

## **Paper 6- Laws, Ethics and Governance**

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	<b>Learning objectives</b>	<b>Verbs used</b>	<b>Definition</b>
<b>LEVEL B</b>	<b>KNOWLEDGE</b>  What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	<b>COMPREHENSION</b>  What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identify	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	<b>APPLICATION</b>  How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	<b>ANALYSIS</b>  How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
Construct		Build up or compile	
Prioritise		Place in order of priority or sequence for action	
Produce		Create or bring into existence	

**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**

- (a) Mr. E joined as Supervisor on monthly salary of ₹ 3450 on 1st Feb 2015 and resigned on 28th Feb 2015. His employer paid Bonus @ 10% to all the eligible employees. Hence Mr. E is entitled to Bonus for the period of his service. Comment
- (b) Factories Act 1948 is applicable to all the factories wherein 50 or more workers are working. Comment
- (c) X draws a cheque in favour of Y. After having issued the cheque he informs Y not to present the cheque for payment and also informs the bank to stop payment. Does the said act of X constitute an offence against him?
- (d) Mr. A purchased a Refrigerator from Mr. B on "hire purchase agreement" expiring on 31.12.17. Mr. A sold on 01.05.15 that Refrigerator to C who purchased against adequate consideration. A has right to give good title to Mr. C. Comment
- (e) Mr. Menon offered on 1st December, 2014 to sell his house to Mr. Polson at INR Thirty Five Lakhs. Mr. Polson accepted by email on 2nd December, 2014 at 8 A.M. At 10 A.M, Mr. Polson sent a Fax revoking the acceptance. Both email (i.e. acceptance) and Fax (i.e. revocation) reached Menon at the same time. Comment
- (f) Provisions of Indian Partnership Act 1932 are applicable to LLPs and the body Corporate may be partner of LLP.
- (g) What may be the probable modes of payment of remuneration to promoters?
- (h) A transferee becomes a member of the company when the instrument of transfer is submitted with company. Comment.
- (i) "Business ethics helps to promote public reputation". Comment.
- (j) "A nation should satisfy its social and economic requirements without damaging the interest of future generations". Comment.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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### **Answer:**

- (a)** Sec.8 of Payment of Bonus Act 1965 provides that an employee to be entitled for bonus in the accounting year should have worked in the establishment for not less than thirty days. Thus in view of above, Mr. E is not entitled to bonus as he has not worked for 30 days in the accounting year.
- (b)** False. The Factories Act, 1948 is applicable to factories where in ten or more workers are or were working on any day of the preceding twelve months and in which manufacturing process is being carried on with the aid of power or twenty or more workers without the aid of power.
- (c)** The drawer has committed an offense U/s 138 of Negotiable Instruments Act, 1881, since the words 'the cheque is returned by the bank unpaid due to insufficiency of funds in the account of drawer' have to be given a wide interpretation to include dishonour of cheque due to issue of stop payment order given by the drawer to the bank, and also where the drawer asks the holder not to present the cheque (Modi Cements Ltd Vs Kuchil Kumar Nandi)
- (d)** Under Hire Purchase Agreement, the ownership passes to buyer only on payment of last installment. The hirer under hire purchase system, has no title to the refrigerator therefore Mr. A cannot give a good title to Mr. C. This is because Mr. C. does not get a better title than Mr. A had.
- (e)** If the letter of acceptance (e -mail) and the revocation (Fax) reached Menon at the same time, the formation of contract would depend on the fact that which of the two was opened first by Menon. If Menon read the Fax first then revocation was valid but if he read the e-mail first, this revocation was not possible.
- (f)** i) Provisions of the Indian Partnership Act are not applicable to LLP's. Limited Liability Partnership Act, 2008 makes provisions for the formulation and regulation of limited liability partnerships and for matters connected therewith or incidental thereto.  
ii) An LLP can be formed by individual and/or by Body Corporate. Hence a Body Corporate may be a Partner of an LLP
- (g)** Remuneration may be paid to the promoters in any of the following ways:
- Issue of shares at discount
  - Right to subscribe for company's shares in future at a fixed price.
  - Purchase of property of promoters at a higher price
  - Paying any lump sum remuneration to promoters
  - Payment of commission to promoters on the purchase price of any property purchased by the company
  - Payment of commission to promoters on shares sold by the promoters.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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- (h) As per Sec 2(55) of the Companies Act, 2013, every person who agrees in writing to become a member of a company and whose name is entered in its register of members, shall be a member of the company. Thus, the transferee becomes a member only when the company gives effect to the transfer deed and enters the name of the transferee in the register of members.
- (i) It is in the long term of a business organization to observe business ethics. Observing business ethics serves as a strategic branding tool in differentiating from competitors. It helps an entity to build trust with all its stakeholders. It also results in positive press coverage, thus enhancing its reputation with the public, customers and within the business community. Hence the statement given above is correct.
- (j) Sustainable development means maintaining development over time. Sustainable development aims at creating a balance between the present and future economic development by emphasizing conservation of natural resources and environmental protection. So, the given statement is correct.

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

**[4 × 12 = 48]**

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

- (i) Mr. Ashoke obtains two loans from Mr. Natobar. First loan ₹ 3000 guaranteed by Mr. Roy and second loan 5000. Ashoke send a cheque of ₹2000 to Mr. Natobar without indicating how this amount is to be appropriated. Mr. Natobar appropriated against loan of ₹5000 which was unsecured. Whether this apportionment was lawful?
- (ii) M/s. wholeseller agreed to supply 500 bales of cotton to M/s. Retailer at ₹ 6,000 per bale by 31.05.2015. On 01.05.2015 M/s.Wholeseller informs the Retailer that he is not willing to supply the cotton bales as the price of cotton has increased to ₹ 7,000 per bale. Examine the right of M/s. Retailer.
- (iii) Mr.Malhotra sold 1000 kgs. of rice to Mr. Basu who delayed in taking the rice from Mr. Malhotra. In the meantime Mr. Malhotra sold that rice to Mr. Roy who took the delivery for value & without notice of prior sale. Hence Mr. Roy has no good title of ownership to goods — Comment.
- (iv) Write a note on Filing of Annual Return by an LLP.

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

#### **Answer:**

- (i) In the absence of any specific clear instruction by Mr. Ashoke, Mr. Natobar may apply this amount at his own discretion to any lawful debt actually due and payable, hence Mr. Natobar's action was lawful (Sec. 60) Even this amount however cannot be applied

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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to disputed debt (Sec. 60) it could be appropriated by Mr. Natobar to a debt which has become time barred.

- (ii) On 01.05.2015 M/s Wholeseller indicated his unwillingness to supply the cotton bales @ ₹6000 per shirt although there is time up to 31.05.2015 for performance of the contract. It is therefore called anticipating breach of contract. In such case M/s. Retailer can claim damages. The Wholeseller may treat the contract as subsisting and wait till the date of delivery or he may treat the contract as rescinded and claim damages for breach.
- (iii) Where Mr. Malhotra having sold goods continues in possession thereof or documents of title to the goods, the delivery by such seller i.e., Mr. Malhotra will pass a good title to Mr. Roy, since Mr. Roy acted on good faith and without notice of the previous sale by paying the value (Sec 30). Where however Mr. Malhotra keeps the goods as Mr. Basu's bailee, this section shall not apply (Sec. 30). In these circumstances Mr. Roy can sue Mr. Malhotra.
- (iv) Every limited liability partnership (LLP) shall file an annual return duly authenticated with the registrar within sixty days of closure of its financial year in such form and manner and accompanied by such fee as may be prescribed.

Any limited liability partnership which fails to comply with the provisions of this section shall be punishable with fine which shall not be less than INR twenty five thousand but which may extend to INR five lakhs.

If the LLP contravenes the provisions of this section, the designated partner of such LLP shall be punishable with fine which shall not be less than INR ten thousand but which may extend to INR one lakh.

### **Question 2(b)**

- (i) **While an employee may increase his contribution to Provident Fund, is an employer also liable to proportionately increase his contribution to the above under the Employees Provident Fund and Miscellaneous Provision Act, 1952? Explain.**
- (ii) **Wages cannot be paid by cheque but can be paid in kind. Answer based on provision of Payment of Wages Act 1936.**
- (iii) **What are the benefits a member of an Employees Provident Fund & Miscellaneous Provisions Act 1952 can get on retirement/death?**
- (iv) **ABC Pvt. Ltd. Incorporated on 2nd January 1980 carrying on business from the date of incorporation employing 50 persons. Due to loss, the number of employees reduced to Five w.e.f. 02.06.2011. Mr. A who retired on 31.05.2013 was refused gratuity on the ground**

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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that the total number of employees is below 10(ten). State whether employer was justified?

**(v) As per factories Act, adequate shelters, restrooms and lunch rooms are mandatory in all the factories. Do you agree?**

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

**Answer:**

**(i)** Rate of contribution to PF is 10% of pay, which may be increased upto 12% of pay by the Central Government by issuing a Notification in the Official Gazette; an employee may opt to contribute at a higher percentage than 10% / 12%, as the case may be. However, the employer shall not be bound to make such higher contribution.

**(ii)** Employer may after obtaining written authorization of employed persons pay them the wages either by cheque or by crediting to their Bank A/c. In all other cases, wages shall be paid in current coins or currency notes or both but cannot be paid in kind.

**(iii)** Retirement benefits are:

- Accumulated Balance in PF A/C of the employee.
- The employee pension on reaching 50/58 years of age or leaving / retirement capital return of pension.
- Widow pension, children pension, nominee pension or death of member.
- Deposit linked insurance to family or to nominee.

**(iv)** Payment of Gratuity Act provides that a shop or establishment to which this Act has become applicable shall continue to be governed by this Act inspite of persons employed therein at any time it has become so applicable falls below ten. Hence ABC Pvt. Ltd. cannot refuse payment of gratuity to Mr. A.

**(v)** Specified Factories which employs 150 or more workers have to provide adequate shelters, rest rooms and lunch rooms so that the workers may use them for eating meals brought by them. The aforesaid shelters etc. must be sufficiently lighted, ventilated and maintained in cool and clean conditions (Sec.4). However, any canteen maintained in accordance with the provisions of Sec. 46 shall be regarded as part of this requirement.

**Question 2(c)**

**(i) "Minimum wage rate may vary". Discuss with the provisions of Minimum Wages Act, 1948.**

**(ii) Vishal (P) Ltd. imposed a fine on Divya, one of its employees for regularly reporting late for work. The fine was imposed on 4th April, 2013. The management wanted to recover the amount in September, 2013 during half yearly increment.**

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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**(iii) A company, employing 50 persons, has been incurring losses right from the commencement of its business. Accordingly, it has made an application to the appropriate Government to exempt it from the application of all the provisions of the Payment of Bonus Act. Do you think that the appropriate Government will exempt from the application of all the provisions of the Payment of Bonus Act, and if so, on what grounds? Give reasons for your answer.**

**(iv) Dharma Ltd discontinued deduction towards contribution to provident fund from its employees salary and stopped remitting contribution of its share of provident fund when the number of its employees on its roll fell to thirteen. Do the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 cease to be applicable under such circumstances?**

**[3+2+4+3 = 12]**

### **Answer:**

**(i)** As per Sec.3(3)(a) of Minimum Wages Act, 1948 minimum wage rate may vary depending on different variables like:

- 1) Different Scheduled employment
- 2) Different Classes of work in same scheduled employment
- 3) Adults, adolescents, children and apprentices
- 4) Different Locality

**(ii)** As per Sec. 8(7) of The Payment of Wages Act, 1936 no fines can be recovered after expiry of 90 days from the date on which it is imposed. So Vishal (P) Ltd. will not be able to recover the fine from Divya in September, 2013 as the gap exceeded 90 days.

**(iii)** As per Section 36 of the Payment of Bonus Act, the appropriate Government may, having regard to the financial position and other relevant circumstances of any establishment or class of establishments, exempt, by notification in the Official Gazette, such establishment or class of establishments from all or any of the provisions of the Payment of Bonus Act. It may do so if it is of opinion that it will not be in public interest to apply all such establishment or class of establishments from the application of such provisions of the Act for such period as may be specified in the notification and impose such conditions as it may think fit to impose.

As in the given case the company has been incurring losses right from the commencement of its business, goes to indicate that its financial position is weak enough, and accordingly, the appropriate Government is most likely to consider that it would be in the public interest to exempt this company from the application of all or any of the provisions of the Act. However, the appropriate Government, according such exemption, may impose such conditions on the company, as it may consider fit.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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**(iv)** According to sec 5(1) of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, an establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time falls below twenty. As such the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 continue to be applicable to Dharma Ltd.

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

**(i)** Binod fraudulently induces Chirag and obtains a Bill of Exchange from Chirag in his own favour. Later, he endorses the same to Asim under a commercial deal as a consideration. Asim gets the bill as holder in due course. Asim subsequently endorses it back to Binod for some other deal and for value. On maturity Chirag refuses to pay up and Binod sues him for recovery of money. With reference to the provisions of the Negotiable Instruments Act, should Binod succeed in the case?

**(ii)** X has balance of ₹ 3000/- in YZ Bank. He draws a cheque of ₹ 10,000/- in favour of C knowing fully that he has no O/D facility. The cheque is dishonoured. Is 'notice of dishonour' to X necessary?

**(iii)** When is a LLP not bound by act of its members?

**(iv)** When is forfeiture of Gratuity possible?

**[3+2+3+4 = 12]**

### **Answer:**

**(i)** The problem stated in the question is based on the provisions of the Negotiable Instruments Act as contained in Section 53. The section provides: 'Once a negotiable instrument passes through the hands of a holder in due course, it gets cleansed of its defects provided the holder was himself not a party to the fraud or illegality which affected the instrument in some stage of its journey. Thus any defect in the title of the transferor will not affect the rights of the holder in due course even if he had knowledge of the prior defect provided he is himself not a party to the fraud. (Section 53).

Thus applying the above provisions it is quite clear that Binod who originally induced Chirag in obtaining the bill of exchange in question fraudulently, cannot succeed in the case. The reason is obvious as Binod himself was a party to the fraud.

**(ii)** Notice of dishonour is not necessary when the party charged could not suffer damage for want of notice. As such notice of dishonour to X is not necessary.

**(iii)** A limited liability partnership is not bound by any act of a member in dealing with a person if:

- the member in fact has no authority to act for the limited liability partnership by doing that thing;

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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- the person knows that the member has no authority or does not know or believe him to be a member of limited partnership.

**(iv) Forfeiture of Gratuity:** Section 4 of the Payment of Gratuity Act, 1972 provides the following provisions for forfeiture of gratuity:

1. In case of damage by employee: The gratuity payable to an employee shall be forfeited to the extent of the damage or loss caused by him if his services have been terminated for any act, willful omission or negligence causing any damage or loss or destruction of the property belonging to the employer.
2. In case of riotous act: The gratuity payable to an employee may be wholly or partially forfeited if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part.
3. In case of offence involving moral turpitude: The gratuity payable to an employee may be wholly or partially forfeited if the service of such employee has been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment. Provided services have not been terminated on any of the above grounds, the Employer cannot withhold gratuity due to the Employee. Where the land of the Employer is not vacated by the Employee, Gratuity cannot be withheld.

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

**(i) List the circumstances under which an LLP formed under the Limited Liability Partnership Act, 2008 may be wound up by tribunal?**

**(ii) Explain 'committee method' and 'notification method' for fixation of minimum wages under the Minimum Wages Act, 1948.**

**(iii) H retired from services on attaining the age of superannuation. After his retirement, it was noticed that he had misappropriated amount from travelling allowance drawn by him. The employer wants to deduct the misappropriated amount from gratuity payable to him. Is the action of the employer legally tenable?**

**(iv) Mr. X was shopping in a self-service Super market. He picked up a bottle of cold drink from a shelf. While he was examining the bottle, it exploded in his hand and injured him. He files a suit for damages against the owner of the market on the ground of breach of condition. Decide, under the Sale of Goods Act, 1930, whether Mr. X would succeed in his claim?**

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

### **Answer:**

- (i) A limited liability partnership may be wound up by the Tribunal,—
1. if, the limited liability partnership decides that limited liability partnership be wound up by the Tribunal;
  2. if, for a period of more than six month ,the number of partners of the limited liability partnership is reduced below two;
  3. if the limited liability partnership is unable to pay its debts;
  4. if the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;
  5. if the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or
  6. if the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up

- (ii) According to Section 5(1)(a) of the Minimum Wages Act, 1948 the appropriate government may 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. This method is called Committee method.

As provided in Section 5(1)(b) of the said Act, the appropriate Government 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 . This method is known as Notification method.

- (iii) Section 4(6) of the Payment of Gratuity Act, 1972 provides that –

1. The gratuity of an employee, whose services have been terminated for any act, willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, shall be forfeited to the extent of the damage or loss so caused.
2. The gratuity payable to an employee may be wholly or partially forfeited—
  - (a) if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part, or
  - (b) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

In the present case the employee has attained the age of superannuation and has retired. His misappropriation was noticed after his retirement. The employer wants to deduct misappropriated amount after his retirement. The decision of the employer is not tenable as H's services have not been terminated.

- (iv) This is based on Section 16(2) of the Sale of Goods Act, 1930, which states that where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

the goods shall be of merchantable quality. Though the term 'merchantable quality' is not defined in the Act, it means that in the present case, the bottle must be properly sealed. In other words, if the goods are purchased for self-use, they should be reasonably fit for the purpose for which it is being used. In the instant case, on an examination of the bottle of cold drink, it exploded and injured the buyer. Applying the provision of Section 16(2), Mr. X would succeed in claim for damages from the owner of the shop.

### **Question 3: Answer any 2 questions**

**[2 × 8 = 16]**

#### **Question 3(a)**

- (i) **The principal business of Vriddhi Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the Chairman of the Company acquired the knowledge of arranging finance for the development of land. The Vriddhi Company introduced a financier to another company Janata Ltd. and received an agreed fee of ₹ 2 lakhs for arranging the finance. The Memorandum of Association of the company authorises the company to carry on any other trade or business which can in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the Companies Act, examine the validity of the contract carried out by Vriddhi Company Ltd. with Janata Ltd.**
- (ii) **Mr. Konar failed to receive certain information in connection with his Provident Fund accumulation. He intends to take shelter under RTI Act 2005. Please advise the steps or Procedure to be followed.**

**[6+2 = 8]**

#### **Answer:**

- (i) Arranging finance or financier is an ultra vires act since it falls outside the object clause of memorandum and since an object contained in the object clause is not valid if it authorises the company to carry on any other trade or business which can be advantageously carried on by the company.

The contract entered into by the company is ultra vires since the company has no power to arrange finance or financier. The Board cannot take the defense that the memorandum authorises the company to carry on any business which can be advantageously carried on in connection with company's present business (since, it is a 'specified purpose' given u/s 17 for alteration of object clause, but it cannot be the ground or basis for carrying on a business which is outside the object clause). The memorandum to be first altered by complying with the requirements of Sec. 17, and afterwards the business of arranging finance is carried on.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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(ii) Mr. Konar may submit:

1. A request in writing in plain paper indicating the information he needed.
2. To the public information officer under Regional Provident Fund Commissioner.
3. With a fee of INR 10 which can be paid in cash or IPO or Demand Order.

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

(i) **What is the effect of Doctrine of Constructive notice, explain with an example.**

(ii) **Mr. Sarkar filed an application with requisite fees (IPO) to the Public Information Officer (PIO) who returned the application and IPO stating that this application was not related to his department. Whether PIO's action justified?**

**[6+2 = 8]**

### **Answer:**

(i) The Doctrine of Constructive Notice operates in favour of the company, ie it creates a presumption in favour of the company. It operates against the person dealing with the company.

**Effect of the Doctrine** – Once registered the memorandum and articles become public documents (Sec 399 of Companies Act, 2013). Therefore, every person dealing with the company is presumed to have read the memorandum and articles. Further, it is presumed that he has understood the provisions of the memorandum and articles correctly, i.e. in the right sense. [T.R. Pratt (Bombay) Ltd. V E.D.Sassoon & Co. Ltd.]

Thus it is required of every person to appraise himself with the requirements of the memorandum and articles, before entering into any contract with a company. The doctrine prevents any person dealing with the company from alleging that he did not know the provisions contained in articles or memorandum. If a person enters into a contract with the company in contravention of the provisions of the memorandum and articles, he cannot enforce such a contract.

In Kotla Venakataswamy v C Rammurthi, the articles of a company required that all the documents and deeds of the company shall be signed by the MD, the secretary and the working director of the company. A mortgage deed was signed by the secretary and the working director only. It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilized for the benefit of the company.

(ii) If the request for information pertains to another Public Authority in whole or part it is the responsibility of public information officer (PIO) to transfer/forward the concerned portions of the application/request to a PIO of the other Department/Public Authority within 5 days but he cannot return the application to the Applicant.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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

- (i) XYZ Ltd. Issued a prospectus inviting the public for subscription of its equity shares stating in it that company possesses good financial health and paying dividends to its equity shareholders consistently and regularly at 20 percent over the last five years. The fact was, the company was running in loss since last three years and it was paying dividends to its shareholders out of accumulated profits. Mr. Ankur read the prospectus and bought 500 shares of the company. Discovering the misstatement made by the company in its prospectus, he wants to rescind the contract and claim damages from the company. Referring to the provisions of Companies Act, 2013, state whether Mr. Ankur will succeed.
- (ii) Nitya Builders Ltd decides to pay 2.5 percent of value of debentures as underwriting commission to the underwriters but the articles of the company authorizes to pay only 2 percent underwriting commission on debentures. Comment on the validity based on Companies Act, 2013.

[5+3 = 8]

### **Answer:**

- (i) 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.

Mr. Ankur, 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].

- (ii) As per the provisions contained in Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014, a company cannot pay underwriting commission of 2.5% since the rate of underwriting commission cannot be more than 2.5% of issue price of debentures or such lower rate as prescribed under the articles, i.e. 2% in the present case

Hence, the maximum permissible underwriting commission in this case is 2%.

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

[2 × 8 = 16]

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

- (i) What is meant by the term 'Stake-holders'. Can you name a few?
- (ii) What are the integrity issues that are required to be addressed by a financial and accounting professional while carrying on his responsibility?

**[4+4 = 8]**

### **Answer:**

- (i) Stake-holders mean all those people or constituents who influence, and are in turn influenced by an organization. In the past, it was considered that a business was accountable only towards investors. However, now a days, a business is considered to be accountable towards all its stakeholders. All the stakeholders have an interest in the conduct of the business of the organization. The stakeholders have certain rights with respect to the working of the organization.
- The term stakeholder usually includes – Investors or Shareholders, Employees, Directors, Customers, Suppliers, lenders, creditors, Government (Enforcement and Regulatory Authorities), Local communities, Environment, Trade unions, Mass media, Competitors.
- (ii) Practitioners of management accounting and financial management have to address certain integrity issues like:
- 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.
  - Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.
  - Recognize and 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.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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

**(i) "To maintain social contract between society and business, the trusteeship relations are essential". Discuss the role of business ethics in this reference.**

**(ii) Explain the Conflict resolution process.**

**[4+4 = 8]**

### **Answer:**

**(i)** The 'trusteeship philosophy' as propounded by Gandhiji suggests that no individual has any right of private ownership of property except so far as may be permitted by the society for its own welfare. Thus, an individual is not free to hold or use his wealth for selfish satisfaction or in disregard of the interest of the society.

Trusteeship provides a means of transforming a capitalist society into an egalitarian one (i.e. democratic, equal)

According to Gandhiji, "a businessman has to act only as a trustee of the society for whatever he has gained from the society. Society bestows upon businesses the authority to own and use natural resources. In return, society has the right to expect that business organization will enhance general interests of consumers, employees and community.

Applying the trusteeship philosophy in the context of business, a business organization should adopt ethical business practices. Adhering to the principles of business ethics creates a positive environment for the long term prosperity of the business. An ethically driven business not only results in prosperity for the business but also for the society.

**(ii)** A finance and accounting professional should determine:

(a) The appropriate course of action,

(b) Weigh the consequences of each possible course of action:

(i) If the matter remains unresolved, the professional should consult with other appropriate persons within the firm and if required, with persons responsible for governance of the organisation (e.g. Board of Directors).

(ii) The following steps are suggested to resolve the issues:

(a) Documentation: He should document the substance of the issue and details of any discussions held or decisions taken, concerning that issue.

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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- (b) Legal Advice: If a significant conflict cannot be resolved, a professional may obtain advice from the relevant professional body or legal advisors without breach of confidentiality.
  
- (c) Withdrawal: If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional should, where possible, refuse to remain associated with the matter creating the conflict, withdraw from the engagement team or specific assignment or resign from the employing organization.

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

**(i) What are the consequences of Unethical behavior?**

**(ii) State the relation of Business and ethics.**

**[5+3 = 8]**

### **Answer:**

**(i)** 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. Unethical behavior has a few consequences, as follows:

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

**(ii)** No matter how hard one tries, it is impossible to separate life from business. For a businessman, business is life. Mahatma Gandhi (1948) said, 'It is difficult but not impossible to conduct strictly honest business. What is true is that honesty is incompatible with amassing of large fortune.' The business world is an important part of society, as it is concerned with the livelihoods of people. Business activity too is subjected to the code of conduct without any exception. People expect businessmen to possess the same rationality as any other citizen. Therefore, there is no separate business ethics for

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec 2015\_Set 1**

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businessmen, as ethics applies to all the activities of people. Consequently, we have to keep business within the bounds of ethics.