

PAPER 6 – Laws, Ethics & Governance

[Answer to Question No.1 is compulsory]

1. Choose the correct answer from the given four alternatives:

[1*20=20]

- (i) Business Ethics is a code of conduct which businessmen should follow while conducting their
- (a) **Normal activities**
 - (b) Special activities
 - (c) Specific activities
 - (d) None of the above
- (ii) The Negotiable Instruments Act, 1881 came into force on:
- (a) 9th December, 1881
 - (b) 19th December, 1881
 - (c) **1st March, 1882**
 - (d) None of the above
- (iii) The first case on the 'doctrine of frustration' as decided by the Supreme Court of India is:
- (a) Basanti Bastralaya v. River Steam Navigation Co. Ltd.
 - (b) Raja Dhuruv Dev Chand v. Raja Harmohinder Singh
 - (c) Sushila Devi v. Hari Singh
 - (d) **Satyabrata Ghosh v. Mugneeram**
- (iv) A, B and C are partners of an unregistered firm. D owns this firm ₹1000 on a contract. The firm filed a suit against D the suit is dismissed for non-registration of the firm. The firm is registered later on. In this case which one of the following statements is MOST APPROPRIATE:
- (a) **The firm can successfully bring the suit against D**
 - (b) Registration must have been effected by the firm, before a suit is filed in the court
 - (c) The firm cannot file suit against D
 - (d) None of the above
- (v) Employer carrying on any public utility service cannot declare lock out without giving
- (a) 3 weeks
 - (b) 4 weeks
 - (c) 5 weeks
 - (d) **6 weeks**
- (vi) A makes a contract with B to buy his house for ₹50,000 if he is able to secure to bank loan for that amount. The contract is:
- (a) Void for vagueness
 - (b) Wagering contract
 - (c) **Contingent contract**
 - (d) Voidable contract

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

- (vii) Where a partnership contract is rescinded on grounds of fraud or misrepresentation, the party entitled to rescind, is also entitled to rank, in respect of any payment made by him for the firm's debts as a:
- (a) **Creditor**
 - (b) Debtor
 - (c) Lender
 - (d) Guarantor
- (viii) Employee pension scheme is 8.33% of
- (a) **Employer**
 - (b) Manager
 - (c) Employer contribution
 - (d) Manager contribution
- (ix) For contravention of provisions of Factories Act or Rules, the occupier shall liable for punishment up to:
- (a) **2 years or fine upto ₹1,00,000 or both**
 - (b) 6 months or fine upto ₹10,000 or both
 - (c) 3 years or fine ₹10,000 or both
 - (d) None of these
- (x) A cheque is crossed when it bears across its face an addition of the name of a banker, either with or without the words "not negotiable".
- (a) **Specially**
 - (b) General
 - (c) Restrictive
 - (d) None of the above
- (xi) In the case of sale by auction, the seller of goods has a right to bid at the auction:
- (a) with the permission of the auctioneer
 - (b) **only when the right to bid has been expressly reserved**
 - (c) even when the right to bid has been impliedly reserved
 - (d) with the permission of the bidder
- (xii) Claim for compensation should be preferred before the Commissioner within of the occurrence of accident.
- (a) 1 year
 - (b) **2 years**
 - (c) 3 years
 - (d) 4 years
- (xiii) State as to why a business should behave ethically?
- (a) To unprotect its own interest and of the business community as a whole
 - (b) **To keep its commitment to society to act ethically**
 - (c) To not meet stakeholder expectations
 - (d) To build distrust with key stakeholder groups
- (xiv) Which of the following statements is incorrect?
- (a) Unless otherwise agreed, the goods are not to be delivered by instalments
 - (b) The delivery of goods to a carrier or a wharfinger in pursuance of a contract of sale, is prima facie deemed to be delivery of goods to buyer
 - (c) Force majeure clause gives an excuse to the parties in case of non-performance of

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

contract

(d) Any risk of deterioration in the goods necessarily incident to the course of transit shall be borne by the seller

(xv) A party who does not suffer any loss in case of breach of contract, is entitled to:

- (a) Statutory damages
- (b) Liquidated damages
- (c) Exemplary damages

(d) Nominal damages

(xvi) Where an appeal is preferred against an order made by a Central Public Information Officer or a State Public Information Officer, as the case may be, under section 11 to disclose third party information, the appeal by the concerned third party shall be made within days from the date of order.

(a) 30 days

- (b) 45 days
- (c) 60 days
- (d) 90 days

(xvii) Application for Director Identification Number(DIN) is to be made to Central Govt. in Form:

(a) DIN-1

- (b) DIN-2
- (c) DIN-3
- (d) None of the above.

(xviii) The minimum paid-up capital for a Public company is:

- (a) ₹2 lakhs
- (b) ₹3lakhs
- (c) ₹4lakhs

(d) ₹5lakhs

(xix) Offences by companies under The Prevention of Money Laundering Act, 2002 are dealt in:

- (a) Section 48
- (b) Section 42
- (c) Section 45

(d) Section 70

(xx) A Drawer is:

(a) A person, who draws a cheque

- (b) A bank on whom a cheque is drawn
- (c) A person in whose favour a cheque is drawn
- (d) None of the above

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

SECTION A

[Attempt any 4 questions]

2. (a) Mr. X transferred his house to his daughter Meera by way of gift. The gift deed, executed by Mr. X, contained a direction that Meera shall pay a sum of ₹10,000 per month to Nina (the sister of the executants). Consequently Meera executed an instrument in favour of Nina agreeing to pay the said sum. Afterwards, Meera refused to pay the sum to Nina saying that she is not liable to Nina because no consideration had moved from her. Decide with reasons under the provisions of the Indian Contract Act, 1872 whether Meera is liable to pay the said sum to Nina. [3]
- (b) Point out the differences between 'transfer by negotiation' and 'transfer by assignment' under the provisions of the Negotiable Instruments Act, 1881. [5]
- (c) Shaan is employed in Golden ice-cream factory, a seasonal establishment. The factory was in operation for four months only during the financial years 2011-12. Shaan was not in continuous service during this period. However, he has worked only 60 days. Referring to the provisions of the payment of Gratuity Act, 1972 decide whether Shaan is entitled to gratuity payable under the Act. Would your answer be the same in case Shaan works for 100 days? [2]
- (d) What do you mean by Auction Sale? What are the liabilities of an Auctioneer? [1+1=2]

Answer 2(a):

Meera is liable to pay to Nina the amount of ₹5,000 per month:

- since there is a contract between Meera and Nina;
- since in consideration of payment of ₹5,000 per month to Nina, Meera has received house of Mr. X;
- since Meera has received consideration, although she has not received such consideration from the other party to the contract, viz. Nina;
- since privity of consideration is not required, i.e., consideration need not move from the other party to the contract;
- since the same decision was given in **Chinnaya v Rammaya** on the same facts as in the given case.

Answer 2(b):

Basis	Negotiation	Assignment
Applicable Act	If a negotiable instrument is transferred by way of negotiation, Negotiable Instrument Act, 1881 applies.	Where any right is transferred by way of assignment, the Transfer of Property Act applies.
Meaning	Negotiation means transfer of a negotiable instrument to any other person so as to constitute that person the holder of such negotiable	Transfer of a right to receive the payment of a debt by one person (viz., assignor) to another person (viz., assignee) by way of

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

	instrument.	a written document is called as assignment.
Scope	Negotiation can be made for transferring negotiable instruments only.	Assignment can be made of any right.
Method or manner	A bearer instrument can be negotiated merely by delivery, and an order instrument can be negotiated by endorsement and delivery.	Assignment is valid only if it is made in writing and is signed by the assignor.
Notice	Notice of negotiation is not required to be given to any party.	Notice of assignment must be given by the assignee to the debtor.
Consideration	It is presumed that every negotiable instrument was negotiated for consideration.	There is no such presumption in case of assignment.
Burden of proof	The other party has to prove that negotiation was without any consideration.	The assignee has to prove that there was some consideration.
Better Title	The transferee of a negotiable instrument acquires a title better than that of the transferor, i.e., he becomes a holder in due course.	The assignee does not acquire a title better than that of the assignor.
Stamp Duty	Negotiation does not require payment of stamp duty.	Assignment requires payment of stamp duty.

Answer 2(c):

Shaan is not entitled to gratuity: Since he has not actually worked for not less than 75% of the number of days on which the establishment was in operation during such period.

If Shaan had worked for 100 days: Then he would have been entitled to gratuity since the number of days on which he would have worked, in that case, would have been 75% or more of the number of days on which the establishment was in operation.

Answer 2(d):

Meaning of Auction Sale:

Auction Sale means a public sale where intending buyer assemble at one place and offer the price at which they are ready to buy the goods. The offer of the price is known as 'bid' and the person making the bid is known as the 'bidder.' The owner of the goods may himself sell them by auction or appoint a person to sell the goods by auction on his behalf. The person so appointed is known as 'auctioneer.' The relationship between the owner of the goods and the auctioneer is that of the principal and agent. In an auction, the goods are sold to the highest bidder. It may be noted that an advertisement to sell the goods by auction is simply an invitation to the public to make offers and not an offer to sell. That is why the intending buyers have no right to sue the auctioneer if auctioneer cancels or postpones the sale by auction.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

Liabilities of an Auctioneer:

On the basis of various decisions taken by the court, it can be said that an auctioneer is liable for damages in the following cases:

- (a) if the auctioneer had no authority to sell the goods. [Anderson v. Creall & Sons Ltd.]
- (b) if there is a defect in principal's title. [Benton v. Compbell Parker & Co.]
- (c) if the auctioneer refuses to give the possession on the payment of the price.
- (d) If the buyer's possession is disturbed by his principal or himself.

3. (a) Miss Zoya, a film actress agreed to work exclusively for a period of 4 years, for a film production company. However, during the said period she enters into a contract to work for another film producer. Discuss the rights of the aggrieved film production company under the Indian Contract Act, 1872. [3]

(b) 'X', a temporary employee drawing a salary of ₹3,000 per month, in an establishment to which the Payment of Bonus Act, 1965 applies was prevented by the employers from working in the establishment for two months during the financial year 2011-12, pending certain inquiry. Since there were no adverse findings 'X' was re-instated in service. Later, when the bonus was to be paid to other employees, the employers refused to pay bonus to 'X', even though he has worked for the remaining ten months in the year. Referring to the provisions of the Payment of Bonus Act, 1965 examine the validity of the employer's refusal to pay bonus to 'X'. [4]

(c) Briefly explain the difference between Partnership and Co-ownership. [5]

Answer 3(a):

Restraint on Miss Zoya is valid since an agreement of service under which an employee agrees to serve a certain employer for a certain duration, and that he will not serve anybody else during such period is a valid agreement [Charlesworth v. Mac Donald].

Miss Zoya cannot be compelled to work with the film production company since specific performance is generally not allowed where personal performance is required.

Miss Zoya may be restrained from working for another producer since in case of breach of a negative term of a contract, the defaulting party is generally restrained from doing what he promised not to do.

Answer 3(b):

As per section 8, every employee is entitled to bonus, if he has worked in the establishment for 30 or more working days in an Accounting Year.

As per section 9, an employee is disqualified from receiving bonus only if he is dismissed from service because of any of the following reasons:

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

- (i) Where he commits fraud.
- (ii) Because of his riotous or violent behavior while on the premises of the establishment.
- (iii) Where he commits theft, misappropriation or sabotage of any property of the establishment.

In the given case, X is entitled to receive bonus, since:

- He is covered under the Payment of Bonus Act, 1965, i.e., the Act applies to the establishment in which he is employed.
- He is an 'employee' as defined u/s 2(13) as his salary or wage does not exceed ₹10,000 per month and he is not an apprentice.
- He has worked for not less than 30 working days in the accounting year; and
- He is not disqualified from receiving bonus u/s 9, since he has not been dismissed from service.

Mere suspension from service and initiation of inquiry against an employee does not disentitle an employee from receiving bonus, if he is not dismissed from service on any of the grounds mentioned u/s 9. In other words, if an employee is prevented from working and is subsequently reinstated in service, employer remains liable to pay bonus to the employee [ONGC v Sham Kumar Sahegal]. Further, the employee is entitled to receive bonus even for the period during which he was suspended, since a person should not be punished where he is not at fault.

Conclusion: The employer's refusal to pay bonus to X is not valid. X is entitled to bonus for full year (including the period of 2 months during which he remained suspended).

Answer 3(c):

The partnership and co-ownership can be distinguished as under:

Basis of Distinction	Partnership	Co-ownership
Agreement	It arises from an agreement.	It may or may not arise from agreement.
Business	It is formed to carry on a business.	It may or may not involve carrying on a business.
Profit or Loss	It involves profit or loss.	It may or may not involve profit or loss.
Mutual agency	Partners have a mutual agency relationship.	Co-owners do not have a mutual agency relationship.
Name of persons involved	The persons who form partnership are called partners.	The persons who own some property jointly are called co-owners.
Maximum limit	The maximum limit of partners is 10 for a banking business and 20 for any other business.	There is no maximum limit of co-owners.
Transfer of interest	A partner cannot transfer his share to a stranger without the consent of other partners.	A co-owner can transfer his share to a stranger without the consent of other co-owners.
Right to claim partition	A partner has no right to claim partition of property but he can sue the other partners for the dissolution of the firm and accounts.	A co-owner has the right to claim partition of property.
Lien on property	A partner has a lien on the	A co-owner has no such lien.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

	partnership property for expenses incurred by him on behalf of the firm.	
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4. (a) Jai accepted a bill of exchange and gave it to Kia for the purpose of getting it discounted and handing over the proceeds to Jai. Kia having failed to discount it returned the bill to Jai. Jai tore the bill in two pieces with the intention of cancelling it and threw the pieces in the street. Kia picked up the pieces and pasted the two pieces together, in such manner that the bill seemed to have been folded for safe custody rather than cancelled. Kia put it into circulation and it ultimately reached Lisa, who took it in good faith and for value. Is Jai liable to pay the bill under the provisions of the Negotiable Instruments Act, 1881? [3]

(b) What are the essential elements of Contract of Sale? [6]

(c) Referring to the provisions of the Payment of Bonus Act, 1965, state whether an employee dismissed on the ground of misconduct is entitled to bonus under the Act. [3]

Answer 4(a):

Lisa is a holder in due course: - since she acquired the bill in good faith and for value;

- since he became the possessor of the bill payable to bearer (assumed that the bill was payable to bearer) (Sec. 9)

Jai cannot deny the validity of the bill: since no drawer or acceptor of a bill shall, in a suit by a holder in due course, be permitted to deny the validity of the bill as originally drawn, and thus, Lisa who is the holder in due course, acquires a good title to the bill (Sec. 120).

Lisa is entitled to recover the payment of the bill from Jai and all prior parties: since a holder in due course has the right to sue all the prior parties (Sec. 36).

Answer 4(b):

According to Section 4(1) of the Sale of Goods Act, 1930, "contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price."

The aforesaid definition clearly indicates the following essential elements:

1. **Seller and Buyer:** There must be a seller as well as a buyer. 'Buyer' means a person who buys or agrees to buy goods [Section 2(1)]. 'Seller' means a person who sells or agrees to sell goods [Section 2(13)]. A person cannot be a seller as well as a buyer as a person cannot buy his own goods. That is why distribution of goods among partners on account of dissolution of a firm does not amount to a sale of goods because the partners are joint owners and they cannot be both sellers and buyers [State of Gujarat v. Raman Lal & Co.]. However, one part owner may be a seller and another part owner may be buyer. Where a person's goods are

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

sold under an execution of decree, a bankrupt may also buy back his own goods from his trustee. [King v. England]

2. **Goods:** There must be some goods. 'Goods' means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale [Section 2(7)]. It may be noted that the contract relating to actionable claims, immovable property and services are not covered by this Act.
Notes: (i) The 'actionable claims' mean a claim which can be enforced through the courts of Law, e.g., a debt due from one person to another is the actionable claim.
(ii) The 'money' here means the legal tender (i.e., currency of the country) and not old coins.
3. **Transfer of Property:** Property means the general property in goods, and not merely a special property [Section 2(11)]. General property in goods means ownership of the goods. Special property in goods means possession of goods. Thus, there must be either a transfer of ownership of goods or an agreement to transfer the ownership of goods. The ownership may transfer either immediately on completion of sale or sometime in future in agreement to sell.
4. **Price:** There must be a price. Price here means the money consideration for a sale of goods [Section 2(10)]. When the consideration is only goods, it amounts to a 'barter' and not sale. When there is no consideration, it amounts to gift and not sale. However, the consideration may be partly in money and partly in goods because the law does not prohibit as such. [Sheldon v. Cox]
5. **Essential Elements of a Valid Contract:** In addition to the aforesaid specific essential elements, all the essential elements of a valid contract as specified u/s 10 of Indian Contract Act, 1872 must also be present since a contract of sale is a special type of a contract. For example, an agreement to sell smuggled gold is not valid because its object is unlawful.

Answer 4(c):

As per section 9, an employee shall be disqualified from receiving bonus, if the following two conditions are satisfied:

- (a) The employee was dismissed from service.
- (b) The employee was dismissed because:
 - (i) he had committed fraud; or
 - (ii) of his riotous or violent behavior while on the premises of the establishment; or
 - (iii) theft, misappropriation or sabotage of any property of the establishment.

As per section 18, deduction can be made from the amount of bonus payable to an employee if all the following conditions are satisfied:

- (a) Financial loss is caused to the employer as a consequence of misconduct of employee.
- (b) The deduction shall be restricted to the amount of financial loss actually caused to the employer.
- (c) The deduction can be made against the amount of bonus payable to the employee in respect of that accounting year only.

Dismissal of employee from service is not a condition for making the deduction u/s 18.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

Accordingly, an employee dismissed on the ground of misconduct is not eligible provided misconduct by him attracts any of the reasons given under section 9.

However, if the misconduct by the employee does not attract section 9, then, the employee is eligible to receive bonus, but the employer shall have a right to deduct from bonus payable, the amount of financial loss caused to him (Section 18).

5. (a) Ramesh sent a consignment of goods worth ₹60,000 by railway and got railway receipt. He obtained an advance of ₹30,000 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 ₹60,000.

Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit? [4]

(b) Can a person apply for review of any order passed by the appropriate authority or any official under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952? If so, state the provisions. [4]

(c) A issues a open 'bearer' cheque for ₹10,000 in favour of B who strikes out the word 'bearer' and puts crossing across the cheque. The cheque is thereafter negotiated to C and D. When it is finally presented by D's banker, it is returned with remarks 'payment countermanded' by drawer. In response to this legal notice from D, A pleads that the cheque was altered after it had been issued and therefore he is not bound to pay the cheque. Referring to the provisions of the Negotiable Instruments Act, 1881, decide whether A's argument is valid or not? [4]

Answer 5(a):

The contract between Ramesh and Bank is a contract of pledge: since deposit of title deeds with the bank as security against an advance constitutes a pledge.

Rights of pawnee: If a third person wrongfully deprives the pawnee of the use of the goods pawned, or does any injury to the goods, the pawnee is entitled to all the remedies as the owner (viz. the pawnor) might have exercised as if the goods were not pawned [Sec. 180].

The Bank would succeed in suit filed against the railways for whole sum of ₹60,000: since in case of pledge, the pawnee can exercise all the rights which the pawnor could exercise in respect of such goods, if the goods are damaged or some third party deprives the pawnee of such goods [Morvi Mercantile Bank Ltd. v Uo].

The bank shall pay over to Ramesh a sum of ₹30,000: since the compensation received by the pawnee shall be divided among the pawnor and pawnee as per their respective interests [Sec. 181].

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

Answer 5(b):

1. **Rights given u/s 7B:** Section 7B confers a right to make an application for review of an order made u/s 7A.
2. **Review at whose instance?**
 - Any person aggrieved by an order u/s 7A can make an application for review.
 - The officer can himself review the order on his own motion.
3. **No review if appeal is filed:** No application for review can be made if an appeal is filed against the order made u/s 7A.
4. **Time limit:** The application for review can be made within 45 days of order made u/s 7A.
5. **Cases in which application can be made:**
 - (a) If new and important evidence is discovered which could not be produced earlier as it was not within the employer's knowledge even after due diligence; or
 - (b) There is some mistake or error apparent from the records; or
 - (c) Any other sufficient reason.
6. **Action by the officer:** The officer may -
 - (a) reject the application for review if there are not sufficient grounds for review; or
 - (b) grant the review.
7. **Appeal against the order of officer:**
 - Appeal cannot be filed against order rejecting the application for review.
 - If fresh order is passed after the review, appeal can be filed against such order.

Answer 5(c):

Effects of striking off the word 'bearer':

- It amounts to a material alteration.
- However, such material alteration is authorized by the Act.
- Therefore, the cheque is not discharged; it remains valid.

Effects of crossing the cheque:

- It amounts to a material alteration.
- However, such material alteration is authorized by the Act.
- Therefore, the cheque is not discharged; it remains valid.

A's argument is not valid:

- Since the reason for dishonour of cheque is not 'material alteration', but 'payment countermanded by drawer'.
- Therefore, A is liable for the payment of the cheque, and he shall also be liable for dishonour of cheque in accordance with the provisions of Sec. 138.

6. (a) Pataudi, a renowned sportsman assumed the honorary presidentship of a publishing business bringing out a sports magazine because other partners requested him to do so. A supplier gave credit to the firm in the bona fide belief that Pataudi was a partner in the firm. Is Pataudi liable to the supplier? [2]

(b) What is the law relating to determination of compensation, on breach of contract, contained in Section 73 of the Indian Contract Act, 1872? [5]

(c) What are the days on which an employee shall be deemed to have worked for the purpose of computation of Bonus payable to him? State with reasons whether such computation of number of working days on which an employee has worked is required in an establishment paying minimum bonus to its employees where none of the employees earned less than ₹2,400 in an accounting year. [1+4=5]

Answer 6(a):

The given problem relates to section 28 of The Indian Partnership Act, 1932.

Yes, Pataudi is liable to the supplier as:

Pataudi is a partner by estoppels. Both the conditions of Section 28 are fulfilled –

- (i) Pataudi has knowingly permitted himself to be represented as a partner.
- (ii) Supplier has acted on the faith of such representation.

[Lake v. Duke of Argyll]

Answer 6(b):

1. Meaning:

Monetary compensation allowed for loss suffered by the aggrieved party due to breach of a contract.

2. Object of awarding damages:

- Not to punish the party at fault
- To make good the financial loss suffered by the aggrieved party due to breach of contract.

3. Kinds of damages:

(i) Ordinary damages: These damages are awarded for such loss suffered by a party which is a natural, direct or proximate consequence of breach. Damages are not awarded if they have resulted because of an indirect consequence.

(ii) Special damages: Special damages are awarded to cover such loss which though does not arise naturally, but was in the contemplation of the parties at the time of formation of contract. These damages can be recovered only if the special circumstances which would result in a special loss in case of breach of a contract are communicated to the other party.

(iii) Exemplary or punitive or vindictive damages: These damages are awarded only in the following 2 cases:

- **Breach of a contract to marry:** The damages shall be calculated on the basis of mental injury sustained by the aggrieved party.
- **Unjustified dishonor of a cheque:** The damages shall be calculated on the basis 'lower the amount of cheque, greater will be the damages'. These damages are not awarded to a non-trader unless he proves loss of reputation.

(iv) Nominal damages: Where no loss is suffered by the aggrieved party, the Court generally awards nominal damages.

(v) Damages for inconvenience: Where a party has suffered physical inconvenience, discomfort or mental agony as a result of breach, the Court may award damages for the same.

(vi) Liquidated damages and penalty:

- Where the parties to a contract specify a certain sum in the contract which will become payable as a result of breach, such specified sum is called as 'liquidated damages' or 'penalty'.
- If the specified sum represents a fair and genuine pre-estimate of the damages likely to result due to breach, such specified sum is called as 'liquidated damages'.
- If the specified sum is disproportionate to the damages which are likely to result as a result of breach, such specified sum is called as 'penalty'.
- In India, damages shall be restricted to a reasonable compensation not exceeding the sum specified in the contract (whether by way of liquidated damages or penalty).

(vii) Forfeiture of security deposit:

- If any loss is suffered by a party as a result of breach, the damages awarded to him shall be limited to the loss suffered by him.
- Any clause in the contract entitling the aggrieved party to forfeit the security deposit is not valid.

(viii) Payment of interest:

- Payment of interest is permissible.
- If no rate of interest is mentioned in the contract, the party shall be liable to pay interest –
 - (a) As per any law for the time being in force;
 - (b) As per the custom or usage of trade.
- However, if the interest is in the nature of penalty, the Court may grant relief.

Answer 6(c):

As per section 10, the minimum bonus is higher of 8.33% of salary or wages earned by the employee during the accounting year or ₹100 (If the age of employee is less than 15 years, the amount of ₹100 shall be taken as ₹60).

As per section 13, if an employee has not worked for all the working days in an accounting year, the minimum bonus of ₹100 (if the employee is aged 15 years or more) or ₹60 (if the employee is aged less than 15 years), shall be proportionately reduced. It is evident that the provisions of section 13 shall apply only if the minimum bonus of ₹100/60 is higher than 8.33% of his salary or wages of the days he has worked in that accounting year.

For the purpose of determining the amount of minimum bonus to which an employee is entitled (since the amount of minimum bonus of ₹100/60 directly depends on number of days worked), it is required to compute the number of working days in respect of each employee. As per section 14, while computing the number of working days (for the purposes of section 13), an employee shall be deemed to have worked in an accounting year on the following days:

- (a) The days during which he has been laid off.
- (b) The days during which the employee was on leave with salary or wages.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

- (c) The days during which the female employee was on maternity leave with salary or wages.
(d) The days during which the employee was absent due to temporary disablement caused by an accident arising out of and in the course of his employment.

In case of an establishment in which none of the employees has earned less than ₹2,400 in an Accounting Year, the minimum bonus of 8.33% shall come to ₹199.92, i.e., ₹200 or more. Thus, in such establishment, an employee shall be entitled to minimum bonus computed on the basis of 8.33% of salary or wage, and thus computation of minimum bonus computed by proportionately reducing the amount of ₹100 (₹60 in case of an employee aged less than 15 years) is of no relevance.

In other words, the provisions of sections 13 and 14 shall apply only if the amount of minimum bonus of ₹100 (₹60 in case of an employee aged less than 15 years) exceeds 8.33% of salary or wage of an employee.

Conclusion: Since the minimum bonus in case of each employee (viz. ₹200 or more) is more than ₹100, section 13 is not attracted. Therefore, there is no need to calculate the number of working days u/s 14.

SECTION B

[Answer any two questions]

7. (a) What do you mean by Lifting of Corporate Veil? Discuss the circumstances when the Corporate Veil can be lifted. [1+5=6]
- (b) A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividends were not paid out of trading profits, but out of capital profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars. Decide. [2]

Answer 7(a):

Lifting the corporate veil means 'disregarding (or ignoring) the corporate entity and paying regard to the individual members behind the legal façade'.

When the company starts using the corporate veil for improper conduct, or to protect fraud or to justify wrongs, the law ignores the separate legal entity of the company and looks at the real persons behind and treat the company and its members as same person.

Circumstances when the Corporate Veil can be Pierced/Lifted:

- (i) Under Express Statutory Provisions
- (ii) Under Judicial Interpretations

(i) Under Express Statutory Provisions

(a) When the no. of members falls below statutory minimum [Section 45]

If the company carries on business for more than 6 months with the number of members reduced below the statutory requirement (i.e. 2 in case of private company and 7 in case of public company), every person who was member of the company during the time when it carried on business after those 6 months and who was aware of this fact, shall be personally liable for all debts of the company contracted after those 6 months.

Although the company continues to enjoy its distinct personality but loses the important feature of limited liability of the members of the company. Such a situation entitles the creditors to disregard the separate entity of the company, and the creditors can take action against the members directly.

(b) Misrepresentation in Prospectus [Sections 62 and 63]

(c) Non-disclosure of Representative capacity [Section 147(4)]

Where an officer or employee of a company enters into a contract on behalf of the company, without properly disclosing the name of the company on whose behalf he is acting, such officer or employee shall be personally liable for the amount due if the company refuses to pay it. He shall be punishable with fine upto ₹10,000. For example, a bill of exchange drawn upon a company is accepted by a director in his personal capacity i.e., without disclosing that he is accepting the bill on behalf of the company, such a director shall be personally liable for the bill.

(d) To examine the relationship of holding and subsidiary [Section 212]

When one company controls the composition of the board of directors of another company or holds majority of its shares, the former is called the holding company and the latter as subsidiary company. In general, a subsidiary company is altogether treated as a separate entity and the holding company is not liable for its acts. But, u/s 212 of the Act, every holding company is required to disclose to its shareholders the accounts of its subsidiaries.

(e) To investigate into the affairs of related companies [Section 239(7)]

According to Section 239(7) of the Act, if an inspector is appointed by the Central Govt. to investigate the affairs of a company he shall also have the power to investigate into the affairs of related (subsidiary) companies in the same management. The power to do so may thus lift the corporate veil.

(f) To investigate ownership of a company [Section 247]

When the Central Govt. feels it necessary to know about the membership of any company and also some other matters relating to the company with the object of determining true persons who are (or have been) financially interested in the success or failure of the company or who are (or have been) able to control the policy of the company, may appoint one or more inspectors to investigate and report on these matters. This will be done by lifting the corporate veil so as to find out the true persons controlling it.

(g) When business is carried on to defraud the creditors [Section 542]

According to section 542 of the Act, if in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud its creditors or any other persons, in such a case the persons who were knowingly parties to such acts may be held personally liable for any debts and other liabilities of the company. In such a situation, the court may disregard the legal entity of a company and make the fraudulent persons personally liable for all or any of the debts of the company without any limitation of liability.

(ii) Under Judicial Interpretations

Besides the above mentioned circumstances, the courts have allowed the lifting of corporate veil for proper administration of taxation laws, wealth tax law, etc. and also in some other circumstances.

(a) For determination of the character of the company

Sometimes, particularly during the war between countries, it becomes necessary to ascertain the character of certain companies. At such times the courts are justified in lifting the corporate veil of a company which is controlled by alien enemy. In this way a company registered in India may be declared alien enemy if it is found that the persons controlling such a company are citizens of an enemy country.

In case of **Daimler Co. Ltd v. Continental Tyre and Rubber Co. Ltd., [(1916) 2 A.C. 207]**, a company with the name Continental Tyre and Rubber Co. Ltd. was registered in England. The object of this company was to sell tyres in UK, which were manufactured in Germany by a German company. Majority of the shares of this company were held by Germans. Besides this, all the directors of the company were German residents. When the First World War broke out, the company filed a suit to recover a trade debt. The court came to the conclusion that the company was an enemy company because the effective control of the company was in the hands of Germans who were alien enemy. Hence, the claim of the company was disallowed on the ground that it was against public policy to allow alien enemies to trade by using the corporate veil.

(b) For prevention of fraud or improper conduct

The courts may lift the corporate veil if the company has been formed to avoid legal obligations or to defraud the creditors.

In the case of **Jones v. Lipman, (1962)**, I.W.L.R. 832, A agreed to sell certain land to B. pending completion of formalities of the said deal, A sold and transferred the land to a company which he had incorporated with a nominal capital of \$100 and of which he and a clerk were the only shareholders and directors. This was done in order to escape a decree for specific performance in a suit brought by B. The court held that the company was the creature of A and a mask to avoid recognition and that in the eyes of equity A must complete the contract, since he had the full control of the limited company in which the property was vested, and was in a position to cause the contract in question to be completed.

(c) For the protection of revenue

The court may lift the corporate veil if the company has been formed to evade the tax. In case of **Re Sir Dinshaw Manekjee Petit, AIR 1927 Bombay 371**, the assessee, Sir Dinshaw who was a very rich man, was earning huge dividend and interest income. He formed 4 private companies and entered into an agreement the income received was credited in company's account and the company handed the amount back to him as a loan (which was never repaid). In this way he divided his income in four parts in order to reduce his tax liability. The court ignored the corporate entity of these companies and held that the company was nothing more than the assessee himself. Sir Dinshaw was held the owner of total income and liable to pay tax.

(d) When company is formed to act as an agent of its members

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

Where a company is regarded as an agent or trustee of its members or of another company, for the acts done by the company, it will be the members who would be responsible and not the company. **[Re F.G. Films Ltd.]**

(e) When company is formed to avoid the welfare laws

The courts have disregarded the separate legal personality of the company when the company's independent status was being used as a device to reduce the amount payable by the company to defeat the provisions of welfare laws, such as payment of bonus to its workmen. **[Workmen employed in Associated Rubber Industries Ltd., Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and Others]**

Answer 7(b):

The prospectus is misleading:

- since non-disclosure of the fact that the company was making losses and that the dividends were paid out of past year profits gave a false impression that the company was making profits;
- since suppression of such fact might have affected investor's decision to subscribe for shares;
- since the prospectus does not disclose all the material facts truly, honestly and accurately.

The allottee of shares is entitled to avoid allotment:

Since the allottee has a right to rescind the contract of allotment of shares if he had relied and acted on the prospectus, i.e., he subscribed for shares after being influenced by a misleading prospectus **[Rex v Kysant]**.

8. (a) DJ Company Ltd. has only 50 preference shareholders. A meeting of the preference shareholders was called by the company for amending the terms of these shares. Mr. B, was the only preference shareholder who attended the meeting. He, however, held proxies from all other shareholders. He took the Chair, conducted the meeting and passed a resolution for amending the terms of the issue of these shares. Referring to the provisions of the Companies Act, 1956, examine the validity of the meeting and the resolution passed thereat. [3]

(b) State the particulars that are required to be published by every public authority within 120 days from the enactment of The Right to Information Act, 2002. [5]

Answer 8(a):

The meeting is a class meeting since it is a meeting of preference shareholders only.

East v Bennet In a class meeting, where all the preference shares were held by one member, the meeting was held to be valid.

Sharp v Dawes A meeting means coming together of more than one person. Therefore, one member cannot constitute a meeting.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

The quorum required is 5 members present in person or proxy since the provisions of Sec. 174 equally apply to class meetings except that quorum for a class meeting of a public company is 5 members, whether present in person or proxy.

The meeting and resolutions passed thereat are not valid since presence of a single member (viz., Mr. B) does not constitute a meeting and also since same judgement was given in **Sharp v Dawes**.

Answer 8(b):

As per section 4(1)(b) of The Right to Information Act, 2005, every public authority shall publish within one hundred and twenty days from the enactment of this Act:

- (i) the particulars of its organisation, functions and duties;
- (ii) the powers and duties of its officers and employees;
- (iii) the procedure followed in the decision making process, including channels of supervision and accountability;
- (iv) the norms set by it for the discharge of its functions;
- (v) the rules, regulations, instructions, manuals and records, held by it or under its control or used by its employees for discharging its functions;
- (vi) a statement of the categories of documents that are held by it or under its control;
- (vii) the particulars of any arrangement that exists for consultation with, or representation by, the members of the public in relation to the formulation of its policy or implementation thereof;
- (viii) a statement of the boards, councils, committees and other bodies consisting of two or more persons constituted as its part or for the purpose of its advice, and as to whether meetings of those boards, councils, committees and other bodies are open to the public, or the minutes of such meetings are accessible for public;
- (ix) a directory of its officers and employees;
- (x) the monthly remuneration received by each of its officers and employees, including the system of compensation as provided in its regulations;
- (xi) the budget allocated to each of its agency, indicating the particulars of all plans, proposed expenditures and reports on disbursements made;
- (xii) the manner of execution of subsidy programmes, including the amounts allocated and the details of beneficiaries of such programmes;
- (xiii) particulars of recipients of concessions, permits or authorisations granted by it;
- (xiv) details in respect of the information, available to or held by it, reduced in an electronic form;
- (xv) the particulars of facilities available to citizens for obtaining information, including the working hours of a library or reading room, if maintained for public use;
- (xvi) the names, designations and other particulars of the Public Information Officers;
- (xvii) such other information as may be prescribed; and thereafter update these publications every year;

9. Discuss the composition and scope of Audit Committee as per Clause 49 of the Listing Agreement. [2+6=8]

Answer 9:

Composition of Audit Committee:

- (i) It shall have minimum 3 directors as members. 2/3rd of the members of audit committee shall be independent directors.
- (ii) All members of audit committee shall be financially literate and at least 1 member shall have accounting or related financial management expertise.

Explanation (i): The term "financially literate" means the ability to read and understand basic financial statements i.e., balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

- (iii) The chairman of the committee shall be an independent director.

Audit committee has a four fold relationship and therefore has to interact with management, internal auditor, statutory auditor and the public.

The Scope of Audit Committee:

- (i) Review of annual financial statements before submission to the Board of Directors.
- (ii) Selection of the statutory auditor.
- (iii) Act as lies on between the statutory auditor and Board of directors.
- (iv) Administrative control of the internal control functions through the feedback between the internal auditor and the audit committee.
- (v) Over seeing internal central operation.
- (vi) Over seeing internal audit operations and feedback between internal audit committee and developing the internal auditing authority through broad based internal audit programming.
- (vii) Review and approval of financial information for publication.
- (viii) Review proposed changes in accounting system and procedures.
- (ix) Help resolve differences between management, internal and statutory auditor.
- (x) Report on the audit committee acting in the annual reports of Board of directors.
- (xi) Ensure reliability of organisation's financial statements and operational activities. To be effective and purposeful, the audit committee should maintain the following:
 - (a) Audit committee should have the independence of management, statutory auditor and internal auditor. The Board of directors allows full freedom to the audit committee to investigate into any areas of operation.
 - (b) The relation between the audit committee and management should be cordial and congenial towards optimum efficiency and healthy growth of the organization.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

- (c) There should be a regular line of communication through occasional meetings with the management.
- (d) There should be good communication relationship interwoven among management, internal auditor and statutory auditor.

SECTION C

[Answer any two questions]

10. (a) Discuss the seven principles of the holders of Public Office. [4]
(b) State the reasons for Unethical Behaviour. [4]

Answer 10(a):

The seven principles of public Life:

Selflessness	Holders of public office should take decisions solely in tells of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family, or their friends.
Integrity	Holders of public office should not place themselves under any financial or other obligation to outside individuals or organizations that might influence them in the performance or their official duties.
Objectivity	In carrying out public business including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
Accountability	Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
Openness	Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.
Honesty	Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.
Leadership	Holders of public office should promote and support these principles by sound leadership and prove to be an example in whatever they perform.

Answer 10(b):

The reasons for which unethical behavior might arise in the organization are:

- A. Over Emphasis on Short Term profitability:** Manipulating accounting entries to show better profitability (window dressing) to raise further capital from the market.
- B. Ignoring small unethical issues:** Companies need to develop an environment where small ethical lapses are taken seriously so that they do not recur in the future.

- C. Economic cycles:** when the company is doing well, no one is bothered to understand its actual financial position. However, when the economy takes a downward turn, finance and accounting managers may take decisions by compromising over the established principles. To prevent disclosure of unethical problems in times of depression, companies need to be careful and vigilant also during prosperous time periods.
- D. Market complexity:** In the era of globalization and massive cross border flow of capital, accounting rules have become more complex. The complexity of principles and rules and the difficulty associated with identifying abuse are reasons which may promote unethical behavior.
- E. Money - Mindedness:** Most business organizations try to display better financial condition by window dressing. Following such a principle towards "showing profits" rather than "earning profits" leads to unethical accounting and financial practices.

11. (a) What is Ethical Conflict? What are the aspects to be considered to resolve the conflict?

[1+3=4]

(b) Explain the various safeguards that should be adopted for overcoming threats faced by an accounting and finance professional.

[4]

Answer 11(a):

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:

- (a) Relevant facts;
- (b) Ethical issues involved;
- (c) Fundamental principles related to the matter in question;
- (d) Established internal procedures; and
- (e) Alternative courses of action.

Answer 11(b):

Various safeguards should be employed to ensure that threats to integrity and independence faced by an accounting and finance professional are eliminated or mitigated to the maximum possible extent. These safeguards are discussed below:

1. Safeguards created by the profession, legislation or regulation:

- Requirements relating to education, training and experience for entry into the profession.
- Continuing education requirements (i.e., continuing professional development programmes) for the professionals so that the professional not only remains updated but is also able to upgrade his skills.
- Legislation governing independence, e.g.-

(a) Section 226 of the Companies Act, 1956 prohibits the appointment of a C.A as auditor of a Company if he is covered in any of the grounds of disqualification stated under the said section.

(b) An auditor is not permitted to undertake book-keeping, or any other service related to maintaining accounting records or financial statements of the audit client.

(c) A statutory auditor of a company cannot also be its internal auditor.

- Professional standards for carrying out the audit and assurance engagements.
- Complaint systems and duty to report breaches.
- External review of Firms Quality Control System by a professional or regulatory body.
- Regulations relating to Corporate Governance.
- Professional and regulatory monitoring and disciplinary procedure (i.e., professional code of conduct), e.g.,

(a) Clause (10) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits acceptance of contingent fees, i.e., fees, which is either based on percentage of profits or otherwise dependent on findings or results.

(b) An auditor shall be deemed to be guilty of professional misconduct, if he accepts the position of auditor previously held by another C.A without first communicating with him in writing.

2. Safeguards within the client's / entity's work environment:

- Corporate Governance structure of the entity.
- Policies, procedures and practices to ensure that employees make ethical decisions, e.g., those relating to rotation of staff, personnel hiring, training, promotion, retention, rewards, fair financial reporting and requirements for internal consultation on technical issues.
- Code of conduct incorporating highest standards of business ethics.
- Strong internal check, internal control and internal audit.
- Strict disciplinary mechanism against those acting unethically in order to deter violations by punishing violators, e.g., a zero tolerance policy to immediately suspend or expel an employee committing violation.
- Policies, procedures and practices for fair treatment to whistle blowers, i.e., to empower and encourage employees to report unethical practices without fear.
- Policies, procedures and practices for auditor impartiality, e.g.,
 - (a) Maintaining a culture in the entity that lays down the emphasis on the expectation that auditors will act in the wider interest and the importance of good audits and auditor impartiality.
 - (b) Maintaining a professional environment and culture in the entity that supports behavior of all personnel that is consistent with auditor impartiality.
 - (c) Management systems to ensure auditor impartiality.
 - (d) Potential threats posed by various circumstances that a professional may face and the safeguards to mitigate or eliminate those threats.

3. Safeguards within the professional's own systems and procedures:

- Before accepting any audit engagement, an auditor must conscientiously consider whether it involves threats to his independence. In case of any such threat, the auditor should desist from accepting the audit.
- Policies and procedures for quality control.

- Documented and detailed guidelines regarding identification of threats and application of safeguards in order to determine independence and objectivity.

12. Discuss the standards of ethical conduct for practitioners of management accounting and financial management. [8]

Answer 12:

Management Accountants have an obligation to provide services at the highest level of ethics possible. Ethics is an integral part of management accounting, and companies need to develop a code of ethics or conduct, to set the expected ethical behavior for an accountant.

In recognition of this obligation, the Institute of Management Accountants has promulgated the following standards of ethical conduct for practitioners of management accounting and financial management. Adherence to these standards internationally is integral to achieving objective of management accounting.

Competence:

Practitioners of management accounting and financial management have a responsibility to:

- Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.
- Perform their professional duties in accordance with relevant laws, regulations and technical standards.
- Prepare complete and clear reports and recommendations after appropriate analysis of relevant and reliable information

Confidentiality:

Practitioners of management accounting and financial management have a responsibility to:

- Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated to do so.
- Inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality.
- Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantage either personally or through third parties.

Integrity:

Practitioners of management accounting and financial management have a responsibility to:

- Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict.
- Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically.
- Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 2

- Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.
- Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.
- Communicate unfavorable as well as favorable information and professional judgment or opinion.
- Refrain from engaging or supporting any activity that would discredit the profession.

Objectivity:

Practitioners of management accounting and financial management have a responsibility to:

- Communicate information fairly and objectively.
- Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations presented.