Trading:- (SEC.224)**

Where any directors, chief executive managing agent, chief accountant, secretary or auditor of a listed company or any other person, who is directly or indirectly the beneficial owner of more than 10% of its listed equity shares, makes any gain by the purchase and sale of such security within a period of less than 6 months,

such person shall make a report and tender the amount of such gain to the company and simultaneously send an intimation to this effect to the registrar and the authority. Provided that nothing in this section shall apply to a security acquired in good faith in satisfaction of debt previously contracted.

**Question No 5:-**

- a) What is a poll?
- b) Who may demand a poll?
- c) When and how may a poll be taken?
- d) When is a resolution passed at an adjourned meeting deemed to have been passed?

**Answer:-**

a) Poll:-

Any resolution put to vote of the meeting can either be decided by show of hands or by demanding a poll. Poll means 'casting of votes' where each shareholder has one vote for each share held.

b) Demand of a poll:-

According to Sec. 167, on or before the declaration of the result of the voting by show of hands on any resolution, a poll may be ordered to be taken by chairman on his own accord or on a demand made in that behalf by:-

1. In case of a public company, at least 5 members having the right to vote on the resolution and present in person or by proxy.
2. In case of a private company, at least 1 member present in person or by proxy if less than seven members are personally present but if more are present than at least 2 members having the right to vote on the resolution and present in person or by proxy.
3. Any member or members having not less than 1/10<sup>th</sup> of the total voting power in respect of the resolution present in person or by proxy.
4. Any member or members holding shares in the company conferring a right to vote on the resolution, being shares on which an aggregate sum has been paid up which is not less than 1/10<sup>th</sup> of the total sum paid upon all the shares concerning that right present in person or by proxy.

The demand of poll can be withdrawn at any time by the person or persons who made the demand.

c) Time for taking poll:-

According to Sec. 168 a poll demanded on the election of a chairman or on a question of adjournment shall be taken immediately while a poll demanded on any other question shall be taken at such time as the chairman may direct but within 14 days from the day on which it was demanded.

After a poll is taken the chairman or his nominee and a representative of the members demanding the poll shall scrutinise the votes and the chairman will announce the result. The result of the poll is deemed to be the decision of the meeting.

**d) Resolution at adjourned meeting:-**

The resolution passed at an adjourned meeting shall be treated as having been passed on the date on which it was first passed and shall not be deemed to have been passed at any earlier date – Sec 169.

**Question No 6:-**

**What are the principal tests to determine whether a charge is a fixed charge or a floating charge?**

**Answer:-**

The principal tests as to whether a charge is a floating charge or not is:

- i. Is it a charge upon all or certain classes of assets, present or future?
- ii. Would the assets charged in the ordinary course of business be change from time to time?
- iii. Has the company got power until such step is taken by the charge to carry on the business of the company in the ordinary way?