Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

7 June 2023
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Corporate Laws and Practices

<u>Instructions to examinees:</u>
(i) Answer all **EIGHT** questions.
(ii) Answer in **black** pen only.

Q.1 Kashmore Textiles Limited (KTL) is a listed company involved in manufacturing and selling textile products. As of 30 June 2022, KTL had an authorized and paid-up share capital of Rs. 1,500 million, consisting of 150 million ordinary shares of Rs. 10 each.

On 15 September 2022, KTL's shareholders passed a special resolution approving the buy-back of 30 million ordinary shares at the prevailing market price. As per the resolution, these shares will be held by KTL in its own name, and the purchase period will be from 20 September 2022 till 13 March 2023. The details of shares purchased by KTL within the designated buy-back period from the Pakistan Stock Exchange (PSX) are as follows:

Date of purchase	30 Sep 22	17 Oct 22	31 Oct 22	15 Nov 22	30 Nov 22
No. of shares purchased (in million)	8	6	9	5	2
Purchase price per share (Rs.)	250	180	195	150	170

Using the above information, respond to each of the following independent situations.

(a) Situation I
The Scandinavian Group of Designers (SGD), a prominent European fashion designing conglomerate, has recently approached KTL to collaborate on supplying of fabric material for 500,000 formal-wear gowns by December 2023. SGD also wants to sign a five-year contract designating KTL as their approved supplier. This price-sensitive information was timely disseminated to the PSX.

In light of the proposed collaboration with SGD, KTL's board is considering the following actions to support operations:

(i) To meet the financing requirements, sell 27 million shares earlier purchased under the special resolution dated 15 September 2022. The shares would be sold at a price of Rs. 350 per share, despite the current market price being Rs. 340 per share and the break-up value being Rs. 250 per share.

(ii) To retain skilled staff members, adopt a unique retention strategy for the first time in KTL's history. This strategy should include selling 3 million shares that were purchased earlier under the special resolution dated 15 September 2022, to all skilled staff members employed by KTL, with a vesting period of five years.

Required:
Under the applicable corporate laws, evaluate each of the above actions being considered by KTL's board. Also, specify the procedure for the sale of shares in accordance with the KTL's board considerations. **(10)**
(Ignore the provisions of the Companies Act, 2017, the Companies (General Provisions and Forms) Regulations, 2018 and the PSX Rule Book)

(b) Situation II

In March 2023, KTL experienced a setback when a major customer, Norwegian Fashion Designers (NFD), chose not to renew its five-year contract. This resulted in a 40% reduction in KTL's working capital requirements. Due to economic slowdown, KTL does not expect increased demand from other customers to cover the shortfall caused by the non-renewal of NFD's contract.

In light of the above circumstances, KTL's board aims to buy-back further shares from the market. They believe that the available cash flows will not be fully utilized for new projects, and there are no outstanding obligations to use the surplus cash. KTL's board expects that buying-back of further shares will not only improve the earnings per share but also offer an exit opportunity for shareholders seeking to liquidate their investment in KTL.

Required:

Under the applicable corporate laws, discuss the situations in which KTL is not permitted to buy-back further shares of KTL. **(06)**

(Ignore the provisions of the PSX Rule Book)

Q.2 Zia Ali, an entrepreneur, has been offered an opportunity to be one of the promoters in a new business. Some of the key highlights of the proposed business are as follows:

- The business aims to create a fund that enables the general public to make a long-term investment for a period of five to ten years under an investment contract. The object of the business is to provide stable and promising investment returns to the general public by managing the investment effectively.
- The returns will be calculated based on the units under the investment contract, with no guarantee of a minimum value for these units.
- The benefit to be paid either on death or on a specified date(s) before death as per the terms of the investment contract.

While reviewing the business proposal, Zia Ali has requested information regarding the mandatory requirements that must be complied with to obtain the registration of the proposed business. Additionally, he has inquired about the maximum time period within which the confirmation of registration would be granted.

Required:

Under the applicable corporate laws, advise Zia Ali regarding the information he has requested/inquired. **(10)**

(Ignore the provisions of the Companies Act, 2017 and the Companies (Incorporation) Regulations, 2017)

Q.3 The share capital of Jacobabad Limited (JL), a listed company, comprises of 70 million shares of Rs. 20 each, with the Federal Government owning 40 million shares through the Ministry of Finance.

Rumors have surfaced in the market regarding alleged misconduct by JL's Chief Operating Officer (COO). It is claimed that the COO has personally benefited by engaging contractors who supply goods and services to JL's business operations. Further, several contractors have lodged complaints stating that their payments were withheld after refusing to comply with the COO's unrelated demands.

Required:

Under the provisions of the Public Sector Companies (Corporate Governance) Rules, 2013, discuss the actions expected of JL's board which may address the alleged misconduct by the COO. **(08)**

Q.4 (a) Sukkur Transport Limited (STL) is a company engaged in the manufacturing and sale of electric vehicles. Majority of the paid-up share capital has been held by the Ahmed Family and Ghani Family, who are the main sponsors of STL since its incorporation in 2015. In June 2022, STL got listed on the PSX.

Extracts from STL's audited statement of financial position as on 31 March 2023 are as follows:

	Rs. in million
Authorized ordinary share capital (Rs. 10 each)	900
Paid-up ordinary share capital (Rs. 10 each)	500
Unappropriated profit	3,500

The current shareholding structure of STL is as follows:

	Rs. in million
Ahmed Family	200
Ghani Family	140
Hafizabad Pesticides Limited	50
Lodhran Bank Limited	30
Jhang Jhelum (SMC-Private) Limited	20
Abbottabad Textiles Limited (ATL)	10
Others (Individuals)	50
Total	**500**

STL intends to launch solar vehicles under its brand name. In this regard, STL plans to acquire large-scale production facilities in Faisalabad specifically for manufacturing solar vehicles. STL would require an initial investment of Rs. 800 million, which will be utilized for acquiring the production facilities and initiating commercial production of solar vehicles. The funds need to be arranged by 30 September 2023.

To cater the financing requirement of the project, STL's board is considering the following proposals:

(I) Right issue
Issue 40 million right shares at a price of Rs. 20 per share. The minimum subscription amount for the issue will be Rs. 600 million. In the event that any portion of the right issue remains unsubscribed, a long-term loan from the bank will be taken to cover the shortfall. While Ghani Family appears reluctant to invest further in STL, the company is confident that the other shareholders will subscribe to the issue. Furthermore, ATL, an associated company of STL, will be offered to adjust its subscription amount to settle an existing loan provided to STL, which is due to mature on 30 November 2023.

(II) Issuance of term finance certificates (TFCs)
Issue 8 million TFCs with a face value of Rs. 100 each. These TFCs will mature after five years from the date of issuance. STL plans to issue 7 million TFCs through a book building mechanism, while the remaining TFCs will be allocated to the retail investors.

Required:
Under the applicable corporate laws, analyze each of the above proposals separately and highlight any shortcomings that must be addressed by STL before making a decision. **(11)**
(Ignore the provisions of the Companies Act, 2017)

(b) Assume that in (a) above, STL proceeds to make arrangements to issue 5 million TFCs of Rs. 100 each through the book building process. The book building was conducted in which following bids were received from various bidders at the close of bidding period:

Name of Bidder	Amount of bid Rs. in million	Profit rate % per annum
A - Ayubia Limited	300	13.0%
B - Badin Limited	250	11.0%
C - Chiniot (Private) Limited	100	10.0%
D - Dadu Limited	90	9.0%
E - Sadiqabad Limited	80	8.5%
F - Faisalabad Limited	60	12.0%
G - Ghotki (SMC-Private) Limited	50	7.0%
H - Hyderabad Limited	50	7.5%
I - Islamabad Limited	40	11.0%

Required:
Under the applicable corporate laws:

(i) advise the profit rate(s) at which the TFCs should be issued and how they should be allotted to the bidders. **(06)**
(ii) specify the information that must be included in the investor agreements regarding the issuance of TFCs. **(03)**

Q.5 While reviewing the condensed interim financial statements of Larkana Bank Limited (LBL) for the quarter ended 31 March 2023, the directors expressed the following viewpoints:

Huzaifa Ali
He referred to the deliberation held in the last board meeting regarding how to address the provisions made against non-performing financing and related assets, which have been increasing significantly year by year. He suggested to the board that LBL should form a company, named Quetta Corporate Management Company (Private) Limited (QCM), in collaboration with other banks. He stated that since the formation of such a company does not require approval of any regulatory body, immediately after incorporation, QCM should takeover non-performing financing of all the banks against mutually agreed consideration. This would result in LBL's books being cleaned. He further stated that in order to achieve the said objective, QCM's principal line of business should be as follows:

(i) Carrying out the acquisition, management, reorganization, revival, and liquidation of commercially or financially distressed companies and their business; and
(ii) Buying or selling any commodity and providing settlement or execution without the actual delivery or transfer of such commodity.

Sarah Yousuf
She raised the concern that since these non-performing financing are sub-judice, LBL cannot transfer and assign these non-performing financing without the permission of the Court, which would be a cumbersome and expensive exercise. However, Huzaifa Ali clarified that since QCM will be LBL's subsidiary, the transfer and assignment of these non-performing financing would be executed without the Court's permission.

Required:
Under the applicable corporate laws, advise the board regarding the shortcomings in the viewpoints of the directors. **(10)**
(Ignore the provisions of the Companies Act, 2017)

Q.6 (a) Farrukh Javed, an IT professional, has developed a system to provide fast, secure and convenient financial services. His intention is to market the system, enabling customers to easily obtain money or make payments through tangible or intangible instruments. Additionally, he aims to offer internationally acceptable benchmark-level services for payment transfer, clearing, and supervision, with the goal of improving efficiency, transparency, and reducing the risk of forgery for all stakeholders.

Considering the substantial funds required for the business venture, Farrukh Javed has decided to approach potential investors to secure the necessary capital. Before presenting the idea to any investor, he seeks clarification, regarding the following matters:

(i) The law(s) applicable to the aforementioned services that require compliance.
(ii) The conditions to be complied with, as per the law(s) identified in (i) above, prior to starting the system.
(iii) The parameters to be considered when selecting employees who will be responsible for operating the system.
(iv) Whether it is a requirement to establish a company in order to operate the system.

Required:
As a corporate consultant, provide clarification to Farrukh Javed on the above matters in light of the applicable corporate laws. **(08)**

(b) Assuming that the system developed by Farrukh Javed as discussed in (a) above received funding from an investor named Chaman Limited (CL), a new private limited company (NPL) was established in November 2022 to provide services to customers. CL made the investment with the intention of positioning NPL as the market leader in the field of payment system.

Currently, NPL is considering to acquire the entire shareholding of Swat International (Private) Limited (SIL), which is also involved in a similar business as NPL. The intention behind this acquisition is to merge the business of SIL with NPL. Upon completion of acquisition, NPL is expected to gain control of approximately 50% of the total market share.

Required:
Under the applicable corporate laws, discuss:

(i) the restriction(s), applicable on NPL that need to be taken into account before the proposed acquisition of SIL. **(05)**
(ii) under what situations, the relevant authority may allow the acquisition of SIL despite the restrictions applicable on NPL in (i) above. **(04)**

(Ignore the provisions of the Companies Act, 2017)

Q.7 On 23 May 2023, a renowned investor, Maroof Shah, agreed to sign a Rs. 45 million investment agreement for five years with Okara Asset Management Limited (OAM). He paid through a cheque from his bank account, directing OAM to execute the agreement under the name of Kasur Associates (KA) instead of his own name.

During an internal audit, it was identified that Maroof Shah had not provided documentation regarding his connection with KA despite multiple requests. As a result, the issue was promptly escalated to Safdar Hasnain, CEO, who directed the team to report it to the investigating agency and the Commission. Safdar Hasnain also directed the team to consult the legal division of another company, where he holds a directorship, for further guidance on this matter.

Required:
Under the applicable corporate laws, critically discuss the directions given by Safdar Hasnain. **(05)**

Q.8 (a) Sentosa Conglomerate Limited (SCL), incorporated in Singapore on 15 July 2015, is engaged in manufacturing and exporting textile products. In January 2021, SCL inaugurated its first outlet in a renowned shopping mall in Lahore and appointed Fahad Ali Baig as its chief operating officer. The Lahore market's response has been remarkable, with exceptionally high sales and a substantial increase in the customer base each year.

SCL's management is presently planning to open five more outlets in other cities of Pakistan and raise the finances for new outlets by offering its own shares for subscription to Pakistani nationals residing in Pakistan.

Required:
Advise the management of SCL on the provisions of the Companies Act, 2017, that SCL must address as a foreign company in order to proceed with its present plan. **(07)**

(b) SCL has decided to issue 50,000 of its shares to Fahad Ali Baig without any monetary consideration as a recognition of his extraordinary efforts to boost SCL's business in Pakistan.

Required:
Advise Fahad Ali Baig regarding the provisions of the Foreign Exchange Manual that he needs to comply with before and after the issuance of shares to him. **(07)**

(THE END)