

Paper-6: LAWS, ETHICS AND GOVERNANCE

Full Marks: 100

Time Allowed: 3 Hours

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

Question 1: Answer all questions

2 X 10 = 20

(i) "Fragrance" Soap Co. advertised that it would give a reward of ₹ 1,000 who developed skin disease after using, "Fragrance" soap of the company for a certain period according to the printed directions. Miss Nisha purchased the advertised "Fragrance" soap and developed skin disease in spite of using this soap according to the printed instructions. She claimed reward of ₹ 1,000. The company refused the reward on the ground that offer was not made to her and that in any case she had not communicated her acceptance of the offer. Decide whether Miss Nisha can claim the reward or not. Refer the relevant case law, if any.

(ii) A draws a bill on B. B accepts the bill without any consideration. The bill is transferred to C without consideration. C transferred it to D for value. Decide -

A. Whether b can sue the prior parties of the bill, and

B. Whether the prior parties other than D have any right of action intense?

Give your answer with reference to the Provisions of Negotiable Instruments Act, 1881.

(iii) Mr. Wadhwa is working as an accountant in a company on salary basis. The following payments were made to him by the company during the previous financial year -

(a) Overtime allowance,

(b) Dearness allowance

(c) Commission on sales

(d) Employer's contribution towards pension fund

(e) Value of free food.

Examine as to which of the above payments form part of 'salary' of Mr. Wadhwa under the provisions of the Payment of Bonus Act, 1965.

(iv) 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 Funds and Miscellaneous Provisions Act, 1952? Comment.

(v) National Steels Limited decided to forfeit the amount of gratuity of its employee Cezar on account of disorderly conduct and other acts which caused loss to the property belonging to the company. Cezar, committed the following act. He, after superannuation, continued to occupy the quarter of the company for six months.

Against the decision of the company, Cezar applied to the court for relief. The Company contented that the right to gratuity is not a statutory right and the forfeited amount of gratuity was within the law.

Examine the contention of the company and the decision taken by the company to forfeit the amount of gratuity in the light of the Payment of Gratuity Act, 1972.

(vi) With a view to boost sales Harmeet Automobiles sells a motorcar to Ms. Nikki on trial basis for a period of three days with a condition that if Ms. Nikki is not satisfied with the performance of

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

the car she can return it back. However the car was destroyed in a fire accident at the place of Ms. Nikki, before the expiry of three days. Would Ms. Nikki be liable for the loss suffered?

(vii) Joint Holder of shares in a public company are not a single member. Comment.

(viii) A private company may, in its articles, incorporate additional disqualifications in respect of directorship of the company.

(ix) What is meant by, 'Iron Law of responsibility'

(x) State what is meant by the principal of confidentiality in business ethics of a finance and accounting professional.

Answer:

(i) Miss Nisha can claim the reward, since there is a contract between Miss Nisha and Fragrance Soap Co.; and in case of a general offer, the acceptance of offer is not to be given by way of communication of acceptance, but is given by way of performance of the terms and conditions of offer.

(ii)

A. Rights of D - D can recover the amount of the bill from all the prior parties since D is a holder for value.

B. Rights of prior parties other than D- No party prior to D can recover the amount of the bill from any prior party since a negotiable instrument creates no obligation of payment between the parties if it was made, drawn, accepted, endorsed, or transferred without consideration.

(iii) Items to be included in 'salary or wage' are:

1. Dearness allowance
2. Value of free food (provided it is given in lieu of salary)

Items not to be included in 'salary or wage'

1. Overtime allowance
2. Commission on sales
3. Employer's contribution towards pension fund

(iv) Rate of contribution of PF is 10% of pay, which may be increased upto 12% of pay by the CG by issuing a Notification in the Official Gazette;

Increase in the rate of contribution - 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.

(v) Forfeiture of gratuity of Mr. Cezar is not valid since the company is entitled to deduct from the gratuity payable the charges or rent due for six months; but occupying company's quarter does not entitle the company to forfeit the gratuity payable (Wazir Chand v Union of India).

(vi) The subject of the contract, i.e. Motor car was destroyed before the transfer of property from seller to the buyer. The risk passes only when the ownership is transferred to the buyer. So, Ms. Nikki is not liable for the loss suffered due to the fire accident over which Ms. Nikki has no control and Harmeet automobiles has to bear the loss arising due to the accident.

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

(vii) The statement is true. Joint holders of shares in a public company are not single member. Each of the joint holders of shares is a member of the company but joint holders are counted as one member for the purpose of determining the maximum number of members ie 200 in a private company and for determining quorum at general meetings etc.

(viii) Section 274(3) of Companies Act, 1956 specifies the provisions regarding disqualifications of directors. According to the said section a private company, which is not a subsidiary of a public company, may by its articles provide for any disqualifications in addition to the disqualifications stated in the above statement.

(ix) Business exists only because it brings invaluable services for society. Society gives business the right to consume its resources and this can be retained only if the business meets the needs and expectations of the society. Thus, a business should be responsible to the society – a resource place for business. Businesses that do not use power in a responsible manner will lose in the long run.

(x) Accounting and financial management should refrain from disclosing confidential information acquired during their work. When such information is to be disclosed to their subordinates in course of their normal work, care should be taken that ultimate confidentiality is maintained. However, an organization must submit information required under a legal obligation or statutory ruling.

Question 2: Answer any 4 questions

[4 × 12 =48]

Question 2(a)

(i) Comment on the following:

- A. 'Goods seized by Customs Authority are a case of bailment under Indian Contract Act', offer your views.**
- B. Mr. A, Mr. B & Mr. C are Sureties to Mr. D for the sum of ₹6000 lent to Mr. E failed to repay on due date. Mr. A. one of the sureties disagreed to pay. Advice whether 'A' is right.**
- C. A deceit which does not deceive is not a fraud.**

(ii) Raman instructed Soman, a transporter, to send a consignment of apples to Mumbai. After covering half a distance, Soman found that the apples will perish before reaching Mumbai. Hence, he sold the same at a half the market price. Raman sued against Soman. Will he succeed?

(iii) Bill of Exchange dated 1st February, 2014 payable two months after date - was presented to the maker for payment 10 days after maturity. What is the date of maturity?

[6+3+3 = 12]

Answer:

(i)

A. True. In the instant case, the possession of goods is transferred to the customs authority. Therefore, the provisions of section 148 of the Contract Act, 1872 as to bailment is applicable in this case.

B. The liability of the surety towards the creditor is co-extensive with that of the principal debtor, unless it is otherwise provided in the contract of guarantee. The Supreme Court, in the

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

case of Industrial Investment Bank of India Ltd v Biswanth Jhunjhunwala, has discussed the issue elaborately and reiterated that the liability of the guarantor/surety and principal debtor is co-extensive and not in the alternative.

Where two or more persons are co-sureties for same debt, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in absence of any contract to the contrary, are liable as between themselves, to pay each an equal share of the whole debt or of that part of it which remains unpaid by the principal debtor. In the instant case, Mr. A, Mr. B & Mr. C are liable to as between themselves to pay ₹ 2000/- each. Mr. 'A' cannot escape.

C. The statement is correct. A mere attempt to deceive by one party is not fraud unless the other party is actually deceived. If the party has not been deceived at all, there is no point in establishing a case of fraud, and gives no ground of action.

(ii) Agent's Authority in an emergency

In the instant case, Soman had acted in an emergency situation and Raman will not succeed against him.

As per section 189 of the sale of Goods Act, 1930, an agent has the authority in an emergency to do all such acts as man of ordinary prudence would do for protecting his principal from losses which the principal would have done under similar circumstances. A typical case is where the agent handling perishable goods like 'apples' can decide the time, date and place of sale, not necessary as per instructions of the principal, with the intention of protecting the principal from losses. Here the agent acts in an emergency and act as a man of ordinary prudence.

(iii) If a bill is made payable a stated number of months after date, it becomes payable three days after corresponding date of months after the stated number of months (section 23 read with section 22 of NI Act, 1881).

Therefore in this case the date of maturity of the bill is 4th April 2014 provided it is not Sunday or Public Holidays (1st April + 3 days).

Question 2(b)

Comment on the following:

- (i) In case of personal injury, the employer is liable to pay compensation within 3 months from the date when it falls due. State legal provisions**
- (ii) Personal Manager told to Director that at least one canteen shall be provided in every factory. Do you agree?**
- (iii) Calculate the amount of gratuity of Mr. X who joined the company on 1.5.83 and retired on 30.11.2013 when his salary was ₹ 26,000 per month. During November, 2013 he received overtime and incentive ₹5,000.**
- (iv) When and under what circumstances a person can receive pension under Employees Provident Fund Scheme?**
- (v) Dr. B has been dismissed by the Manager of an Industrial Establishment. Workmen demanded his reinstatement. Comment legal position.**
- (vi) 'A' saved life of 'B' who was drowning, Latter A' demanded remuneration from 'B' for saving of life was valid consideration, A' would succeed.**

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

[6 × 2 = 12]

Answer:

- (i) In case of personal injury to a workman by accident arising out of and in the course of his employment, compensation in accordance with the provision of the workmen's Compensation Act, shall be paid within 30 days from the date when it falls due otherwise the Employer is to pay interest and penalty too.
- (ii) False: In any specified factory wherein more than 250 workers are ordinarily employed, a canteen shall be provided for the workers. Hence it is not mandatory for every factory to provide Canteen.
- (iii) Mr. X worked from 1.5.83 to 30.11.13 i.e. 30 years 6 months 29 days.
For the purpose of gratuity calculation, service period is taken for 31 years.
Hence $31 \times 26000 / 26 \times 15 = 4,65,000$ or ₹ 10,00,000
Whichever is lower. Hence he will be entitled to ₹ 4,65,000. Overtime or incentives are excluded.
- (iv) Under following circumstances pension can be allowed:
- A. On superannuation on reaching 58 years of age or more and at least 10 years of service.
 - B. Before superannuation but on reaching 5 years of age or more up to 58 years with at least 10 years of service but the members may not be in service.
 - C. On death of the member while in service or not in service.
 - D. Permanent disability totally unfit for the employment which the member was doing at the time of such disablement.
- (v) As per Industrial Disputes Act a workman includes any person including an apprentice employed in an industry to do manual, unskilled, skilled, technical, operational, clerical or supervisory work. However it excludes those employed in Managerial or Administrative capacity.
- A. The workmen can demand reinstatement of Dr. B treating Dr. B as workman.
 - B. However Dr. B may not be termed as workman as he was employed in Administrative or managerial capacity
 - C. Hence there may be industrial disputes.
- (vi) Consideration should be at the desire of promisor 'A' cannot demand payment for his service to save B's life because (i) it was voluntary gratuitous act and not at the desire of 'B'. Where, however, a 'Person' lawfully does anything for "another person" not intending to do so gratuitously and such other persons enjoys the benefit thereof the "another person" bound to make compensation to the "person" in respect of the thing so done.

Question 2(c)

- (i) **Zen, a known smuggler, was caught in transfer of funds by illegally exporting narcotic drugs from India to some countries in America. State the maximum punishment that can be awarded to him under prevention of Money Laundering Act.**
- (ii) **How the surety is discharged from liability?**
- (iii) **There are in total two parties to a Promissory Note. Comment.**

[4+6+2 = 12]

Answer:

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

(i) The punishment for Zen for money laundering is explained below:

Imprisonment up to 7 years (Section 4): Who ever commits the offense of money laundering shall be punishable with rigorous imprisonment for a term which shall not be less than 3 years but which may extend to 7 years and shall also be liable to fine which may extend to ₹5 lakhs.

Imprisonment up to 10 years (Proviso to section 4): However, if the proceeds of crime involved in money laundering relates to any offense specified under para 2 of Part A of the schedule, the provisions of this section shall have effect as if for the words 'which may extend to 7 years', the words 'which may extend to 10 years' has been substituted.

(ii)

(a) Under any of the following circumstances a surety is discharged from liability.

1. By revocation of the contract of guarantee.
2. By notice of revocation by surety.
3. Due to death of surety.
4. By novation i.e., when a fresh contract entered into, the original contract of guarantee comes to an end and so the surety stands discharged with regard to the old contract.

(b) By conduct of the creditor

1. Due to variance in terms of a contract, between the principal debtor and creditor without the surety's consent.
2. Release or discharge of the principal debtor by the creditor - A surety is discharged if the creditor makes a contract with the principal debtor by which the principal debtor is released or by any act or omission of the creditor which results in the discharge of the principal debtor.
3. A contract between the creditor and the principal debtor by which the creditor makes a composition with or promises to give time to or not to sue the principal debtor discharges the surety.
4. By creditor's act or omission impairing surety's eventual remedy (Section 189).
5. Loss of surety - if the creditor parts with or loses any surety given to him at the time of guarantee without the consent of the surety, the surety is discharged to the extent of the value of surety.

(c) By invalidation of contract - A contract of guarantee may be avoided if it becomes void or voidable at the option of the surety. A surety in this respect may be discharged from liability in the following cases.

1. When guarantee obtained by misrepresentation.
2. When guarantee obtained by concealment of some material fact relating to contract.
3. Due to failure of co-surety to join a surety. When contract of guarantee provides that creditor shall not act on it until another person joined in it as a co-surety. The guarantee is not valid if that other person does not join.

(iii) A 'promissory note' is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

There are only two parties, the maker (debtor) and the payee (creditor). A note contains an unconditional promise by the maker to pay the payee. No prior acceptance is needed. The liability of the maker on drawer is primary and absolute. No notice of dishonour need be given. The maker of the note stands in relation with the payee.

Question 2(d)

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

(i) Mr. Ambika an agent of a buyer obtained goods from Railways and loaded such goods on his truck on 02.10.14. In the meantime, the Railways received a Notice from the seller (i.e. consignor) for stopping goods in transit as the Buyer become insolvent. Referring to the provisions of the Sale of Goods Act, 1930 decide whether the Railways can stop goods in transit as instructed by the seller?

(ii) Mr. Paul sold to Mr. Ray certain quantity of foreign refined palm oil warranted equal to sample. The samples consisted of palm oil mixed with vegetable oil. The oil tendered corresponds with the sample but it was not such as is known in market as foreign refined palm oil. Mr. Ray wants to reject the oil on the ground that the oil supplied was not in accordance with the foreign refined palm oil. Advise Mr. Ray.

(iii) During 2001-2002, the employees were 50 and subsequently reduced to 10 during 2013-2014, Employer discontinued deduction as EPF not applicable due to reduction of Employees. Comment.

(iv) Manager of the factory fixed the working hours of women from 6:00 P.M. to 1:00 A.M. during the period from Monday to Friday of first week of May 2014. Whether it is permissible, cite with Rule position.

(v) What are the circumstances in which limited liability partnership may be wound up by Tribunal?

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

Answer:

(i) The right of stoppage in transit can be exercised only so long as the goods are in the course of transit. In the given case, the transit came to an end as soon as the Agent of the Buyer obtained goods from the Railways. Therefore Railways cannot act as instructed by the seller who lost the right of stoppage of goods in transit as provided in Section 50 of Sale of Goods Act 1930.

(ii) Mr. Ray can reject the goods. In case of sale by sample as well as by description, goods must not only correspond to sample but also to description i.e. foreign refined palm oil. (Section 15 of the Sale of Goods Act, 1930)

No amount of exemption clauses can compel a person to buy a thing different from contracted to buy.

(iii) Employees' Provident Fund & Misc. Provisions Act, 1952 provides that once the Act, applies to any establishment it shall continue to be governed by the Act irrespective of the fact that the number of employees working there in have subsequently fallen below 20.

Hence in this case EPF scheme shall continue.

(iv) As per provisions of Factories Act no women shall be allowed to work from 7:00 P.M. to 6:00 A.M.

However the State Government may in respect of any factory or group or class or description of factories vary the above limits. No such variation shall authorize the employment of any women between, the hours of 10:00 P.M. and 6:00 A.M.

Hence factory manager violated the rules.

(v) The circumstances in which a limited liability of partnership may be dissolved by Tribunal are provided in section 64 of the Limited Liability Partnership Act, 2008 A limited liability partnership may be wound up by the Tribunal in following ways-

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

1. 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 has acted against the interests of the sovereignty and integrity of India, the security of the state or public order;
4. 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 year; or
5. If the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.
6. If the limited liability partnership is unable to pay its debts.

Question 2(e)

(i) Mr. Arun was an employee of High Developers Limited. He retired from the company after 30 years of continuous service. He applied to the company for payment of gratuity within the prescribed time. The company refused to pay the gratuity and contended that due to stringent financial conditions the company is unable to pay the gratuity. Mr. Arun applied to the appropriate authority for recovery of the amount of the gratuity. Examine the validity with reference to Payment of Gratuity Act, 1972

(ii) Kumari is an employee of Rahul software limited, which works 5 days a week. Kumari was not in continuous service during the financial year 2013-14. However, she worked only for 150 days because she was on maternity leave with full pay for 50 days. Referring to the provisions of Payment of Gratuity Act, 1972 decide whether kumari is entitled to gratuity payable under this Act. Would your answer be different had Rahul Software worked for 6 days a week.

(iii) X, a temporary employee drawing a salary of ₹3000 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 2013-14, pending certain injury. Since there were no adverse findings X was re-instated in service. Later when the bonus was to be paid to the other employees, the employers refused to pay bonus to X, even though he had worked for the remaining ten months in the year. Referring to the provisions of Payment of Bonus Act, 1965 examine the validity of employers refusal to pay bonus.

[2+5+5 = 12]

Answer:

(i) The refusal of the company to pay gratuity is not valid, since it is a statutory obligation of the employer to pay gratuity to Mr. Arun and no such ground is provided under the Act for non-payment of gratuity.

Hence Mr. Arun is entitled to recover the gratuity with the provisions of Sec 8.

(ii) Number of working days for Kumari as per Sec 2A would be:

= Days actually worked + Days on which a female employee was on maternity leave provided that the period of maternity leave does not exceed 12 weeks
= 150 + 50 = 200 days

Kumari shall be deemed to be in continuous service since she has worked for not less than 190 days in the establishment which works for less than 6 days in a week. Therefore, kumari shall be entitled to Gratuity, since she was in continuous service, as per Sec 2A

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

Kumari would not have been entitled for gratuity if Rahul Software Ltd. worked for 6 days a week since, in such a case the legal requirement for being in continuous service is that the employee should have worked for 240 days, whereas Kumari has worked only for 200 days.

(iii) X is an employee since his salary is not more than ₹10,000. It is immaterial that he is a temporary employee. Sec 2(13).

X would be eligible to receive bonus since he has worked for 10 months i.e. 30 days or more during the AY (sec 8) and since it is immaterial that the employment of X was of temporary nature or permanent nature. X is not disqualified u/s 9 since he has not been dismissed from service.

Therefore we may conclude, employer's refusal to pay bonus to X is not valid. X would be entitled to bonus for the entire period of 12 months since absence for the period of 2 months due to suspension was not due to the fault of X. [Project Manager, Ahmedabad Projects, ONGC Vs Shyam Kumar Sahegal]

Question 3: Answer any 2 questions

[2 × 8 = 16]

Question 3(a)

(i) State the meaning of 'Records' under the Right To Information Act, 2005.

(ii) Under Right to Information Act if life or liberty of any person is involved, the Public Information Officer expected to reply within one month. Correct the statement with relevant provisions if it is wrong.

(iii) Under the Articles of Association of Sunshine Ltd. Company directors had power to borrow up to ₹10,000 without the consent of the general meeting. The Directors themselves lent ₹ 35,000 to the company without such consent and took debentures of the Company. Decide under the provisions of the Companies Act, 1956 whether the company is liable? If so, what is the extent of liability of the company in this case?

[2+2+4 = 8]

Answer:

(i) As per Section 2 of the Right to Information Act 2005 "Record" includes-

1. any document, manuscript and file;
2. any microfilm, microfiche and facsimile copy of a document;
3. any reproduction of image or images embodied in such microfilm (whether enlarged or not); and
4. any other material produced by a computer or any other device;

(ii) One month is wrong. The Public Information Officer has to give the information within 48 hours.

As per Section 3 of the Right to Information Act, 2005 provides that all citizens shall have the Right to Information subject to the provisions of the Act. The Act stipulates time limits for replying to the request. If the request has been made to the Public Information Officer designated under the statute, the reply is to be given within 30 days of receipt. However, if life or liberty of any person is involved, the Public Information Officer is expected to reply within 48 hours.

(iii) The company is not liable for ₹ 35,000, since, the benefit of doctrine of indoor management

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

can be availed of only by an outsider who has no knowledge of any irregularity in the internal management of the company.

The liability of the company is limited to ₹ 10,000, since the directors, having knowledge of the fact that the limit of borrowings specified under the articles would be exceeded, themselves lent ₹ 35,000 without the consent of the general meeting; since on the similar facts as in the given case, same decision was given in Howard v Patent Ivory Manufacturing Company.

Question 3(b)

(i) Ultimate Limited has only 7 shareholders having fully paid-up shares. On 30th April, 2013, all the shares of X (a shareholder of the company) are sold to Yasmin (another shareholder of the Company) in an auction by the order of the court. Zeeshan, (a shareholder of the company) was in USA for a business trip from January and thus he was not aware of the developments. The company continues to carry on its business thereafter. In December, 2013, the company borrowed a sum of ₹ 5 Lac from the Unique Bank. Later, the company was wound up and the Assets of the company were not sufficient for the payment of its Liabilities. The Bank filed a suit against Yasmin and Zeeshan for recovery of the said loan from them. Decide the Liabilities of Yasmin and Zeeshan under the provisions of Companies Act, 1956. Would your answer be the same, if the said loan was taken in the month of March, 2013?

(ii) The objects clause of the Memorandum of Association of the XYZ (Pvt.) Ltd., New Delhi, authorized to do trading in mangoes. The company, however, entered into partnership with Mr. A and traded in mangoes and incurred liabilities to Mr. A. The Company, subsequently, refused to admit the liability to 'A' on the ground of 'ultra vires' the Company'.

Advice whether stand of the company is legally valid and if so, gives reasons in support of your answer.

[5+3 = 8]

Answer:

(i)

Yasmin is personally liable for loan taken from Unique Bank, since:

1. The number of members has reduced below statutory minimum, viz. 7;
2. The company continues to carry on business for more than 6 months.
3. Yasmin is cognisant of the fact of reduction in number of members;
4. Loan from Unique Bank was taken by the company after 6 months of the date the number of members was reduced below 7.

Zeeshan is not personally liable for loan taken from Unique Bank, since Zeeshan was not cognisant of the fact of reduction in number of members, as he was not in India.

Limitation on liability of Yasmin and Zeeshan - Yasmin shall be liable only for such of the debts as have been incurred by the company after a period of 6 months, viz. after 31.10.2013.

Yasmin shall not be personally liable, if the loan was obtained by the company in March, 2013, since the personal liability u/s 45 of Companies Act, 1956 arises only for such of the debts as are incurred by the company after a period of 6 months from the date of reduction in number of members below statutory minimum.

(ii) The company is not liable to A, since the partnership agreement for trading in mangoes is an ultra vires contract, and an ultra vires contract is void ab initio, and is not binding on the company or the other party; since the power to enter into partnership is not an ancillary or

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

incidental power; since such power can be legally exercised by the company only if the object clause of memorandum expressly authorises the company to enter into partnership

Question 3(c)

(i) Define free reserves as per section 2(43) of Companies Act, 2013.

(ii) What are the steps to measure corporate governance?

[3+5 = 8]

Answer:

(i) Free reserves' as per section 2(43) of Companies Act, 2013 means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. Provided that -

1. any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
2. any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves

(ii) The proper steps to measure corporate governance would be:

1. Ensure adequacy of internal controls so as to prevent any possible abuse of power.
2. Constitute various committees for ensuring compliances and review of business decisions.
3. Timely and balanced disclosure of financial information and executive compensation.
4. Placing constraints on powers of the management.
5. Ensuring an optimum board composition consisting of executive and non-executive directors, independent directors, professionals and experts.
6. Overloaded stock options create the possibility of unwarranted share value dilution. Corporate governance seeks to check misuse of stock options.
7. Corporate governance should be given prominence in entity's Mission, Vision and Values Statements.

Question 4: Answer any 2 questions

[2 × 8 = 16]

Question 4(a)

(i) What are the reasons for which unethical behaviour might arise in an organization?

(ii) Differentiate between Ethics and Morals.

[5+3 = 8]

Answer:

The reasons for unethical behaviour arise in the organization are:

1. Over Emphasis on Short Term Profitability: Manipulating accounting entries to show better profitability (window dressing) to raise further capital from the market.
2. 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.

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

3. 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 period.
4. 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.
5. 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.

(ii)

Sl. No.	Ethics	Morals
1.	'Ethics' is derived from the Greek word 'Ethikos' which means character.	'Moral' is derived from Latin word 'Mos' which means 'custom'.
2.	Ethics defines the 'character' which is a personal attribute. It severs the analysis of concepts such as right and wrong, good and evil and acting with responsibility.	Customs are set by a group over a period of time. The group may have cultural or religious authority.
3.	'Ethics' is the response of an individual to a specific situation, for example, in a given situation, whether it will be ethical to state the truth?	"Morals" are expressed as general principles and statements, for example, "one should always speak the truth".
4.	'Ethics' has a much wider scope. Ethics examine the moral standards of a group or society to determine their relevance in specific situations and specific issues.	'Morals' works on a smaller scale than Ethics and more reliable.

Question 4(b)

(i) Discuss the benefits of Ethical business.

(ii) 'Small ethical lapses do not result into unethical behaviour'. Comment.

[6+2 = 8]

Answer:

(i) The major benefits of Ethical business may be enumerated as below:

1. Improved Moral of the Employees

Employees of a business firm that adopts ethical practices feel proud about their organisation. Besides, the outlook of the management towards employees being kind and fair earns their trust and cooperation. On the other hand, unethical practices cause employees to be unhappy thereby affecting their loyalty as well as productivity.

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

2. Team work and Improved Productivity

Adherence to moral values at the workplace and the faith of the employees in the integrity of the management leads to team work and thus improved productivity.

3. Improved Corporate Image

Ethical practices help earn business good image in the society. People see such organizations as valuing people more than profit and striving to operate with the utmost integrity and honour.

4. Support of Society

A business that follows ethical practices always receives the support of the society during difficult times.

5. Legal compliances

It results in the firm being not subject to any fines and penalties. Govt. agencies including tax authorities develop faith in the organisation and are reluctant to file cases against such company.

6. Improvement of Society

Business is a part of society. When business firms follow ethical policies and practices, social climate improves.

(ii) The statement is incorrect as ignorance of small lapses may lead to a large problem later. Therefore, companies need to develop an environment where small ethical lapses are taken seriously so that these are not repeated in future, otherwise tolerance of such issues would give rise to grave problems in the future. Thus ignoring small ethical issues may result in unethical behavior.

Question 4(c)

(i) What are the key factors that influence ethical decisions?

(ii) Does Ethical behavior has any importance in workplace? What are they, if any.

[4+4 = 8]

Answer:

(i) The three key factors that influence decision making are as follows:

1. Individual Moral Standards

If an individual has sound personal values and moral standards, it will contribute to an ethical workplace, e.g. the self-actualisation need to excel in one's work, to perform one's duties diligently and properly, to get along with superiors and subordinates, and to feel as "part" of the enterprise's goal-achievement process.

2. Influence of Managers and Co-workers

Co-workers and management exert significant control on one's choices at work, through authority and example. The activities and examples set by coworkers, along with rules and policies established by the Company, are important in gaining consistent ethical compliance in the Company's workplace.

3. Opportunity to engage in misconduct

Answer to PTP_Intermediate_Syllabus 2012_Dec 2014_Set 2

If the Company fails to provide good examples and direction for appropriate workplace conduct, confusion and conflict will develop and result in the opportunity for unethical behaviour. If punishments / reprimands for undesirable behaviour are not implemented, each individual may misuse the opportunities available to him, since there is no punishment system.

(ii) An organization, whether a business or a government agency, is first and foremost a human society. If an employer does not take steps to create a work environment where the employees have a clear, common understanding of what is right and wrong, and feel free to discuss and ask questions about ethical issues and report violations, significant problems could arise, including:

- A. Increased risk of employees making unethical decisions
- B. Increased tendency of employees to report violations to outside regulatory authorities (whistle blowing) because they lack an adequate internal forum
- C. Inability to recruit and retain top people
- D. Diminished reputation in the industry and the community
- E. Significant legal exposure and loss of competitive advantage in the marketplace.