

**Paper-6: LAWS, ETHICS AND GOVERNANCE**

Full Marks: 100

Time Allowed: 3 Hours

This paper contains 4 questions. All questions are compulsory, subject to instructions provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

**Question 1: Answer all questions**

**[2 X 10 = 20]**

(i) H lends a sum of ₹15,000 to D, on the security of two shares of a Limited Company on 1<sup>st</sup> April 2011. On 15<sup>th</sup> September, 2011, the company issued two bonus shares. D returns the loan amount of ₹15,000 with interest but H returns only two shares which were pledged and refuses to give the two bonus shares. Advise D in the light of the provisions of the Indian Contract Act, 1872.

(ii) Mr. D of RB Textile Ltd. enters into a contract with RS Garments Show Room for supply of 1,000 pieces of Cotton Shirts at ₹300 per shirt to be supplied on or before 31<sup>st</sup> December, 2011. However, on 1<sup>st</sup> November, 2011 RB Textiles Ltd informs the RS Garments Show Room that he is not willing to supply the goods as the price of Cotton shirts in the meantime has gone up to ₹350 per shirt. Examine the rights of the Retail Garments Show Room in this regard.

(iii) B holds agricultural land on a lease granted by A, the owner. The land revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of B's lease. B, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from A. Referring to the provisions of the Indian Contract Act, 1872 decide whether A is liable to make good to B, the amount so paid?

(iv) G's goods were seized by Custom Authorities. Whether this is bailment under Indian Contract Act, 1872?

(v) In an agreement between P and Q, there is a condition that they will not institute legal proceeding against each other without consent. Is the contract valid or void?

(vi) R sent a consignment of goods worth ₹160,000 by railway and got railway receipt. He obtained an advance of ₹80,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for ₹160,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

(vii) What are the core objectives of Corporate Governance?

(viii) The articles of association of a listed company has fixed payment of sitting fee for each Meeting of Directors subject to maximum of ₹10,000. In view of increased responsibilities of independent directors of listed company, the company proposes to increase the sitting fee to ₹25,000. Would it be possible under Companies Act, 1956?

(ix) State 'The Utilitarian Approach' of ethical standard.

(x) What is meant by 'Ethical Dilemma'?

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### **Answer:**

**(i)** As per provisions of Section 163(4) of the Indian Contract Act, 1872, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed."

Applying the provisions to the given case, the bonus shares are an increase on the shares pledged by D to H. So H is liable to return the shares along with the bonus shares and hence D the bailor, is entitled to them also.

**(ii)** In the given problem RB Textiles Ltd has indicated its unwillingness to supply the cotton shirts on 1st November 2011 itself when it has time upto 31st December 2011 for performance of the contract of supply of goods. It is therefore called anticipatory breach of contract. Thus RS Garments show room can claim damages from RB Textiles Ltd immediately after 1st November, 2011, without waiting upto 31st December 2011. The damages will be calculated at the rate of ₹50 per shirt i.e. the difference between ₹350 (the price prevailing on 1st November) and ₹ 300 the contracted price.

**(iii)** Yes, A is bound to make good to B the amount so paid. Section 69 of the Indian Contract Act, 1872, provides that "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other. In the given case has made the payment of lawful dues of A in which B had an interest. Therefore, B is entitled to get the reimbursement from A.

**(iv)** Yes, the possession of the goods is transferred to the custom authorities. Therefore bailment exists and section 148 of Contract Act, 1872 is applicable.

**(v)** An agreement in restraint of legal proceedings is void as per Section 28 of the Indian Contract Act, 1872.

**(vi)** As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledge, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of ₹ 1,60,000 against Railway.

**(vii)** The core objectives of Corporate Governance are:

- Transparency – Every step shall be taken to ensure that timely and accurate information is imparted to all concerned.
- Participation – Steps taken to provide adequate information to share holders and ensure their participation in policy matters.
- Legal Adherence – all legal policies and rules are duly complied with.
- Effectiveness – Effectiveness of governance to be achieved.

**(viii)** With reference to section 309, of Companies Act, 1956, increase in sitting fees is not permissible, since approval of Central Government is required as the proposed sitting fees exceeds the permissible maximum limit of ₹ 20,000 per Board meeting per director (not being MD or WTD).

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**(ix)** This approach provides that the ethical action is the one that provides the most good or does the least harm, in other words it states that Ethical approach produces the greatest good and does the least harm for all who are affected – customers, employees shareholders, the community and the environment.

**(x)** Ethical Dilemma refers to a situation of selecting right and wrong from several alternatives available. Many business issues may seem straight forward and easy to resolve by choosing the one option which appears to be the clear choice. However problem might be different where one is faced with problem having to make a choice from various alternatives in which more than one option seems right resulting in ethical dilemma.

### **Question 2: Answer any 4 questions**

**[4 × 12 = 48]**

#### **Question 2(a)**

**(i) What is meant by Anticipatory Breach of Contract?**

**(ii) What is meant by 'Undue Influence'?**

**(iii) State the circumstances where under an agent is personally liable to a third party for the acts during the course of agency?**

**(iv) When a contract need not be performed?**

**[2+4+4+2 = 12]**

#### **Answer:**

**(i)** Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promisor is over.

**(ii)** Section 16 of the Indian Contract Act, 1872, states that a contract is said to be induced by undue influence where the relations subsisting between the parties are such that the parties are in a position to dominate the will of the other and used that position to obtain an unfair advantage over the other.

A person is deemed to be in that position:

1. where he holds real or apparent authority over the other or stands in a fiduciary relation to him;
2. where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of old age, illness or mental or bodily distress.
3. where a man who is in position to dominate the will of the other enters into contract with him and the transaction appears to be unconscionable, the burden of proving that it is fair, is on him, who is in such a position.

When one of the parties who has obtained the benefits of a transaction is in a position to dominate the will of the other, and the transaction between the parties appears to be unconscionable, the law raises a presumption of undue influence [section 16(3)]. Every

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transaction where the terms are to the disadvantage of one of the parties need not necessarily be considered to be unconscionable. If the contract is to the advantage of one of the parties but the same has been made in the ordinary course of business the presumption of undue influence would not be raised.

**(iii)** Under the following circumstances an agent is personally liable.

1. When he represents that he has authority to act on behalf of his principal, but who does not actually possess such authority or who has exceeded that authority and the alleged employer does not ratify his acts. Any loss sustained by a third party by the acts of such a person (agent) and who relies upon the representation is to be made good by such an agent.
2. Where a contract is entered into by a person apparently in the character of agent, but in reality on his own account, he is not entitled to required performance of it.
3. Where the contract expressly provides for the personal liability of the agent.
4. When the agent signs a negotiable instrument in his own name without making it clear that he is signing as an agent.
5. Where the agent acts for a principal who cannot be sued on account of his being a foreign Sovereign, Ambassador, etc.
6. Where the agent works for a foreign principal.
7. Where a Government Servant enters into a contract on behalf of the Union of India in disregard of Article 299 (1) of the Constitution of India, In such a case the suit against the agent can be instituted by the third party only and not by the principal (Chatturbhuj v. Moheshwar).
8. Where according to the usage of trade in certain kinds of business, agents are personally liable.
9. Where his authority is coupled with interest, he can be sued only to the extent of his interest in the subject matter

**(iv)** A contract need not be performed under following circumstances:

1. When performance becomes impossible.
2. When parties to contract agree to substitute it with a new one or rescind it or alter it. (Sec. 6)
3. When the promisee waives or remits the performance of promise made to him, wholly or in part or extends the time of performance or accepts any other satisfaction for it. (Sec.63)
4. When a person at whose option it is voidable, rescinds it (Sec. 64)
5. When the promisee refuses or neglects to provide reasonable facilities to the promisor for performance of the promise. (Sec.67)
6. When the contract is illegal.

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### Question 2(b):

(i) A sold his car to B for ₹175,000. After inspection and satisfaction, B paid ₹87,500 and took possession of the car and promised to pay the remaining amount within a month. Later on A refuses to give the remaining amount on the ground that the car was not in a good condition. Advise A as to what remedy is available to him against B.

(ii) K the owner of a Fiat car wants to sell his car. For this purpose he hands over the car to M, a mercantile agent for sale at a price not less than ₹100, 000. The agent sells the car for ₹75,000 to B, who buys the car in good faith and without notice of any fraud. M misappropriated the money also. K sues B to recover the Car. Decide given reasons whether K would succeed.

(iii) What are the consequences of “destruction of goods” under the Sale of Goods Act, 1930, where the goods have been destroyed after the agreement to sell but before the sale is affected.

(iv) G absented himself from duty without applying for leave and left the job. When he claimed gratuity, the company refused to pay gratuity quoting his absence from duty without proper leave resulted in break in service. Will he get gratuity?

[3+3+3+3 = 12]

### Answer:

(i) As per the section 55 of the Sale of Goods Act, 1930 an unpaid seller has a right to institute a suit for price against the buyer personally. The said Section lays down that—

Where under a contract of sale the property in the goods has passed to buyer and the buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for the price of the goods [Section 55(1)].

Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price. It makes no difference even if the property in the goods has not passed and the goods have not been appropriated to the contract [Section 55(2)].

This problem is based on above provisions. Hence, A will succeed against B for recovery of the remaining amount. Apart from this Suraj is also entitled to:

1. Interest on the remaining amount.
2. Interest during the pendency of the suit.
3. Costs of the proceedings

(ii) The problem in this case is based on the provisions of the Sale of Goods Act, 1930 contained in the proviso to Section 27. The proviso provides that a mercantile agent is one who in the customary course of his business, has, as such agent, authority either to sell goods, or to consign goods, for the purpose of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)]. The buyer of goods from a mercantile agent, who has no authority from the principal to sell, gets a good title to the goods if the following conditions are satisfied:

1. The agent should be in possession of the goods or documents of title to the goods with the consent of the owner.

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2. The agent should sell the goods while acting in the ordinary course of business of a mercantile agent.
3. The buyer should act in good faith.
4. The buyer should not have at the time of the contract of sale notice that the agent has no authority to sell.

In the instant case, M, the agent, was in the possession of the car with K's consent for the purpose of sale. B, the buyer, therefore obtained a good title to the car. Hence, K in this case, cannot recover the car from B. A similar decision, in analogous circumstances, was taken in *Folkes vs. King*

### (iii) Destruction of Goods-Consequences:

1. In accordance with the provisions of the Sale of Goods Act, 1930 as contained in Section 7, a contract for the sale of specific goods is void if at the time when the contract was made; the goods without the knowledge of the seller, perished or become so damaged as no longer to answer to their description in the contract, then the contract is void ab initio. This section is based on the rule that where both the parties to a contract are under a mistake as to a matter of fact essential to a contract, the contract is void.

2. In a similar way Section 8 provides that an agreement to sell specific goods becomes void if subsequently the goods, without any fault on the part of the seller or buyer, perish or become so damaged as no longer to answer to their description in agreement before the risk passes to the buyer. This rule is also based on the ground of impossibility of performance as stated above.

It may, however, be noted that section 7 & 8 apply only to specific goods and not to unascertained goods. If the agreement is to sell a certain quantity of unascertained goods, the perishing of even the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver the goods.

**(iv)** Section 2A of the Payment of Gratuity Act, 1972 provides that an employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order 3 [treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), lay-off, strike or a lock-out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act.

Therefore G is eligible and will get Gratuity.

### Question 2(c):

**(i) Fortunate Ltd. was running in continuous losses for 7 years. As a result, the company's financial position worsened. The company declared lay-off of 25 of its employees. The employees protested the lay-off. Is this action of employer justified?**

**(ii) An electrician, who had to go frequently to a heating room from a cooling plant, contracted pneumonia which resulted in his death. Is the employer liable to pay compensation under the Employees Compensation Act, 1923?**

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**(iii) F failed to give details of travelling expenses on account of tour inspite of several reminders. His company deducted the amount of tour advance from F's salary after expiry of 3 months. Is the company justified under the Payment of Wages Act, 1936?**

**(iv) X, an out worker prepared goods at his residence and later on supplied these goods to the M/s ABC . Is he an employee under the Minimum Wages Act, 1948?**

**(v) Y, on retirement withdrew the entire amount of his accumulation in the provident fund. Later on, he was re-appointed for a fixed tenure. The PF Inspector claimed contribution in respect of salary paid to Y. Is the demand made by PF Inspector tenable in law under The Employees 'Provident Funds and Miscellaneous Provisions Act, 1952?**

**[3+2+2+3+2 = 12]**

### **Answer:**

**(i)** As per section 2(kkk) of the Industrial Dispute Act lay-off - means failure, refusal or inability of an employer to give employment to a workman (a) whose name is borne on the muster –rolls of his industrial establishment, and (b) who has not been retrenched. The failure, refusal or inability of an employer to give employment may be due to-

1. shortage of coal, power, or raw materials,
2. the accumulation of stocks
3. breakdown of machinery
4. natural calamity or any other connected reasons.

In the given problem, because of continuous losses, the company's financial position worsened. The company declared lay-off of 25 of its employees. The words 'for any other reason' used in the definition is analogous to the reasons given in the definition. But the cause stated by the company is not covered under the definition. As such, the action of the employer is not justified. Similar observation was made in J. K Hosiery vs. LAT of India.

**(ii)** According to Section 3 of the Employees Compensation Act, 1923 , employer is liable to pay compensation if personal injury is caused in course of employment. The course of employment is not interrupted by intervals of rest.

In the given problem, an employee had to frequently go into a heating room and from there to a cooling room in course of his duties. He suffered pneumonia and died. This is out of employment and employer is liable to pay compensation. [Indian News Chronicle Ltd. vs Lazarus(1951) 3 FJR 190]

**(iii)** According to Sec. 7(2) f and Sec . 12 of the Payment of Wages Act, 1936 no recovery can be made of such advances given for travelling expenses. The recovery of such advance is governed by rules made by appropriate Government in this regard. So the company on its own cannot make such recovery.

**(iv)** As per section 2(i) of the Minimum Wages Act, 1948 an "employee" means any person who is employed for hire or reward to do any work, skilled or unskilled, manual or clerical, in a scheduled employment in respect of which minimum rates of wages have been fixed; and includes an out- worker to whom any articles or materials are given out by another person to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of that other person where the process is to be carried out either in the home of the out- worker or in some other premises not

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being premises under the control and management of that other person; and also includes an employee declared to be an employee by the appropriate Government; but does not include any member of the Armed Forces of the 2 [Union].

So X is an employee under the Minimum Wages Act, 1948.

(v) An employee who has been member of PF, withdrew the full amount of his accumulations is an 'excluded employee.' However, once he is reappointed in connection with work of the company, he attracts definition of 'employee' and the Act becomes applicable to him afresh. In Harrison Malayalam Ltd. and Ors vs. RPF & Ors. (CAL H.C) 2001 I LLJ 1160, the company was held liable to cover an employee who took VRS and later appointed for a lump sum basis. Thus the demand made by authorities is tenable.

### **Question 2(d):**

**(i) Explain the term 'Arbitration' for resolution of industrial dispute under the Industrial Dispute Act, 1947.**

**(ii) What is the procedure of fixing minimum wages under the Minimum Wages Act, 1948?**

**(iii) S delivered his car to M for repairs. M completed the work, but did not return the car to S within reasonable time, though S repeatedly reminded M for the return of car. In the meantime a big fire occurred in the neighborhood and the car was destroyed. Decide whether M can be held liable under the provisions of the Indian Contract Act. 1872.**

**[5+5+2 = 12]**

### **Answer:**

**(i) Arbitration:**

A process in which a neutral third party listens to the disputing parties, gathers information about the dispute, and then takes a decision which is binding on both the parties. The conciliator simply assists the parties to come to a settlement, whereas the arbitrator listens to both the parties and then gives his judgement.

### **Advantages of Arbitration:**

- It is established by the parties themselves and therefore both parties have good faith in the arbitration process.
- The process is informal and flexible in nature.
- It is based on mutual consent of the parties and therefore helps in building healthy Industrial Relations.

### **Disadvantages:**

- Delay often occurs in settlement of disputes.
- Arbitration is an expensive procedure and the expenses are to be shared by the labour and the management.
- Judgment can become arbitrary when the arbitrator is incompetent or biased.

There are two types of arbitration:

### **Voluntary Arbitration:**

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In voluntary arbitration the arbitrator is appointed by both the parties through mutual consent and the arbitrator acts only when the dispute is referred to him.

### Compulsory Arbitration:

Implies that the parties are required to refer the dispute to the arbitrator whether they like him or not. Usually, when the parties fail to arrive at a settlement voluntarily, or when there is some other strong reason, the appropriate government can force the parties to refer the dispute to an arbitrator.

**(ii)** Section 5 of the Minimum Wages Act, 1948 provides for fixing and revising minimum wages under the minimum wages which states that—

1. In fixing minimum rates of wages in respect of any scheduled employment for the first time under this Act or in revising minimum rates of wages so fixed the appropriate government shall either—
  - A. appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision as the case may be, or
  - B. by notification in the Official Gazette, publish its proposals for the information of persons likely to be affected thereby and specify a date not less than two months from the date of the notification on which the proposals will be taken into consideration.
2. After considering the advice of the committee or committee appointed under clause (a) of sub-section (1) or as the case may be, all representations received by it before the date specified in the notification under clause (b) of that sub-section, the appropriate government shall by notification in the Official Gazette, fix or as the case may be revise the minimum rates of wages in respect of each scheduled employment and unless such notification otherwise provides it shall come into force on the expiry of three months from the date of its issue :

Provided that where the appropriate government proposes to revise the minimum rates of wages by the mode specified in clause (b) of sub-section (1) the appropriate government shall consult the Advisory Board also.

**(iii)** The problem asked in the question is based on the provisions of section 160 and 161 of the Indian Contract Act 1872. Accordingly, it is the duty of the bailee to return or deliver the goods bailed according to the bailor's directions, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed for any loss, destruction of the goods from that time (Section 161), notwithstanding the exercise of reasonable care on his part.

Therefore, applying the above provisions in the given case, Mahesh is liable for the loss, although he was not negligent, but because of his failure to deliver the car within a reasonable time (Shaw & Co. v. Symmons & Sons).

### **Question 2(e):**

**(i) 'X' stands surety for 'Y' for any amount which 'Z' may lend to Y from time to time during the next three months subject to a maximum of ₹150,000. One month later X revokes the guarantee, when Z had lent to B ₹15,000. Referring to the provisions of the Indian Contract Act, 1872 decide whether 'X' is discharged from all the liabilities to 'Z' for any subsequent loan. What would be**

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your answer in case 'Y' makes a default in paying back to 'Z' the money already borrowed i.e. ₹ 15,000?

(ii) Explain the provisions of the Payment of Bonus Act, 1965 relating to application of the Act to the establishments in public sector. What is the time limit within which payment of bonus due to an employee under the Act, be paid?

(iii) Explain the term 'designated partners' under LLP Act, 2008.

[3+4+5 = 12]

### Answer:

(i) The problem as asked in the question is based on the provisions of the Indian Contract Act 1872, as contained in Section 130 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways:

#### By Notice:

X continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor.

#### By death of surety:

The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Section 131). The liability of the surety for previous transactions however remains.

Thus applying the above provisions in the given case, X is discharged from all the liabilities to Z for any subsequent loan.

Answer in the second case would differ i.e. X is liable to Z for ₹15,000 on default of Y since the loan was taken before the notice of revocation was given to Z.

(ii) Application of the Act to the establishment in public sector:

Section 20 of the Payment of Bonus Act, 1965 provides that if in any accounting year, an establishment in public sector may sell any goods produced or manufactured by it or it may render any services in competition with an establishment in private sector. And if the income from such sale or service or both is not less than 20% of the gross income of establishment in public sector, then the provisions of Bonus Act shall apply in relation to establishment in private Sector (Sub-section 1) Save as otherwise provided in Subsection (1), nothing in this Act shall apply to the employees employed by any establishment in the public sector (Sub-section 2).

#### The time limit for a payment of bonus:

The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22 of the Act. In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting. But this period of 8 months may be extended upto a maximum of 2 years by the appropriate Government or by any authority specified; by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

(iii) The term, "Designated partners" is defined in Section 7 of LLP Act, 2008.

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1. Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India :

Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

Explanation:

For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding one year.

2. Subject to the provisions of sub-section (1),—

(i) if the incorporation document—

- specifies who are to be designated partners, such persons shall be designated partners on incorporation; or
- states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;

(ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

3. An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

4. Every limited liability partnership shall file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

5. An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

6. Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of sections 266A to 266G (both inclusive) of the Companies Act, 1956 shall apply mutatis mutandis for the said purpose.

**Question 3: Answer any 2 questions**

**[2 × 8 = 16]**

**Question 3(a)**

**(i) Write a short note on Statutory Audit.**

**(ii) The maximum number of directors of each of the following companies as per their articles is 11:**

- 1. Aaron Company Ltd.**
- 2. Sharon Trading Private Ltd.**
- 3. United Traders Association (a company registered u/s 25)**

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**4. Hindustan Paper Ltd. (A Government company u/s 617)**

**The Board of directors of the company wants to increase the number of directors to 15. State with reference to the provisions of the Companies Act, 1956 whether the directors can be do so.**

**[5+3 = 8]**

**Answer:**

**(i)** Continuing globalization will increase the complexity of principles, regulations, and the cultures in which organizations operate, increasing litigation, legislation, and regulations will carry important compliance implications. Ever growing competition will increase the pressure on organizations to enhance productivity.

The principal objectives of the Statutory Audit is to ensure that the financial statements i.e. the Balance Sheet, Profit & Loss Account and Cash Flow Statement give a true & fair view and are free from any material misstatements.

Our approach to Statutory Audit of the financial statements is to provide reasonable assurance that the accounts have been prepared in accordance with the Generally Accepted Accounting Principles (GAAP) and are free of any misstatements, errors and discrepancies. In addition to the traditional statutory audit, we also help the clients by monitoring organizational ethics, conducting effective reviews of operational and financial performance, assessing the quality, economy and efficiency of their operations and suggesting continuous improvement strategies in simple terms statutory audit in India is equated with audit under the companies act. Every company incorporated under the companies act is required to get its accounts audited by a chartered accountant in Practice to ensure true and fair view of the accounts. Further, the auditor has to ensure compliance with various provisions of the companies act. Statutory audit ensures reliability of annual accounts of the company for various consumers of Accounts of the Company like government, shareholders, debtors, creditors, bankers etc.

The complexity of statutory audit function has increased manifolds during recent times. Globalisation, fast changing business and statutory environment combined with need for synchronisation with various global accounting standards and ever increasing reliance on audited accounts by a variety of interested parties has put ever increasing responsibilities on the shoulders of any statutory auditor. Generally the firm will follow the following steps:

- Getting appointment letter and Board resolution copy.
- Getting NOC from previous auditor.
- Filling the firm's no disqualification status to the company.
- Filling of Form 23B to ROC.
- Getting Letter of engagement.
- Assessment of internal control.
- Formulation of internal control action plan and calendar.
- Conduct of audit as per IGAAP, Companies Act, ICAI Accounting Standards and Auditing Standards.
- Forming an opinion of financial statement prepared by the company.
- Reporting to shareholders.
- Attending AGM.

**(ii)** Amendment of Articles (by Special Resolution) - Shall be made by all the companies, viz., Aaron Company Ltd., Sharon Trading Private Ltd., United Traders Association and Hindustan Paper Ltd.

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Approval of CG is required:

- For Aaron Company Ltd.
- Unless the number of directors specified in its articles as first registered is 15 or more.

No approval of CG is required for

- Sharon Trading Private Ltd. (since Sec. 259 does not apply to a private company)
- United Traders Association (Since Sec. 259 does not apply to a company licenced u/s 25)
- Hindustan Paper Ltd. (Since Sec. 259 does not apply to a Government company).

### **Question 3(b):**

**(i) State the powers and functions of the Information Commissions as per the Right to Information Act, 2005.**

**(ii) Notice has been received from a member proposing himself for appointment as a director after the issue of notice convening the annual general meeting. As a secretary of a public company, how will you deal with the above situation, with reference to Companies Act, 1956?**

**[6+2 = 8]**

### **Answer:**

**(i)** As per Section 18 of the Right to Information Act, 2005, the powers and functions of the Information Commissions are as follows:

1. Subject to the provisions of this Act, it shall be the duty of the Central Information Commission or State Information Commission, as the case may be, to receive and inquire into a complaint from any person -

**A.** who has been unable to submit a request to a Central Public Information Officer or State Public Information Officer, as the case may be, either by reason that no such officer has been appointed under this Act, or because the Central Assistant Public Information Officer or State Assistant Public Information Officer, as the case may be, has refused to accept his or her application for information or appeal under this Act for forwarding the same to the Central Public Information Officer or State Public Information Officer or senior officer specified in sub- section (1) of section 19 or the Central Information Commission or the State Information Commission, as the case may be;

**B.** who has been refused access to any information requested under this Act;

**C.** who has not been given a response to a request for information or access to information within the time limit specified under this Act;

**D.** who has been required to pay an amount of fee which he or she considers unreasonable;

**E.** who believes that he or she has been given incomplete, misleading or false information under this Act, and

**F.** in respect of any other matter relating to requesting or obtaining access to records under this Act.

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2. Where the Central Information Commission or State Information Commission, as the case may be, is satisfied that there are reasonable grounds to inquire into the matter, it may initiate an inquiry in respect thereof.

3. The Central Information Commission or State Information Commission, as the case may be, shall, while inquiring into any matter under this section, have the same powers as are vested in a civil court while trying a suit under the Code of Civil Procedure, 1908, in respect of the following matters, namely -

- summoning and enforcing the attendance of persons and compel them to give oral or written evidence on oath and to produce the documents or things;
- requiring the discovery and inspection of documents;
- receiving evidence on affidavit;
- requisitioning any public record or copies thereof from any court or office;
- issuing summons for examination of witnesses or documents; and
- any other matter which may be prescribed.

4. Notwithstanding anything inconsistent contained in any other Act of Parliament or State Legislature, as the case may be, the Central Information Commission or the State Information Commission, as the case may be, may, during the inquiry of any complaint under this Act, examine any record to which this Act applies which is under the control of the public authority, and no such record may be withheld from it on any grounds.

(ii) With reference to Section 257, of Companies Act, 1956, the notice is valid:

- Even if it is received after dispatch of notice of AGM
- Provided the notice is received at least 14 days before the AGM.

### **Question 3(c):**

**(i) The Board of Directors of Bikash Steels Limited consists of one Managing Director, one Technical Director and three ordinary Directors. Mr. Shyam, an ordinary Director sent his resignation in writing to the Company. Mr. Rohan, the Managing Director also sent his resignation to the Chairman of the Board of Directors and requested that he shall be relieved immediately. When does the resignation take effect? It is possible for a Director to resign orally or withdraw the resignation? Explain as per Companies Act, 1956.**

**(ii) The articles of association of Sundar Ltd. mentioned in it that Mr. Lal and Mr. Neel will act as directors of the company from the date of incorporation. The company was incorporated on 2nd January, 2014. The articles also provided that the directors will have to obtain qualification shares within one month from the date of appointment as director. Mr. Lal purchased the shares of the company on 28th February, 2014 and Mr. Neel purchased on 28th March, 2014 thus violating the provisions contained in the articles. Having regard to the provisions of the Companies Act, 1956 examine the validity of the appointments of Mr. Lal and Mr. Neel as directors.**

**[5+3 = 8]**

### **Answer:**

**(i)** Mr. Shyam cannot be compelled to continue in office

- After he had submitted his resignation;
- Since he is neither a whole time director nor a managing director

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- Assuming that –
  - (a) The articles do not require acceptance of resignation; and
  - (b) The resignation does not does not state that acceptance of resignation is required [Glossop v Glossop]

Mr. Rohan may be compelled to continue in office

- Until his resignation is accepted;
- Since he is a director as well as an employee of the company [Achutha Pai v ROC].
- But, he must be relieved within a reasonable time.

Mr. Rohan may withdraw his resignation

- Provided such withdrawal is made with the consent of the Board or the shareholders.

Verbal resignation is sufficient

Provided the intention to resign is clear.

Verbal resignation is not effective

- If the articles require resignation to be in writing.
- Verbal resignation is effective if made in the GM and accepted at the GM. This will be so, even if the articles require resignation in writing [Latchford Premier Cinema Ltd. v Ennion and Paterson].

**(ii)** The first directors of Sundar Ltd. w.e.f., 02.01.2014 are

Mr. Lal and Mr. Neel since they are named in the articles as first directors (Sec. 254).

The articles are void

- In so far as the articles require the directors to obtain the qualification shares within 1 month.
- Mr. Lal and Mr. Neel must acquire the qualification shares within 2 months of incorporations of Sundar Ltd.

Mr. Lal can continue in office

Since he had obtained the qualification shares within 2 months.

Mr. Neel shall vacate his office

Since he failed to obtain the qualification shares within 2 months of incorporation of Sundar Ltd.

### **Question 4: Answer any 2 questions**

**[2 × 8 = 16]**

#### **Question 4(a)**

**(i) What is the difference between business ethics and an ethical business?**

**(ii) What is Ethical Conflict? What are the aspects to be considered to resolve the conflict?**

**[4+4 = 8]**

#### **Answer:**

Business ethics relates to how any organisation conducts its business in order to make profit or achieve other goals. Any organisation can seek to do business in a way that is guided by ethical values. Whether an organisation is judged to be an ethical business however, may involve a subjective assessment of any of the following: the products and services it offers, its founding

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priorities, goals and values, its philanthropy, its reputation among its stakeholders, the way it treats customers and staff etc.

**(ii)** Ethical conflict is a situation where the professionals have to decide between compliance with principles and actions which are beneficial to the business organization.

An Ethical conflict is a complex situation that often involves an apparent mental conflict between moral imperatives, in which to obey one would result in transgressing another. This is also called an ethical paradox since in moral philosophy, paradox often plays a central role in ethics debates.

To resolve the conflict, following aspect should be considered:

1. Relevant facts;
2. Ethical issues involved;
3. Fundamental principles related to the matter in question;
4. Established internal procedures; and
5. Alternative courses of action.

### **Question 4(b)**

**(i)** X have just starting working for a plc and all his colleagues have warned him that his predecessor was asked to inflate the value of products, as well as to overvalue stock, when reporting.

This was to benefit the directors' bonus. To date X has not been asked to do anything untoward, but wonder how best he can approach the issue should he be put in this position. Share your views with him.

**(ii)** P is the financial manager for KBC Ltd. He has worked there for three years and it has been doing well.

One of the directors is also a director at another firm. He has been asked to transfer a large sum of money between the two – unrelated – companies.

Although he has requested further information, as he do not feel comfortable, he has been asked to "sign off" the transfer urgently. He has been verbally told that it is in the business's interest and has the support of the Board.

But he does not want to be responsible for approving such a transfer without the appropriate paperwork and feels awkward questioning the director's decision again. Advise him

**[4+4 = 8]**

### **Answer:**

**(i)** At present what he has been told is hearsay, so he needs to be sure of any facts. Being new to a post sets him in a stronger position to professionally guide future action should a similar request be made of him.

He needs to consider threats and safeguards within the company) as well as options for resolution. Misleading reporting is a clear breach of overall integrity and in particular principles for preparation and reporting of information.

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He needs to remember that once he has breached an ethical line, it is harder the next time to push back.

**(ii)** He has to consider carefully how you are implicated in this transaction.

The fundamental principle of professional behaviour, as well as objectivity, is at stake. Potential conflicts of interest exist, as a result of either intimidation or familiarity, depending on his relationship with the director.

Safeguards would include referring to the compliance systems that should be in place within a listed company – have all policies and procedures been followed? He needs to be sure that he is in no way acting contrary to any law or regulation, technical or professional standards, or is facilitating any unethical management strategies.

How would the transfer be explained to an auditor? When there is conflict within the organisation, a professional accountant should consider consulting with those charged with the governance of the organisation. It is in his interest to document the substance of the issue, the details of any discussions, and decisions made. Should pressure continue after such dialogue, he should consider seeking legal advice.

### **Question 4(c)**

**(i) Explain the types of Ethical issues.**

**(ii) What are the consequences of an unethical behaviour?**

**[5+3 = 8]**

### **Answer:**

**(i)** Ethical dilemma exists in all walks of business. Business situations are highly complex with no clear guidelines and equally justifiable alternatives. Hence, ethical dilemma should be dealt carefully. They arise when there are conflict in values with superiors in the area of strategy, goals, policy and administration. Ethical issues get categorized in the following four main areas:

#### 1. Business Relationships

Business relationships, i.e. relationships with customers, suppliers and others in the work place also have ethical concerns. Ethical behaviour in the business involves meeting obligations and responsibilities duly on time, keeping company secrets and avoiding undue pressure that may force others to act unethically.

The managers and other superiors can use their authority to influence the employees and make them act in an unethical manner. In the process, the manager may tell the employees to adopt unethical practices which the employee may not be willing to adopt. The ethical practices of the business must be focused on customer needs as the customer is the life line of the business. Organisations that cater to customer needs by adopting an honest & ethical approach make the customer feel that they are important and this in turn guarantees the success of the organisation in the long run.

#### 2. Conflict of interest

Conflict of interest exists when a person has to decide whether to proceed with his own personal interest or in the interest of the organization.

Example: Bribe is a conflict of interest because it benefits the individual but harms the organization and the society.

Conflict of interest can be managed in an effective manner when employees are able to separate their personal interests from their business dealings. Sam Walton, the late founder of Wal-Mart, banned company buyers from accepting even a cup of coffee from suppliers. It is not always necessary that conflict of interest should be financial.

### 3. Fairness and honesty

Fairness and honesty are difficult principles of business ethics, which an organization is expected to follow. It is not enough for a company to ensure compliance with applicable laws and regulations, it should not cause any harm to employees, customers, competitors knowingly by means of unfair and deceptive trade practices. Disclosure of potential harm caused by product use is an example of "fairness and honesty". Though the legal system encourages competition and prevents monopoly, business organizations continue doing activities causing harm to the competition. Thus, ethical conduct of business depends on their commitment to fairness and honesty.

### 4. Communications

Organizations need to communicate with its environment to sustain and grow. They have to give true and correct information about their products and services. Nowadays, false and misleading advertisements occupy the business world. Consumers have a right to know full and true information about product's quality, price and safety. Manufacturers often fail to communicate the differences or similarities between products.

Example: Johnson & Johnson agreed to pay a claim amount of \$860 million dollars since they gave false information and misleading information about two products - Acuvue and 1 -day Acuvue contact lenses.

Ethical issues also arise in product labelling. It is obligatory for the cigarette manufacturing company to indicate on the packs that smoking is injurious to health.

#### **(ii) Consequences of Unethical Behavior-**

Unethical behavior has adverse effects on business. Moreover, working for an unethical, deceptive, unfair or dishonest organization requires one to take unethical or compromised decisions which also take a toll on physical, mental and emotional health of individuals.

Firstly, if a company is unethical, the word spreads fast, and the reputation and goodwill of the company is at stake. Such impact can be of a permanent nature destroying the company's reputation possibly forever. Secondly, unethical behavior can also have a detrimental impact on the productivity of a company due to mistrust and lack of faith among the employees. Thirdly, unethical behavior can, not only cause a company to lose good and valuable employees, but also it can be quite difficult to find new employees.

Moreover, indulgence in unethical behavior shall not only be instrumental in expediting the cost of training of new employees in terms of money, but also loss of valuable time which could be spent in production. Such disruptions or slowing down of production will result in greater customer dissatisfaction and fewer new customers. It is proved that good ethics carries many

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benefits, and its violations – penalties, and therefore refraining from unethical behavior should be the sine-qua-non consideration for an organization