

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

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) The primary purpose of employee safety programme is to preserve the employees':
(a) Mental health
(b) Physical health
(c) Emotional health
(d) All of the above
- (ii) The first Factories Act was enacted in:
(a) 1881
(b) 1895
(c) 1897
(d) 1885
- (iii) When parties enter into a contract on telephone the contract becomes complete at the place where acceptance is heard by the proposer. This has been provided:
(a) In no section of Indian Contract Act but so decided by the Supreme Court
(b) In section – 2
(c) In section – 3
(d) In section – 4
- (iv) In case of conflict of jurisdiction of the courts, the incidence of a contract shall be governed by the law of the place where the:
(a) Contract is made
(b) Contract is performed
(c) Acceptor resides
(d) Proposer resides
- (v) In order to prosecute an employer under section 14 of The Child Labour (Prohibition and Regulation) Act, 1986, the age of the child must be proved to be less than of age.
(a) 12 years
(b) 13 years
(c) 14 years
(d) 15 years
- (vi) Which of the following statements is correct?
(a) A partner can be admitted in a firm by the consent of the majority of partners
(b) A minor can be a partner in a firm
(c) The liability of a retired partner to third parties continues even after his retirement
(d) A partner of an unregistered firm cannot sue for the dissolution of a firm
- (vii) Under the provisions of section 143 of the Negotiable Instruments Act, 1881, all offences under the Act are to be tried by:
(a) any Judicial Magistrate
(b) Judicial Magistrate of the First Class or by a Metropolitan Magistrate
(c) only a District Judge
(d) none of the above

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- (viii) The space for every worker employed in the Factory after the commencement of Factories Act, 1948 should be Cubic Meters.
(a) 9.9
(b) 10.2
(c) 14.2
(d) 13.2
- (ix) As per Employees' State Insurance Act, 1948, the rate of Employer's contribution is:
(a) 4.25%
(b) 4.50%
(c) 4.75%
(d) 4.95%
- (x) The nominal value of qualification shares of a director should not exceed:
(a) ₹7,000
(b) ₹5,000
(c) ₹10,000
(d) ₹8,000
- (xi) Clause 49 is applicable to all the listed companies which has a minimum paid-up capital of:
(a) ₹5 crores
(b) ₹3 crores
(c) ₹6 crores
(d) ₹4 crores
- (xii) The Sarbanes-Oxley Act was formed by the US in the year:
(a) 2002
(b) 2003
(c) 2004
(d) 2005
- (xiii) "Business ethics is the study of business situations, activities and decisions where issues of right and wrong are addressed". This definition is given by:
(a) Raymond C. Baumhart
(b) Andrew Crane
(c) Adam Smith
(d) Campbell Jones
- (xiv) Which of the following is not a threat that may affect the business environment and influence finance and accounting professionals:
(a) Self-interest threats
(b) Advocacy threats
(c) Functional threats
(d) Intimidation threats

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- (xv) As per section 252 of the Companies Act, every public company shall have at least:
(a) 2 directors
(b) 3 directors
(c) 4 directors
(d) 1 director
- (xvi) Section 4 of The Prevention of Money Laundering Act, 2002 provides for:
(a) Fine and Imprisonment
(b) Fine only
(c) Imprisonment only
(d) Fine or Imprisonment
- (xvii) Power to exempt any LLP or class of LLP for Audit of Accounts is with:
(a) Central Government
(b) Inspector
(c) Any other regulatory authority
(d) None of the above
- (xviii) Right of Stoppage in transit can be exercised by the Unpaid Seller, where the Buyer:
(a) is solvent
(b) becomes insolvent
(c) acts fraudulently
(d) acts smartly
- (xix) A gives a recognizance binding him in a penalty of ₹500 to appear in the court on a certain day. He forfeits his recognizance. He is:
(a) **Liable to pay the whole penalty**
(b) Is not liable to pay the penalty
(c) Is liable to pay partially
(d) None of these
- (xx) The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 extends to:
(a) The whole of India
(b) The whole of India except the States of Jammu and Kashmir and Sikkim
(c) The whole of India except the States of Jammu and Kashmir
(d) The whole of India except the State of Sikkim

SECTION A

[Attempt any 4 questions]

2. (a) Mr. Rama proposed to sell his house to Ramesh. Ramesh sent his acceptance by post. Next day, Ramesh sends an e-mail withdrawing his acceptance. Examine the validity of the acceptance in the light of the following:
(i) The e-mail of revocation of acceptance was received by Rama before the letter of acceptance.
(ii) The e-mail of revocation and letter of acceptance both reached together.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

[2+2=4]

(b) Discuss with reasons, whether the following persons can be called as a 'holder' under the Negotiable Instruments Act, 1881:

- (i) X who obtains a cheque drawn by Y by way of a gift.
- (ii) A, the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.
- (iii) M, who finds a cheque payable to bearer, on the road and retains it.
- (iv) B, the agent of C, is entrusted with an instrument without endorsement by C, who is the payee.
- (v) B, who steals a blank cheque of A and forges A's signature. [5]

(c) ABC Textiles Ltd. employed 20 full-time and 5 part-time employees who were drawing salary of less than ₹10,000 per month. After completing service of 28 days, in an accounting year, 10 full-time employees submitted their resignations and left the service of the company. The Board of directors of this company decided not to give the bonus to the employees, who resigned, to the remaining full-time employees and to the part-time employees. Against the decision, all the employees applied to the authorities for relief. Decide, stating the provisions of the payment of Bonus Act, 1965, whether the employees, who resigned, remaining full-time employees and part-time employees will get relief. [3]

Answer 2(a):

(i) In the first situation,

The revocation is valid and there is no contract: since revocation of acceptance binds the offeror if letter of revocation of acceptance is received by the offeror before receipt of letter of acceptance.

(ii) In the second situation,

The revocation is valid and there is no contract: if Rama opens the e-mail (containing the revocation of acceptance) first and reads it.

The revocation is not valid and the contract is formed: if Rama opens the letter (containing the acceptance) first and reads it.

Answer 2(b):

| | |
|-------------------------|--|
| (i) X is a holder | - since X is entitled in his own name to the possession of the cheque and to receive the amount of the cheque. |
| (ii) A is not a holder | - since he is not entitled to recover the amount of the cheque as per court's order. |
| (iii) M is not a holder | - since the cheque was not negotiated to him; - since mere 'possession' does not make a person a holder; it is the 'entitlement to possession' which makes a person 'holder'; - since M is not entitled to the possession and is not entitled to receive or recover the amount of the cheque (Sec. 8); - since a finder of a lost negotiable instrument has no right to receive |

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

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| | the amount of the negotiable instrument (Sec. 58). |
| (iv) B is not a holder | <ul style="list-style-type: none">- since he is entitled to the possession of the negotiable instrument, but not in his own name;- since he is entitled to receive the amount of the negotiable instrument, but not in his own name. |
| (v) B is not a holder | <ul style="list-style-type: none">- since he is in wrongful possession of the negotiable instrument;- since he is not at all entitled to the possession of the negotiable instrument;- since he is not entitled to receive or recover the amount of the negotiable instrument;- since a cheque containing forged signature of the drawer is a nullity, and does not confer any title to any person. |

Answer 2(c):

1. The Act is applicable to the establishment:
 - since the establishment has employed 20 or more persons during any day of the AY;
 - since if the provisions of the act become applicable to an establishment once, they shall continue to be applicable notwithstanding subsequent reduction in the number of persons employed (Sec. 1).
2. 20 full-time and 5 part-time employees:
 - are 'employees' within the definition of 'employee' [Sec. 2(13)].
3. The 10 full-time employees who resigned are not eligible for bonus:
 - since they have not worked for 30 days (Sec. 8).
4. The remaining 10 full-time employees and all the part time employees are eligible for bonus:
 - since they have worked for 30 days or more during the AY (Sec. 8).
 - since even a part-time employee is entitled to bonus (Automobile Karmchari Sangh v Industrial Tribunal).

3. (a) 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. Explain. [2]

(b) State the difference between 'Sale' and 'Agreement to Sell' [7]

(c) Z rents out his house situated at Delhi to W for a rent of ₹10,000 per month. A sum of ₹5 lac, the house tax payable by Z to the Municipal Corporation being in arrears, his house is advertised for sale by the corporation. W pays the Corporation, the sum due from Z to avoid legal consequences. Referring to the provisions of the Indian Contract Act, 1872 decide whether W is entitled to get the reimbursement of the said amount from Z. [3]

Answer 3(a):

Rate of contribution to 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:

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- 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.

Answer 3(b):

A 'Sale' and an 'Agreement to Sell' can be distinguished as follows:

| Basis of distinction | Sale | Agreement to sell |
|---|---|--|
| 1. Transfer of ownership | Transfer of ownership of goods takes place immediately . | Transfer of ownership of goods is to take place at a future time or subject to fulfillment of some condition. |
| 2. Executed Contract or Executory Contract | It is an executed contract because nothing remains to be done. | It is an executory contract because something remains to be done. |
| 3. Conveyance of property | Buyer gets a right to enjoy the goods against the whole world including seller. There-fore, a sale creates jus in rem (Right against property). | Buyer does not get such right to enjoy the goods. It only creates jus in personam (Right against the person). |
| 4. Transfer of Risk | Transfer of risk of loss of goods takes place immediately because ownership is transferred. | Transfer of risk of loss of goods does not take place because ownership is not transferred. As a result, in case of destruction of goods, the loss shall be borne by the seller even though the goods are in the possession of the buyer. |
| 5. Rights of seller against the buyer's breach | Seller can sue the buyer for the price even though the goods are in his possession. | Seller can sue the buyer for damages even though the goods are in the possession of the buyer. |
| 6. Rights of buyer against the seller's breach | Buyer can sue the seller for damages and can sue the third party who bought those goods, for goods. | Buyer can sue the seller for damages only. |
| 7. Effect of insolvency of seller having possession of goods | Buyer can claim the goods from the official receiver or assignee because the owner-ship of goods has transferred to the buyer. | Buyer cannot claim the goods even when he has paid the price because the ownership has not transferred to the buyer. The buyer who has paid the price can only claim rateable dividend. |
| 8. Effect of insolvency of the buyer before paying the price | Seller must deliver the goods to the official receiver or assignee because the owner-ship of goods has transferred to the buyer. He can only claim rateable dividend for the unpaid price. | Seller can refuse to deliver the goods unless he is paid full price of the goods because the ownership has not transferred to the buyer. |

Answer 3(c):

W is entitled to recover from Z the amount paid to the Municipal Corporation:

- Since there is a contract between W and Z, viz., quasi contract;
- Since Z is bound to make the payment of house tax to the Municipal Corporation;
- Since W is interested in such payment;
- Since W is not himself liable for such payment.

- 4. (a) Abhi induced Bani by fraud to draw a cheque payable to Chandni or order. Abhi obtained the cheque, forged Chandni's endorsement and collected proceeds to the cheque through his bankers. Bani, the drawer, wants to recover the amount from Chandni's bankers.**

Decide in the light of the provisions of Negotiable Instruments Act, 1881-

(i) Whether Bani, the drawer, can recover the amount of the cheque from Chandni's bankers?

(ii) Whether Chandni is the fictitious payee?

(iii) Would your answer be still the same in case Chandni is a fictitious person? [3]

(b) Natural Steels Ltd. decided to forfeit the amount of gratuity of its employees A, B and C on account of disorderly conduct and other acts which caused loss to the property belonging to the company. A, B and C, committed the following acts:

(i) A refused to surrender the occupied land belonging to the company.

(ii) B committed theft under law involves offence of moral turpitude.

(iii) C, after superannuation, continued to occupy the quarter of the company for six months. Against the decision of the company, A, B and C applied to the court for relief. The Company contended 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. [3]

(c) What is Partnership? What are the essential elements of Partnership? [2+4=6]

Answer 4(a):

Bani's banker is not liable:

- Since a paying banker is not liable even if it is subsequently found that any endorsement on the cheque has been forged;
- Provided the paying banker made the payment in due course (Sec. 85).

Abhi's banker is not liable:

- Since a collecting banker is not liable for any loss caused to the true owner due to defective title of the holder;
- Provided the collecting banker acted in good faith and without negligence while collecting the amount of the crossed cheque as an agent (Sec. 131).

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- (i) **Chandni's banker is not liable** since it has neither collected nor paid the cheque.
- (ii) **Chandni is not the fictitious payee** since Chandni, in fact, exists.
- (iii) **If Chandni were a fictitious payee, the answer would have remained same:**
 - Since protection is available to a collecting banker u/s 131 and paying banker u/s 85, irrespective of the fact that the payee is a fictitious person or not;
 - Since Chandni's banker would have neither collected nor paid the cheque.

Answer 4(b):

- (i) **Forfeiture of gratuity of Mr. A is not valid:**
 - Since refusal of an employee to surrender the occupied land belonging to the company is not sufficient ground to withhold gratuity u/s 4(6) (**Travancore Plywood Industries Ltd. v Regional Joint Labour Commissioner**).
- (ii) **Forfeiture of gratuity of Mr. B is valid:**
 - Since he has committed an act which constitutes an offence involving moral turpitude.
 - Provided that such offence is committed by him in the course of his employment.
- (iii) **Forfeiture of gratuity of Mr. C is not valid:**
 - Since the company is entitled to deduct from the gratuity payable to 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**).

Answer 4(c):

A partnership is the relationship existing between two or more persons who join to carry on a trade or business. Each person contributes money, property, labor or skill, and expects to share in the profits and losses of the business.

As per Section 4 of the Indian Partnership Act, 1932 "Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

Persons who have entered into partnership with one another are called individually, "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm-name".

Essential Elements of Partnership are as follows:

1. **Two or more Persons:** There must be at least two persons to form a partnership and all such persons must be competent to contract. According to Section 11 of the Indian Contract Act, 1872, every person except the following, is competent to contract:
 - (i) Minor
 - (ii) Persons of unsound mind (e.g. lunatics, idiots), and
 - (iii) Persons disqualified by any law to which they are subject (e.g., alien enemies, insolvents).
2. **Agreement:** There must be an agreement to form a partnership. This agreement may be express (whether written or oral) or implied. This essential element is further clarified under Section 5. Section 5 provides that the relation of partnership arises from contract and not from status. That is why, a Hindu undivided family carrying on a family business is not

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

considered a partnership. The reason is that the coparceners of a Hindu undivided family acquire interest in the business because of their status (i.e., birth) in the family and not because of any agreement between them. Thus, partnership is voluntary and contractual in nature.

3. **Business:** There must exist a business. According to Section 2(b), the terra 'Business' includes every trade, occupation and profession. For example, when two or more persons agrees to share the income of a joint property (e.g., rent from a building), it does not amount to a partnership because there does not exist any business. Similarly, an association created for charitable, religious or social purpose cannot be regarded as partnership because there does not exist any business. It may also be noted that an agreement to carry on business at a future time does not result in partnership unless that time arrives and the business is started. [R.R. Sarna, v. Reuben].
4. **Sharing of Profits:** There must be sharing of profits. Sharing of profits does not necessarily imply sharing of losses as well. That is why there are minor partner and partner in profits only. It may also be noted that sharing of profits is a prima facie evidence and not a conclusive evidence of partnership. That is why, everyone who shares the profits of business need not necessarily be a partner. **For example**, a manager who receives a particular share in the profits of a business as part of his remuneration, is simply an employee and not a partner.
5. **Mutual Agency:** There must exist a mutual agency relationship among the partners. 'Mutual Agency' relationship means that each partner is both an agent and a principal. Each partner is an agent in the sense that he has the capacity to bind other partners by his acts done. Each partner is a principal in the sense that he is bound by the acts of other partners. The mutual relationship of agency is emphasised in Section 18 of the Indian Partnership Act, which reads as under:
"Subject to the provision of this Act, a partner is the agent of the firm for the business of the firm."
Moreover, the use of the words 'carried as by all or by any of them acting for all', in Section 4 of the Act clearly emphasises agency relationship.
5. (a) **Starline Airways Ltd. was incorporated at Chennai in the year 2012 with 125 workmen. Due to strike of workers, mismanagement in the company and accidental loss of the assets the company suffered heavy losses continuously since its incorporation, resulting which the large part of the capital and assets were wiped out. Consequently, the company moved an application to the Govt. of Tamilnadu requesting to exempt the company fully from the application of the provisions of the Payment of Bonus Act, 1965. Decide, whether the Govt. of Tamilnadu may grant exemption to the Company. State the provisions of law in this regard as stated under the Payment of Bonus Act, 1965. [4]**

(b) **Mr. X agreed to sell to Mr. Y a parcel of 1000 bags of groundnuts lying in his godown. Unknown to Mr. X, 150 bags had been stolen at the time of contract. Mr. X tendered delivery of 850 bags. Mr. Y declined to accept. State the legal position. [3]**

(c) **What is Money Laundering? What are the obligations of Banking Companies, Financial Institutions and Intermediaries as per Section 12? [2+3=5]**

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Answer 5(a):

1. The Appropriate Government is the Government of Tamilnadu:

- Since Starline Airways Ltd. does not have branches in more than one State.

2. The Government of Tamilnadu is empowered to grant exemption:

- Since exemption u/s 36 may be granted, if the Appropriate Government is satisfied that it is not in public interest to apply all or any of the provisions of this Act to an establishment or class of establishments.
- Provided that before granting exemption, Appropriate Government shall consider financial position and other relevant circumstances;
- Since incurring heavy losses continuously and wiping out of large part of capital and assets establish that financial position of the company is not sound;
- Since strike of workers and mismanagement in the company are such grounds as would amount to 'relevant circumstances' for seeking exemption from the provisions of the Act.

Answer 5(b):

| | |
|-------------------------|--|
| Relevant Section | Section 7 |
| Decision | The contract of sale has become void and thus, Mr. Y cannot be compelled to accept 850 bags. |
| Reason | There was a contract for sale of an indivisible lot of specific goods and some goods are destroyed at the time when the contract was made without the knowledge of the seller. [Barrow Lane & Ballard Ltd. v Phillips & Co.] |

Answer 5(c):

Money Laundering is the generic term used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such process appear to have derived from the legitimate source.

Section 3 of the Prevention of Money Laundering Act, 2002 says "Whosoever directly or indirectly attempts to indulge or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering".

Section 12 of the Act cast a duty upon every banking company, financial institution and intermediary to:

- Maintain a record of all transaction, the nature and value of which may be prescribed whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other and where such series of transactions take place within a month. Such record should be maintained for a period of ten years from the date of transaction between the clients and the banking company or financial institution or intermediary as the case may be.
- Furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

(c) Verify and maintain the records of the identity of all its clients in such a manner as may be prescribed.

Such record should be maintained for a period of 10 years from the date of cessation of transaction between the clients and the banking company or financial institution or intermediary as the case may be.

Where the Principal officer of a banking company or a financial institution or intermediary as the case may be has reasons to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

6. (a) State the provisions relating to Inspectors as per The Payment of Bonus Act, 1965. [5]

(b) What is Quantum meruit? State the cases in which the claim of Quantum Meruit arise. [2+5=7]

Answer 6(a):

PROVISIONS RELATING TO INSPECTORS [SECTION 27]

- 1. Who can appoint Inspector? [Section 27(1)]:** The Appropriate Government may, by notification in the Official Gazette appoint such persons as it thinks fit to be Inspector and may define the limits within which they shall exercise jurisdiction.
- 2. Powers of Inspectors [Section 27(2)]:** For the purpose of ascertaining whether any of the provisions of this Act has been complied with, an Inspector has the following powers:
 - (a) To require an employer to furnish such information as he may consider necessary;
 - (b) To enter any establishment or any premises connected therewith at any reasonable time and with such assistance, if any, as he thinks fit, and require any one found in charge thereof to produce before him for examination any accounts books, registers, and other documents relating to the employment of persons or the payment of salary or wage or bonus in the establishment;
 - (c) To examine the employer, his agent or servant or any other persons found in charge of the establishment or any premises connected therewith or any person whom the Inspector has reasonable cause to believe to be or to have been an employee in the establishment.
 - (d) To make copies of, or take extracts from any book, register or other document maintained in relation to the establishment.
 - (e) To exercise such other powers as may be prescribed.
- 3. Inspector Deemed to be Public Servant [Section 27(3)]:** Every Inspector shall be deemed to be a public servant within the meaning of the Indian Penal Code.
- 4. Duty of Persons called upon:** Any person directed by an Inspector to produce any accounts, books, register or other document or to give information shall be legally bound to do so.
- 5. No Power to Obtain certain information in case of Banking Co.:** The Inspector cannot require a banking company to furnish or disclose any statement or information or to produce, or

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

give inspection of, any of its books of account or other documents, which a banking company cannot be compelled to furnish, disclose, produce or give inspection of, under the provisions of Section 34A of the Banking Regulation Act, 1949. [Section 27(9)].

Answer 6(b):

Meaning of Quantum Meruit: The term 'quantum meruit' means as much as merited or 'as much as earned'. In other words, it means payment in proportion to the amount of work done. Generally, one cannot claim performance from another unless one has performed his obligation in full but in certain cases, a person who has performed some work under a contract can claim remuneration for the work which he has already done. The right to claim on quantum meruit does not arise out of a contract as the right to damages does. It is a claim on the quasi contractual obligations which is implied by the circumstances. The claim for quantum meruit arises only when the original contract is discharged.

The various cases in which the claim of quantum meruit arise are discussed below:

(a) In Case of Void Agreement, or Contract that becomes Void [Section 65]

When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it.

Example I: A pays B, ₹1,000 in consideration of B's promise to marry C, A's daughter. C is dead at the time of the promise. The agreement is void but B must repay A ₹1,000.

Example II: A, a singer contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹100 for each night's performance. On the sixth night, A willfully absents herself from the theatre, and B, in consequence rescinds the contract. B must pay A for the five nights on which she had sung.

(b) In Case of Non-gratuitous Act [Section 70]

The obligation to pay arises if the following three conditions are satisfied:

- (i) The thing must have been done or delivered lawfully;
- (ii) The person who had done or delivered the thing must not have intended to do so gratuitously; and
- (iii) The person for whom the act is done must have enjoyed the benefit of the Act.

Example A, a tradesman leaves goods at B's shop by mistake. B treats the goods as his own. He is bound to pay A for them.

(c) In Case of Act Preventing the Completion of Contract

If a party does not complete the contract or prevents the other party to complete the contract, the aggrieved party can sue on quantum meruit.

Example: C, an owner of a magazine engaged P to write a book to be published as series in his magazine. After a few series were published, the publication of the magazine was stopped. It was held that P could claim payment on quantum meruit for the part already published [Planche v. Calburn].

(d) In Case of Divisible Contract

The party at default may sue on a quantum meruit if the following conditions are satisfied:

- (i) If the contract is divisible; and
- (ii) If the party not at default has enjoyed benefits of the part performance.

Example S agreed to construct a house for H for ₹965 but he abandoned this contract after having done the work worth ₹333. Afterwards, H got the work completed. It was held that S could not recover anything for the work done because he was entitled to the payment only on the completion of the work.

(e) In Case of Indivisible Contract Performed Completely but Badly

The party at default may claim the lumpsum less deduction for bad work if the following conditions are satisfied:

- (i) If the contract is indivisible;
- (ii) If the contract is for lumpsum;
- (iii) If the contract is completely performed; and
- (iv) If the contract is performed badly.

Example X agreed to decorate Y's flat for a lumpsum of ₹20,000. X did the complete work but Y complained of faulty workmanship. It costs Y another ₹3,000 to remedy the defect. It was held that X could recover only ₹17,000 from Y. [Hoenig v. Issacs (1952)]

SECTION B

[Answer any two questions]

7. (a) **UMA Ltd. has only 7 shareholders having fully paid-up shares. On 30th April, 2012, all the shares of X (a shareholder of the company) are sold to Y (another shareholder of the company) in an auction by the order of the court. Z, (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, 2012, 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 Y and Z for recovery of the said loan from them. Decide the Liabilities of Y and Z under the provisions of Companies Act, 1956. Would your answer be the same, if the said loan was taken in the month of March, 2012?** [4]

(b) **Discuss the qualifications and disqualifications of a Cost Auditor?**

[2+2=4]

Answer 7(a):

Reduction of Membership [Sec. 45]:

- (a) Where the no. of members of a Company is reduced below the statutory minimum (7 for Public Company and 2 for Private Company), and the Company carries on business for more than 6 months while the number is so reduced, every person who is a Member of the

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Company, at the time the Company so carries business after those 6 months, and is aware of that fact, shall be severally (individually) liable for the payment of Company's debts contracted during that time, and shall also be liable to be sued therefore.

- (b) The privilege of Limited Liability of Shareholders is lost when the law pierces Corporate Veil u/s 45 and makes persons behind the Company personally liable (inspite of their limited liability).

Case A (Loan Date = Dec. 2012): Only Member Y along with others will be liable. (Z is not liable, as he was not aware of reduction below 7 Members.)

Case B (Loan Date = March 2012): No further liability of Members, since liability was contracted before April 2012. Sec.45 is not applicable in such case.

Answer 7(b):

Cost audit is necessary only when Central Government makes an order directing a company to conduct cost audit in respect of a particular year.

Qualifications of cost auditor:

The cost auditor shall be a cost accountant within the meaning of the Cost and Works Accountants Act, 1959. However, a chartered accountant possessing the prescribed qualifications may be appointed as the cost auditor if the Central Government is of the opinion that sufficient number of cost accountants are not available for conducting the cost audit and a notification is issued to this effect. At present, no such notification has been issued.

Disqualifications of a cost auditor:

- (a) A person disqualified to act as a statutory auditor of the company under section 226(3) and (4) shall not be appointed for conducting the cost audit.
- (b) The statutory auditor of the company shall not be appointed as the cost auditor.
- (c) If the cost auditor, after his appointment, becomes subject to any of the above disqualifications, he shall be deemed to have vacated his office.
- (d) A person who is an employee of any of the partners of a firm of chartered accountants which is appointed as company auditor under section 224 shall not be appointed as a cost auditor [Notification issued by ICWAI, added 10.12.1969 as amended].
- (e) An internal auditor of a company shall not be appointed as its cost auditor [Department Circular No. 1/83, dated 20.1.1983].

8. (a) The Right to Information is associated with which fundamental right? Discuss the composition and appointment of Central Information Commission as per The Right to Information Act, 2005. [1+3=4]

(b) Why is Internal audit necessary to Management? Discuss. [4]

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Answer 8(a):

Right to Information Act 2005 is an important Act enacted by the Parliament to secure to the citizen of India the fundamental right of freedom of speech and expression enshrined in Article 19(1) of the Constitution of India.

Composition and Appointment of Central Information Commission (CIC) is as follows:

As per Section 12 of the Act,

1. The Central Government shall, by notification in the Official Gazette, constitute a body to be known as the Central Information Commission to exercise the powers conferred on, and to perform the functions assigned to, it under this Act.
2. The Central Information Commission shall consist of:
 - (a) the Chief Information Commissioner; and
 - (b) such number of Central Information Commissioners, not exceeding ten, as may be deemed necessary.
3. The Chief Information Commissioner and Information Commissioners shall be appointed by the President on the recommendation of a committee consisting of:
 - (i) the Prime Minister, who shall be the Chairperson of the committee;
 - (ii) the Leader of Opposition in the Lok Sabha; and
 - (iii) a Union Cabinet Minister to be nominated by the Prime Minister.

Explanation: For the purposes of removal of doubts, it is hereby declared that where the Leader of Opposition in the House of the People has not been recognised as such, the Leader of the single largest group in opposition of the Government in the House of the People shall be deemed to be the Leader of Opposition.

4. The general superintendence, direction and management of the affairs of the Central Information Commission shall vest in the Chief Information Commissioner who shall be assisted by the Information Commissioners and may exercise all such powers and do all such acts and things which may be exercised or done by the Central Information Commission autonomously without being subjected to directions by any other authority under this Act.
5. The Chief Information Commissioner and Information Commissioners shall be persons of eminence in public life with wide knowledge and experience in law, science and technology, social service, management, journalism, mass media or administration and governance.
6. The Chief Information Commissioner or an Information Commissioner shall not be a Member of Parliament or Member of the Legislature of any State or Union territory, as the case may be, or hold any other office of profit or connected with any political party or carrying on any business or pursuing any profession.
7. The headquarters of the Central Information Commission shall be at Delhi and the Central Information Commission may, with the previous approval of the Central Government, establish offices at other places in India.

As per Section 13 of the Act,

1. The Chief Information Commissioner shall hold office for a term of five years from the date on which he enters upon his office and shall not be eligible for reappointment:

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Provided that no Chief Information Commissioner shall hold office as such after he has attained the age of sixty-five years.

2. Every Information Commissioner shall hold office for a term of five years from the date on which he enters upon his office or till he attains the age of sixty-five years, whichever is earlier, and shall not be eligible for reappointment as such Information Commissioner:

Provided that every Information Commissioner shall, on vacating his office under this sub-section be eligible for appointment as the Chief Information Commissioner in the manner specified in sub-section (3) of section 12:

Provided further that where the Information Commissioner is appointed as the Chief Information Commissioner, his term of office shall not be more than five years in aggregate as the Information Commissioner and the Chief Information Commissioner.

3. The Chief Information Commissioner or an Information Commissioner shall before he enters upon his office make and subscribe before the President or some other person appointed by him in that behalf, an oath or affirmation according to the form set out for the purpose in the First Schedule.

Answer 8(b):

Internal Audit has become an important management tool for the following reasons:

1. It ensures compliance of Companies (Auditors Report) Order, 2003.
2. Internal Auditing is a specialized service to look into the standards of efficiency of business operation.
3. Internal auditing can evaluate various problems independently in terms of overall management control and suggest improvement.
4. Internal audit's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting on the basis of which the top management can take firm decisions.
5. Internal Audit system makes sure the internal control system including accounting control system in an organization is effective.
6. Internal Audit ensures the adequacy, reliability and accuracy of financial and operational data by conducting appraisal and review from an independent angle.
7. Internal Audit is an integral part of "Management by System".
8. Internal Audit can break through the power ego and personality factors and possible conflicts of interest within the organization.
9. It ensures compliance of accounting procedures and accounting policies.
10. Internal auditor can be of valuable assistance to management in acquiring new business, in promoting new products and in launching new projects for expansion or diversification of business.

9. **What is meant by Pre-Incorporation Contracts? Can these contracts be enforced by the prospective company after its incorporation against the third parties with whom the promoters had entered into certain contracts? Explain.** **[2+6=8]**

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Answer 9:

Meaning: A pre-incorporation contract means a contract entered into by the promoters on behalf of a proposed company, i.e., before incorporation of a company. These contracts are usually made by the promoters to acquire some property or right for the proposed company.

Requirement of adoption of a pre-incorporation contract:

As per Sec. 19 and 15 of Specific Relief Act, a company as well as the other party to the contract is bound by a pre-incorporation contract, if the following conditions are satisfied:

- (a) The promoters entered into a contract before incorporation of a company.
- (b) The contract so entered is for the purpose of the company, i.e., the promoters entered into the contract on behalf of the proposed company.
- (c) Such contract is warranted by the terms of incorporation of the company (i.e., the contract must fall within any of the clauses contained in 'object clause').
- (d) The company has accepted such contract after incorporation of the company.
- (e) The company has communicated such acceptance to the other party to the contract.

Position where a company adopts a pre-incorporation contract:

- (a) The contract can be enforced by the company.
- (b) The contract becomes binding on the company.
- (c) The promoters are not personally liable on such a contract.

Position where a company does not adopt a pre-incorporation contract:

- The pre-incorporation contract shall not bind the company.
- Even if the contract stipulates that the company, after incorporation, shall be bound by it, the company shall not be bound by such contract.
- Even if the company takes the benefit of pre-incorporation contract, it is not bound by it [**Re, English & Colonial Produce Co. Ltd.**].
- A company cannot ratify a pre-incorporation contract.
- The company, after incorporation, cannot enforce a pre-incorporation contract [**Natal Land & Colonisation Co. Ltd v Pauline Colliery & Development Syndicate Ltd.**].
- The promoters are personally liable on pre-incorporation contract [**Kelner v Baxter**].

Examples:

I. The promoters of a proposed company entered into a contract with a third party. The contract was entered on behalf of the proposed company. The contract provided that the proposed company shall be lessee of certain properties owned by **the third party**.

The company was incorporated, and afterwards it adopted the lease contract. However, the third party refused to lease the properties to the company. It was held that adoption of pre-incorporation contract by the company resulted into a binding contract between the company and the third party, and therefore third party was bound by it [**Vali Pattabhirama Rao v. Sri Ramanuja Ginning and Rice Factory Pvt. Ltd.**],

II. The promoters of a proposed company entered into a contract with a third party for allotment of shares of the company after incorporation of the company. It was held that such contract was not for the purpose of the company (i.e., it was not necessary for incorporation of the company or for carrying on business of the company) and therefore it could not be adopted by

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

the company after incorporation. Therefore, such a contract was not enforceable by the company or the third party.

III. The promoters entered into a pre-incorporation contract with M for taking over of his proprietorship business by the proposed company. The company, after incorporation, adopted the said contract (i.e., accepted such contract and communicated the acceptance to M). It was held that the company could sue M for taking over the business of M.

Fresh contract in terms of pre-incorporation contract creates a binding effect:

If a company, after incorporation, enters into a fresh contract in terms of the pre-incorporation contract, the pre-incorporation contract shall stand cancelled, and accordingly, the liabilities of promoters shall come to an end [**Howard v Patent Ivory Manufacturing Co.**].

SECTION C

[Answer any two questions]

10. (a) What are the various threats which can be faced by a Finance and Accounting Professional while working as an Auditor, Consultant or an Employee in an organization?

[4]

(b) State the fundamental principles of Ethical Behaviour.

[4]

Answer 10(a):

Threats can be faced by a Finance and Accounting Professional while working as an Auditor, Consultant or an Employee in an organization, whereby the basic principles cannot be complied with. Such Threats may be classified as follows:

- 1. Self-Interest Threats** may occur as a result of the financial or other interests of a Finance and Accounting Professional or of an immediate or close family member.
- 2. Self-Review Threats** may occur when a previous judgement needs to be re-evaluated by the Finance and Accounting Professional responsible for that judgement.
- 3. Advocacy Threats** occur when a Finance and Accounting Professional promotes a position or opinion to the point that subsequent objectivity may be compromised.
- 4. Familiarity Threats** occur when a Finance and Accounting Professional has close relationships in the work environment and such relationships impair his selfless attitude towards work.
- 5. Intimidation Threats** occur when a Finance and Accounting Professional may be prohibited from acting objectively by threats, actual or perceived.

Answer 10(b):

The fundamental principles of Ethical Behaviour are:

A. Integrity: The principle calls upon all accounting and finance professional adhere to honesty and firmness while discharging their respective professional duties:

- Avoid being involved in activities which would impair the goodwill of the organization.
- Communicate adverse as well as favorable information with those concerned.
- Refuse any favour which could influence his actions in a negative way.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- Refuse to get involved in any activity which would adversely affect objectivity.
- Avoid conflicts and advise related parties on imminent conflicts.

B. Objectivity: Communicate information fairly and objectively in a transparent manner.

C. Confidentiality: 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.

D. Professional competence: Finance and accounting professionals need to update their professional skills from time to time. It has to be ensured that the client or employer receives competent professional services based upon current and contemporary developments in the related areas.

E. Obedience to Rules: Accounting and finance professionals should comply with relevant laws and regulations and avoid such actions which may result into discrediting the profession.

11. (a) Give examples of Self-Interest Threats which can be faced by a Finance and Accounting Professional while working as (a) Auditor or Consultant, or (b) Employee in a Company. [4]

(b) What are the basic reasons for Ethical Dilemmas in workplace? Give examples of ethical issues faced by the individual in the workplace. [4]

Answer 11(a):

Self-Interest Threats which can be faced by a Finance and Accounting Professional while working as Auditor or Consultant are:

1. A financial interest in a Client or jointly holding a financial interest with a Client.
2. Undue dependence on total fees from a Client.
3. Having a close business relationship with a Client.
4. Concern about the possibility of losing a Client.
5. Potential employment with a Client.
6. Contingent Fees relating to an assurance engagement.

Self-Interest Threats which can be faced by a Finance and Accounting Professional while working as Employee in a Company:

1. Financial interests, loans and guarantees in the Company in which the professional is working.
2. Incentive compensation arrangements.
3. Inappropriate personal use of corporate assets.
4. Concern over employment security.
5. Commercial pressure from outside the employing organization.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Answer 11(b):

1. **Ethical Dilemmas / Concerns:** An individual's ethical concerns are differential relationships and responsibilities at the workplace where there are no "correct" rules to follow. The ethical issues arise due to the following reasons / conflicts:

(a) Differential Roles: One set of relationships and responsibilities is directly related to Employees, e.g., discipline, performance appraisal, safety, and the administration of reward systems. Another set is concerned with Customers and Suppliers, e.g. aspects like timing, quality, and price.

(b) Hierarchy: Ethical dilemmas arise when there are conflicts in values with superiors or peers over aspects like strategy, goals, policy, and administration.

2. **Examples of ethical issues faced by an individual in the workplace are:**

| vis-à-vis Suppliers and Business Partners | vis-à-vis Customers | vis-à-vis Employees | vis-à-vis Resource Management |
|---|---|--|--|
| <ul style="list-style-type: none"> ▪ Bribery and immoral entertainment ▪ Discrimination between Suppliers ▪ Dishonesty in making and keeping contracts | <ul style="list-style-type: none"> ▪ Unfair Pricing ▪ Cheating Customers ▪ Deceitful Advertising ▪ Research Confidentiality | <ul style="list-style-type: none"> ▪ Discrimination in hiring and treatment of employees ▪ Harassment in workplace | <ul style="list-style-type: none"> ▪ Misuse of Company funds ▪ Tax evasion |

12. **Outline the need for Ethics in business.**

[8]

Answer 12:

Business ethics is currently a very prominent business topic, and the debates and dilemmas surrounding business ethics have attracted enormous amount of attention from different quarters of organizations and society. Hence, it has emerged as an increasingly important area of study. Some of the major reasons why a good understanding of business ethics is important can be stated as follows:

- **Stop business malpractices:** Some unscrupulous businessmen do business malpractices by indulging in unfair trade practices like black-marketing, artificial high pricing, adulteration, cheating in weights and measures, selling of duplicate and harmful products, hoarding false claims or representations about their products etc. These business malpractices are harmful to the consumers. Business ethics help to stop these business malpractices.
- **Improve customers' confidence:** Business ethics are needed to improve the customers' confidence about the quality, quantity, price, etc. of the products. The customers have more trust and confidence in the businessmen who follow ethical rules. They feel that such businessmen will not cheat them.
- **Survival of business:** Business ethics are mandatory for the survival of business. The businessmen who do not follow it will have short-term success, but they will fail in the long

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

run. This is because they can cheat a consumer only once. After that, the consumer will not buy goods from that businessman. He will also tell others not to buy from that businessman. So this will defame his image and provoke a negative publicity. This will result in failure of the business. Therefore, if the businessmen do not follow ethical rules, he will fail in the market. So, it is always better to follow appropriate code of conduct to survive in the market.

- **Safeguarding consumers' rights:** Consumer sovereignty cannot be either ruled out or denied. Business can survive so long it enjoys the patronage of consumer. The consumer has many rights such as right to health and safety, right to be informed, right to choose, right to be heard, right to redress, etc. But many businessmen do not respect and protect these rights. Business ethics are must to safeguard these rights of the consumers.
- **Protecting employees and shareholders:** Business ethics are required to protect the interest of employees, shareholders, competitors, dealers, suppliers, etc. It protects them from exploitation through unfair trade practices.
- **Develops good relations:** Business ethics are important to develop good and friendly relations between business and society. This will result in a regular supply of good quality goods and services at low prices to the society. It will also result in profits for the businesses thereby resulting in growth of economy.
- **Creates good image:** Business ethics create a good image for the business and businessmen. If the businessmen follow all ethical rules, then they will be fully accepted and not criticised by the society. The society will always support those businessmen who follow this necessary code of conduct.
- **Smooth functioning:** If the business follows all the business ethics, then the employees, shareholders, consumers, dealers and suppliers will all be happy. So they will give full cooperation to the business. This will result in smooth functioning of the business. So, the business will grow, expand and diversify easily and quickly. It will have more sales and more profits.
- **Consumer movement:** Business ethics are gaining importance because of the growth of the consumer movement. Gone are the days when the consumer can be taken for ride by the unscrupulous business by their false propoganda and false claims, unfair trade practices. Today, the consumers are aware of their rights and well informed as well as well organised. Now they are more organised and hence cannot be cheated easily. They take actions against those businessmen who indulge in bad business practices. They boycott poor quality, harmful, high- priced and counterfeit (duplicate) goods. Therefore, the only way to survive in business is to be honest and fair. Consumer forums and Consumer Associations are more active and vocal now.
- **Consumer satisfaction:** Today, the consumer is the king of the market. Any business simply cannot survive without the consumers. Therefore, the main aim or objective of business is consumer satisfaction. If the consumer is not satisfied, then there will be no sales and thus no profits too. Consumer will be satisfied only if the business follows all the business ethics, and hence are highly needed.
- **Importance of Labour:** Labour, i.e. employees or workers play a very crucial role in the success of a business. Therefore, business must use business ethics while dealing with the employees. The business must give them proper wages and salaries and provide them with better working conditions. There must be good relations between employer and employees. The employees must also be given proper welfare facilities.
- **Healthy competition:** The business must use business ethics while dealing with the

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

competitors. They must have healthy competition with the competitors. Healthy competition brings about efficiency, break complacency and leads to optimal utilisation of scarce resource. Hence, is always welcome. They must not do cut-throat competition. Similarly, they must give equal opportunities to small-scale business. They must avoid monopoly. This is because a monopoly is harmful to the consumers.