FINAL EXAMINATION

GROUP III

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2013

Paper-13 : CORPORATE LAWS & COMPLIANCE

Time Allowed : 3 Hours **Full Marks : 100**

The figures in the margin on the right side indicate full marks.

Please answer all parts of a question at one place. Wherever necessary, the students can make suitable assumption and state them clearly in the answer.

SECTION A

Answer* Question No. 1 *which is compulsory and any* four *from rest in this section.

1. (a) What is the effect of the registration of the Memorandum of Association of a company on
(i) the subscribers of the Memorandum;
(ii) such other persons as may from time to time become members of the company;
(iii) the company and
(iv) outsiders dealing with the company? 4

(b) A Private Limited Company reports the following position as on 31st March, 2014.

Paid up capital	**₹30 Lacs**
Revaluation Reserve	**₹ 10 Lacs**
Capital Reserve	**₹11 Lacs**
P & L A/c. (Dr. Balance)	**₹ 2 Lacs**

The management of the company contends that CARO 2003 is not applicable to it. Comment. 4

(c) An Audit Committee of a Public Limited Company constituted under section 292A of the Companies Act, 1956 submitted its report of its recommendation to the Board. The Board however did not accept the recommendations. In the light of the situation, State whether ;
(i) The Board is empowered not to accept the recommendations of the Audit Committee.
(ii) If so, what alternative course of action, would be Board resort to?
(iii) As a chairman of the Audit Committee, how would you respond to the situation? 3

(d) The Vewar Rural Financial Corporation, Udaipur, established under a special statute issued 7 years bonds to public directly and not through any stock exchange. Decide whether the said act of the Vewar Rural Financial Corporation is in violation of the provisions of the Securities Contracts (regulation) Act. 1956. 2

(e) A producer company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard. 2

Answer:

1. (a) When the Memorandum of Association of a company has been registered, it has the following effect: -

1) The signatories become members of the company, the entry of their names in the register of members not being legally necessary, and they are bound to observe all the provisions of the memorandum.
2) Such other persons as may from time to time become members of the company are bound by the memorandum, as if it had been signed by them, to observe all the provisions thereof.
3) The company is bound to observe all the provisions of its memorandum of association, as if it had been signed by the company.
4) The memorandum of association of a company is a public document, and every person dealing with the company is deemed to have notice of its contents. If a person deals with a company in a way contrary to its memorandum, he must take its consequences.

(b) According to the Guidance Note on Terms Used in Financial Statements, the term "capital reserve" means "a reserve of a corporate enterprise which is not available for distribution as dividend". The said Guidance Note defines the term "revenue reserve" as "any reserve other than capital reserve". For determining the applicability of the Order to a private limited company, both capital as well as revenue reserves should be taken into consideration while computing the limit of rupees fifty lakhs prescribed for paid-up capital and reserves. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose of determining the applicability of the Order. The credit balance in the profit and loss account should also be considered as a part of reserve since the balance in the profit and loss account is available for general purposes like declaration of dividend. The debit balance of the profit and loss account, if any, should be reduced from the figure of revenue reserves only. Therefore, if the company does not have revenue reserves, debit balance of profit and loss account cannot be reduced from the figures of paid-up capital, capital reserves and revaluation reserves. However, miscellaneous expenditure to the extent not written off should not be deducted from the figure of reserves for the purpose of computing the above limit.

Accordingly, the profit and loss account (Dr. Balance) of ₹2 lacs cannot be deducted and hence CARO, 2003 is applicable to the company.

(c) (i) As per section 292A, a recommendations of the audit committee on any matter relating to financial management, including the audit Report, shall be binding on the Board.

(ii) The Board does not accept the recommendation of the Audit committee, it shall record the reasons therefore and communicate such reasons to the shareholders.

(iii) The chairman of the Audit committee shall attend the Annual general Meeting(s) of the company to provide any clarifications on matters relating to Audit.

(d) Since the Vewar Rural financial corporation is a corporations established under a special statute enacted by competent legislature the provisions of Sec 28 of securities contracts (Regulation) Act 1956 shall not apply to it.

Therefore, Vewar rural financial corporation can issue 7 years Bonds to the public directly without requiring any permission of any stock exchange.

(e) As per provisions of sec 581 ZJ of the Companies Act,1956, any producer company may,

upon recommendation of the Board and passing of Resolution in the general meeting, issue bonus shares by capitalization of amounts from General Reserves. Referred to in Section 581ZJ, Bonus shares should be issued in proportion to the shares held by the members on the date of issue of such shares.

2. (a) In what way does the Reserve Bank of India regulate the determination of the loans and advances which can be made by a banking company under the Banking Regulation Act, 1949? 4

(b) The Directors of Welldone Company Limited are required to file declaration of solvency as they desire to proceed for voluntary winding up of the company. Advise them about the requirements to be followed for the said purpose. 6

(c) What provisions has been made under section 15G of the SEBI Act, 1992 in connection with penalty for insider trading? 3

(d) Mr. Kabir is an exporter of goods and services. Explain his duties under Foreign Exchange Management Act, 1999 regarding realization and repatriation of Foreign Exchange on such exports. 2

Answer:

2. (a) Power of RBI to regulate determination of loans and advances by banking companies:

By virtue of provisions of Banking Regulations Act, 1949 as contained in Section 21 the RBI is empowered to issue directives to a banking company to determine the policy in relation to loans and advances. Such direction may relate to:

(1) Purpose for which loan may or may not be made.
(2) Margin stipulation.
(3) Maximum amount of advances to any company, firm individual or association of persons (at present 15% for individual borrower without infrastructure project, if infrastructure project go by additional 10%, 40% for group borrower and for infrastructure project of group borrower it may be up to 50% of bank's capital and reserve (presently tier-I & tier-II capital from capital adequacy point of view.)
(4) Maximum amount of guarantee liability on behalf of any individual firm/company.
(5) The rate of interest and other terms and conditions on which such advances are made or guarantee given.

It may further be mentioned that in accordance with the provisions of Section 21A, rate of interest charged by banking company on the basis of loan contract between the bank and debtor is not to be subject to scrutiny by the court.

(b) Members' voluntary winding up- Declaration of solvency (section 488):

Where the company is solvent, a Declaration of solvency is made by the directors and consequently, winding up proceedings remain in the control of the members of the company. The provisions relating to declaration of solvency are explained as follows:

Requirements of a valid declaration of solvency.

To be effective, the declaration of solvency must fulfill the following conditions:

(a) Made by whom? It shall be made by a majority of the directors or all the directors if there are only two directors.
(b) Verification, it shall be verified by an affidavit.
(c) No inability to pay debts. The declaration must specify, that the directors have made a full enquiry into the affairs of the company. The declaration shall further state-
  (I) that the company has no debts., or
  (II) the period not exceeding three years, within which, in the opinion of directors, the company will be able to pay its debts in full.
(d) Date of declaration of solvency. It shall be made within five weeks immediately

preceding the date of passing of the resolution for voluntary winding up.

(e) Filing with the registrar. It shall be registered with the registrar before the date of passing of the resolution for voluntary winding up.

(f) Auditor's report. The declaration shall be accompanied by a copy of the auditor's report on the profit and loss account and balance sheet of the company. The report shall also contain a statement of assets and liabilities of the company as on the latest practicable date immediately before the date of the declaration of solvency.

The report on the profit and loss account and balance sheet shall relate to a period-

(I) commencing from the date upto which the last profit and loss account was prepared: and

(II) ending with the latest practicable date immediately before the making of the declaration of solvency.

(c) Section 15G of the Securities and Exchange Board of India (SEBI) Act, 1992 deals with penalty for Insider Trading. According to this any insider

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course for business or under any law, or

(iii) counsels or procures for, any other person to deal in any securities of anybody corporate on the basis of unpublished price sensitive information, shall be liable to a penalty of twenty- five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

(d) As per the provisions of FEMA Act, 1999, every exporter of goods shall; -

- Furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India;
- Furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.
- Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services.

3. (a) What are the qualifications of appointment of members of State Commission as per Indian Electricity Act, 2003? 3

(b) Indian citizens incorporated a company in London for the purpose of carrying on business there. Examine with reference to the relevant provisions of the Companies Act, 1956 whether it is a "Foreign Company". What would be your answer in case the London Company was incorporated by a company registered in India. 4

(c) X Ltd. has accumulated losses of ₹12 crores. The reserves and surplus of the said company also include "Securities Premium Account" of ₹15 crores. The company intends to adjust the accumulated losses against the "Securities Premium Account". Is the company permitted to do so under the provision of the Companies Act, 1956? 4

(d) Somex Ltd. having paid up capital of ₹99 Lacs, entered into an agreement for purchase of raw

materials worth ₹50 Lacs with ABC Private Ltd., in which 2 Directors of the company are the Directors. With the prior approval of the board but before material could be supplied, the paid up capital of the company became ₹ 1.50 crores. The company did not obtain approval of the Central Govt. even after the increase of paid up capital. Decide whether there is any violation of sec. 297. 2

(e) What are Non performing Asset under the Sarfaesi Act, 2002? 2

Answer:

3. (a) Qualifications of Appointment of Members of State Commission (Section 84):

(i) The Chairperson and the Members of the State Commission shall be persons of ability, integrity and standing who have adequate knowledge of, and have shown capacity in, dealing with problems relating to engineering, finance, commerce, economics, law or management.

(ii) Notwithstanding anything contained in sub-section (1), the State Government may appoint any person as the Chairperson from amongst persons who is, or has been, a judge of a High Court: is or has been, a judge of a High Court:
Provided that no appointment under this sub-section shall be made except after consultation with the Chief Justice of that High Court.

(iii) The Chairperson or any other Member of the State Commission shall not hold any other office.

(iv) The Chairperson shall be the Chief Executive of the State Commission.

(b) As per Section 591, a company shall be foreign company if –
(i) It is incorporated outside India; and
(ii) If has established a place of business in india
Thus, for deciding as to whether a company is a foreign company or not, the criterion is to see as to whether the company has established a place of business in India or not, and not the persons who have incorporated the company.
In this case, Indian citizens have formed a company outside India. Since, the company has not established any place of business in India, the company cannot be said to be a foreign company. The fact that Indian citizens have formed a company in a foreign country is immaterial in deciding whether the company is a foreign company or not.
The answer have remained same even if the London company had been incorporated by a company registered in India for the same reason as stated above.

(c) Section 78 of the Companies Act, 1956 deals with the application of premium received on issue of securities. Sub-section (1) of the said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called "the securities premium account"; and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the securities premium account were paid-up share capital of the company.
Sub-section (2) of the said section provides that notwithstanding anything in sub-section (1), be applied by the company—

(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus securities;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or

(d) in providing for the premium payable on the redemption of any redeemable

preference shares or of any debentures of the company.

In view of the above provisions of the Companies Act, 1956, the company is not permitted to adjust its accumulated loss against the Securities Premium Account.

(d) Language of Section 297 clearly suggests that the paid up capital of the Company is to be seen as on the date of making of contract and not when Contract is executed.
In the given case when contract is made out, paid up Capita! of the Company is ₹99 Lacs only and for that prior approval of the Board is sufficient. Therefore, there is no violation of Sec 297.

(e) 'Non-performing asset', means an asset or account of a borrower, which has been classified by a bank or financial institution, as sub-standard, doubtful or loss asset –

- In case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force in accordance with the directions or guidelines relating to asset classification issued by such authority or body
- In any other case, in accordance with the directions or guidelines relating to asset classification issued by RBI.

4. (a) State briefly the composition of Competition Commission of India. Examine whether the chairperson of the competition commission shall be only a person, who has been or is qualified to be a Judge of a High Court. 3

(b) On 24th January, 2014, the Board of Directors of BUL Limited appointed Mr. A as the company's sole selling agent for a period of 5 years. At the first general meeting of the company, held after the board meeting, on April 10, 2014, the above appointment was disapproved. Referring to the provisions of the Companies Act, 1956.

(i) State the date from which the above appointment comes to an end.

(ii) What would be your answer in case a conditon in the above appointment that "The appointment must be made by the company in general meeting" was not attached thereto? 4

(c) "In an Audit of an Insurance Company, the Receipts and Payments account is also subjected to Audit." Justify. 3

(d) Examine with reference to the provisions of the Companies Act, 1956 whether the following Act, of the company is valid :
The Board of Directors of a company has made a bonafide decision not to declare any dividend for the year ended 31st March, 2013. A group of shareholders complain to the company law board against the above decision of the Board of directors on the ground of mismanagement and wants the company to declare dividend. 3

(e) DHP LTD. wants to make the liability to its directors unlimited. You are required to state with reference to the provisions of the Companies Act, 1956 whether this can be done. 2

Answer:

4. (a) Competition Commission of India:

The Competition Commission of India shall consist of a Chairperson and not less than two and not more than six other members to be appointed by the Central Government (Section 8) while the appointment is made by the Central Government, the Chairperson and other members shall be selected in the manner as may be prescribed (Section 9).

The Chairperson and every other member shall be a person of ability, integrity and' standing and who has special knowledge of, and such professional experience of not less than 15 years in international trade, economics, business, commerce, law, finance accountancy, management, industry, public affairs or competition metters including competition law and policy and which, in the opinion of the Central Government may

be useful to the commission [Section 8(2)]. As the qualification prescribed in the Act is the same for chairperson and other members, chairperson of commission may or may not be a judicial person.

(b) The legal position:

(a) Where the Board of directors of a company appoints a Sole Selling Agent, such appointment shall be subject to the condition that the appointment shall cease to be valid if it is not approved by the shareholders in the first general meeting held after the date of the appointment.

(b) If the shareholders in the general meeting disapprove the appointment, the appointment shall cease to be valid with effect from the date of that general meeting.

(c) The provisions regarding incorporation of this condition are mandatory. If there is no such condition, the agreement will be void ab initio even if the appointment is approved by the general meeting [Arantee Manufacturing Corporation v Bright Bolts Pvt. Ltd. AIR (1967) 37 Comp Cas 758; Department Circular No. 12(11)-CL-VI/68, dated 6.11.1968].

(i) Thus the appointment of Mr. A as the sole-selling agent will come to an end on 10th April, 2014.

(ii) Again as discussed above, in absence of the above clause, the appointment of Mr. A as a sole-selling agent of the company would be void ab-initio.

(c) The IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002 require that the auditor of an insurance company should:

(i) report whether the receipts and payments account of the insurer is in agreement with the books of account and returns;

(ii) express an opinion as to whether the receipts and payments account has been prepared in accordance with the provisions of the relevant statutes; and

(iii) express an opinion whether the receipts and payments account give a true and fair view of the receipts and payments of the insurer for the financial year/period under audit.

It may hence be said that auditor is required to audit the Receipts and Payments Account of the insurer and also express an opinion on the same.

(d) The term 'mismanagement' has not been defined under the Act. Normally, mismanagement means gross mismanagement of affairs of company. It may include

a. drawing of funds for personal expenses,
b. gross negligence in managing the affairs,
c. inaction can also be mismanagement

Hence, Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. (Thomas Vettom (V.J.O V. Kutlanad Rubber Co. Ltd (1984) 56 Com. Cases 284 (kER)(DD).

Thus in the present case the group of shareholders who complain to CLB against the decision of the Board not to declare any dividend and to accumulate available profits into Reserves, would not succeed, as the act of directors does not amount to mismanagement. Furthermore, the shareholder cannot compel the Board to recommend the dividend. The Board's recommendations arc placed in the general meeting. The general meeting can reduce the dividend but cannot increase the dividend as recommended by the Board. Therefore, the shareholder cannot compel the company to declare dividend and cannot charge the directors for the mismanagement under Sections 397 and 398.

(e) Section 323(1) Of the Companies Act, 1956 states that a limited company may, if so authorized by its Articles of Association, by special resolution, alter is Memorandum of Association so as to render unlimited the liability of its directors or of any director or manager. Hence, by amending the Memorandum of Association of the company by way of passing a special resolution in a general meeting, DHP Ltd. can make the liability of directors unlimited.

5. (a) State your views on the following with reference to the provision of the Companies Act, 1956:

(i) Complex Ltd, a well reputed manufacturing Public Limited Company has made a contribution of ₹2.5 Lacs during the financial year ended, 31-03-13 to a political party for running a school, situated in the village, where most of the workers of the company reside. It is admitted that the benefit of the school is mostly for the children of the workers of the company. The company has not made any profits in the last four years.

(ii) The statutory Auditor of a Government company have issued a qualified Audit report on the accounts of the company. In his supplementary Audit, the Comptroller and Auditor General of India (C&AG) has also made further qualifications on the accounts of the company.

But the report of the board of directors of the company is silent on the comments of statutory Auditors and those of C&AG. 3+3=6

(b) Mr. Prasad is Managing Director of Bapi Ltd. He gave his resignation letter to the Chairman of the Board of Directors on 31st December, 2013, and requested that he should be relieved immediately. When does the resignation of Mr. Prasad take effect? 3

(c) Advise the Board of Directors of a Limited Company regarding validity and extent of their powers, under the provisions of the Companies Act, 1956 in relation to the following matters:

(i) Buy-Back of the shares of the company, for the first time up to 10% of the paid up equity share capital without passing a special resolution.

(ii) Delegation of power to the Managing Director of the company to invest surplus funds of the company in the shares of some companies. 2+2=4

(d) X Ltd. Issued Bonds to the tune of ₹ 100 Lacs and provided security to the tune of ₹80 Lacs for the same. It insists that it will disclose the Bonds as "Secured" in the balance sheet of the company. Comment. 2

Answer:

5. (a) (i) Section 293A of the Companies Act,1956 deals with prohibitions and restrictions regarding political contributions. A non Government company which has been in existence for not less than three years may contribute any amount or amounts directly or indirectly to any political party or for any political purpose to any person provided that the aggregate of the amounts which may be so contributed by a company in any financial year shall not exceed 5% of its average net profits determined in accordance with the provisions of Sections 349 and 350 during the three immediately preceding financial years. The company in question has not made any profit in last four years and contributed ₹ 2.5 lacs during the year to a political party for running a school. This is violation of the provisions of Section 293-A of the Companies Act although the children of its workers are benefited. The auditor would have to qualify his report stating the contravention of the provision of the Companies Act.

(ii) Board's report and Qualifications in the Auditor's Report:
Section 217(3) of the Companies Act, 1956 imposes a duty on the Board of directors of a company to give the fullest information and explanations in the Directors' report

regarding every reservation, qualification or adverse remarks contained in the auditors' report. The remarks of the Board on the auditors' report are to be given as addendum to the report and are to form part of the main body of the report as per section 217(3). Hence there is failure on the Board of directors in not having offered its explanation on the reservations qualifications adverse remarks made in the auditors' report.

So, Section 217(3) of The Companies Act, 1956 imposes a duty on the Board of Directors of a company to give the fullest information and explanations in the Directors' Report regarding every reservation, qualification or adverse remarks contained in every Auditor's report (including supplementary audit). Hence, there is failure on the board of Directors in not having offered its explanation on the reservation, qualification, adverse remarks made in the Statutory Auditors and C&AG's report.

(b) A director can resign from his office by serving a notice of his resignation upon the Company or the Board. There is no need for its acceptance by the Board or the Company.

However, if a Managing Director resigns, he cannot give up his office at his pleasure simply by serving the notice. This is because he occupies two positions i.e., of a director and an employee. In case of Managing Director, the notice or letter of resignation is required to be approved or accepted by the company and he has to be relieved of his duties and responsibilities attaching to his office from which he has resigned. Similar views were accepted in the case of Achutha Pal vs. Registrar of Companies,(1956) 36 Comp. Cases 598.

Accordingly, in the given case, the resignation of Mr. Prasad, the Managing Director shall be effective when approved or accepted by the company and he is relieved of his duties and responsibilities attaching to his office within a reasonable time.

(c) (i) Section 292 (i) (aa) of the Companies Act, 1956 facilitates buy-back of shares upto 10 % of the total paid up equity capital and free reserves. Hence, special resolution in general meeting of the company is not required. The proposed buy-back of shares is in order provided other conditions laid down in Section 77A of the Companies Act, 1956 are fulfilled.

(ii) Section 292 of the Companies Act, 1956 empowers the Board of Directors to delegate to the Managing Director the power to invest in general terms. But Section 372A (2) of the said Act provides that no investment shall be made unless it is sanctioned by a resolution passed at a meeting of the board with the consent of all Directors present. Section 372A does not provide for delegation. Hence the proposed delegation of power to the Managing Director to invest is not in order

(d) Prima facie, the Bonds to the tune of ₹100 lacs are provided security to the tune of ₹80 lacs i.e. they are neither fully secured nor unsecured. Guidance Note (GN) on the 'Terms used in Financial Statements" issued by ICAI, states "Secured Loans" as Loan secured wholly on partly against an asset. Hence, the Bonds should be classified under "Secured Loans" for the purpose of disclosure in the Balance sheet. However, the nature of security should be clearly specified.

6. (a) What are the provisions available in the Companies Act, 1956 for protection of employees during investigation? 3

(b) Write a brief note on personal expenses of Directors. 3

(c) Examine with reference to the provisions of the Companies Act, 1956 whether notice of a Board Meeting is required to be sent to the following persons :

(i) Alternate Director;
(ii) An interested Director;
(iii) A Director who has expressed his inability to attend a particular Board Meeting;
(iv) A Director who has gone abroad. 4

(d) State the distinction between a Mandatory provision and a Directory provision. 2

(e) State the powers of the Court about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act,1956. 3

Answer:

6. (a) Protection of employees during investigation:

Section 635B of the Act protects against dismissal, discharge, removal, etc., of the employees of the company under investigation, who make disclosure during the course of investigation. The section provides that if during the course of investigation, under sections 235, 237 239 and 247 the company proposes to discharge any employee from service or punish him by way of dismissal, removal or reduction in rank, then the company must send to the CLB a previous intimation in writing of the action proposed to be taken, against the employee. If the CLB has any objection, it must send a notice thereof to the employer. The CLB is not bound to hear the company or any other person before issuing the notice- Ashoka Marketing Ltd. v. Company Law Board [1968] 38 Comp. Cas. 519 (Cal.). If the company does not receive any notice of objection from the CLB within thirty days of sending of the previous intimation of the action proposed against the employee, then the company may proceed to take the proposed action against the employee.

If the company is dissatisfied with the objection raised by the CLB, it may, within thirty days of the receipt of the notice of the objection, prefer an appeal to the Court in the prescribed manner and on payment of the prescribed fee. The decision of the court on such appeal shall be final and binding on the CLB and on the company.

The aforesaid provisions of section 635B are without prejudice to the provisions of any law for the time being in force.

(b) Reimbursement of personal expense of Director:

All payments to Directors as remuneration or perquisites whether in the case of a public or private company are required to be authorized both in accordance with the Companies Act and Articles of Association of the company. Articles may provide that such remuneration require sanction of the shareholders either by ordinary or special resolution while in some cases it may require only approval of Directors. If the terms of appointment of a Director include payment of expenses of a personal nature, then such expenses can be incurred by the company, otherwise, no such expense can be incurred or reimbursed by the company. In the instant case the auditor has to ensure that the above is complied with, without which, if such expenses are paid, he has to disclose the fact in his report, as also in the accounts. In this regard attention is invited to section 227 (1A) (e) of the Companies Act wherein auditor has to inquire into whether personal expenses have been charged to revenue. However, reporting requirements " the requirement of identifying and reposting on personal expenses" has been dispensed with in CARO, 2003.

(c) Notice of Board meeting:

(i) Alternate Director: Where a director goes abroad for a period of more than 3 months and an alternate director has been appointed in his place under Section 313, the notice should be served to the alternate director as well as on the original director who is outside India for the time being although there is no legal precedence in this regard, it would be a prudent practice on strictly construing Section 286.

(ii) An Interested Director: Notice must be given to a director even though he is

precluded from voting at the meeting on the business to be transacted [John Shaw & Sons (Salford) Ltd. v Peter Shaw & John Shaw [1935] 2 KB 1132].

(iii) A Director who has expressed his inability to attend a particular Board Meeting: If a director states that he will not be able to attend the next Board meeting, notice must be given to that director [Re Portuguese Consolidated Coffee Mines Steel's Case 42 Ch. D. 160].

(iv) A Director who has gone abroad: A director is entitled to a notice even though he is outside India provided he has made sufficient arrangement with the company for sending such notice to him. The right to receive notice cannot be waived. [H.M. Ebrahim Sait v. South Indian Industrial Ltd., (1938) 8 Com Cases 308: AIR 1938 Mad 962 and Young v. Ladies Imperial Club, (1920) All ER Rep 223 (CA)].

(d) Distinction between a mandatory and directory provision:
The distinction between a provision which is mandatory and one which is 'directory' is that when it 'mandatory', it must be strictly complied with, when it is 'directory', it would be sufficient that it is substantially complied with. Non-observance of mandatory provisions involves the consequences invalidating. But non-observance of directory provision does not entail the consequence of invalidating, whatever other consequences may occur.

(e) While sanctioning the scheme of amalgamation, the Court under Section 394 of the Companies Act, 1956 may make provision for all or any of the following matters:
(i) The transfer to the transferee company of the whole or any part of the undertaking property or liabilities of the transferor company.
(ii) The allotment by the transferee company of any shares, debenture etc. in that company which under the scheme are to be allotted by that company to any person.
(iii) The continuation of any legal proceedings by or against any transferor and transferee company.
(iv) The dissolution, without winding up of any transferor company.
(v) The provisions to be made for any persons who within such time and in such manner as the court directs, dissent from the scheme of amalgamation.
(vi) Such incidental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.

SECTION B

Answer any five Questions from Question No. 7(a) to 7(f).

5x5=25

7. (a) Discuss various reasons for Corporate Social Responsibility (CSR)?
(b) Enumerate the principles of corporate Governance as evolved by OECD?
(c) Explain the need of corporate Governance in Banks.
(d) CSR is an integral part of sustainable development. Explain.
(e) "The development of corporate Governance in the U. K. was initially the findings of a trilogy of codes". Discuss in brief.
(f) What are the pros and cons of adopting Corporate Social Responsibility?

Answer:

7.(a) The rationale for CSR has been articulated in a number of ways. In essence, it is about building sustainable businesses, which needs healthy economies, markets and communities. The major reasons for CSR can be outlined as:

(i) Globalisation:

As a consequence of cross-border trade, multinational enterprises and global supply chains, there is an increased awareness on CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things. Reporting on the CSR activities by corporates is therefore increasingly becoming mandatory.

In an increasingly fast-paced global economy, CSR initiatives enable corporates to engage in more meaningful and regular stakeholder dialogue and thus be in a better position to anticipate and respond to regulatory, economic, social and environmental changes that may occur.

(ii) International legal instruments and guidelines

In the recent past, certain indicators and guidelines such as the SA 8,000, a social performance standard based on International Labour Organisation Conventions have been developed. International agencies such as United Nations and the Organisation for Economic Co-operation and Development have developed compacts, declarations, guidelines, principles and other instruments that set the tone for social norms for organisations, though these are advisory for organisations and not mandatory. One of the United Nations Millennium Development Goals calls for increased contribution of assistance from country states to help alleviate poverty and hunger, and states in turn are advising corporates to be more aware of their impact on society. In order to catalyze actions in support of the MDGs, initiatives such as Global Compact are being put in place to instrumentalise CSR across all countries.

(iii) Changing public expectations of business

Globally companies are expected to do more than merely provide jobs and contribute to the economy through taxes and employment. Consumers and society in general expect more from the companies whose products they buy. This is coherent with believing the Idea that whatever profit is generated is because of society, and hence mandates contributing a part of business to the less privileged.

Further, separately in the light of recent corporate scandals, which reduced public trust of corporations, and reduced public confidence in the ability of regulatory bodies and organisations to control corporate excess. This has led to an increasing expectation that companies will be more open, more accountable and be. prepared to report publicly on their performance in social and environmental arenas .

(iv) Corporate Brand

In an economy where corporates strive for a unique selling proposition to differentiate themselves from their competitors, CSR initiatives enable corporates to build a stronger brand that resonates with key external stakeholders, customers, general public and the government.

Businesses are recognizing that adopting an effective approach to CSR can open up new opportunities, and increasingly contribute to the corporates' ability to attract passionate and committed workforces.

Corporates in India are also realizing that their reputation is intrinsically connected with how well they consider the effects of their activities on those with whom they interact. Wherever the corporates fail to involve parties, affected by their activities, it may put at risk their ability to create wealth for themselves and society.

(b) The Organisation for Economic Co-operation and Development (OECD) was one of the earliest non-governmental organisations to work on and spell out principles and practices that should govern corporates in their goal to attain long term shareholder value. They include the following elements :

(i) The rights of shareholders: The rights of shareholders include a set of rights to secure

ownership of their shares, the right to full disclosure of information, voting rights, participation in decisions on sale or modification for corporate assets, mergers and new share issues. The guidelines go on to specify a host of other issues connected to the basic concern of protecting the value of the corporation.

(ii) Equitable treatment of shareholders: The OECD is concerned with protecting minority shareholders' rights by setting up systems that keep insiders, including managers and directors, from taking advantage of their roles. Insider trading, for example, is explicitly prohibited and directors should disclose any material interest regarding transactions.

(iii) The role of stakeholders in corporate governance: The OECD recognizes that there are other stakeholders in companies in addition to shareholders and workers, for example, are important stakeholders in the way in which companies perform and make decisions. The OECD guidelines lay out several general provisions for protecting stakeholder's interests.

(iv) Disclosure and transparency: The OECD lays down a number of provisions for the disclosure and communication of key facts about the company ranging from financial details to governance structures including the board of directors and their remuneration. The guidelines also specify that independent auditors in accordance with high quality standards should perform annual audits.

(v) The responsibilities of the board: The OECD guidelines provide a great deal of details about the functions of the board in protecting the company and its shareholders. These include concerns about corporate strategy, risk, executive compensation and performance as well as accounting and reporting systems.

(c) If we examine the need for improving corporate governance in banks, two reasons stand out: (i) Banks exist because they are willing to take on and manage risks. Besides, with the rapid pace of financial innovation and globalisation, the face of banking business is undergoing a sea-change. Banking business is becoming more complex and diversified. Risk taking and management in a less regulated competitive market will have to be done in such a way that investors' confidence is not eroded, (ii) Even in a regulated set-up, as it was in India prior to 1991, some big banks in the public sector and a few in the private sector had incurred substantial losses. This, along with the massive failures of non-banking financial Companies (NBFCs), had adversely impacted investors' confidence.

Moreover, protecting the interests of depositors becomes a matter of paramount importance to banks. In other corporates, this is not and need not be so for two reasons: (i) The depositors collectively entrust a very large sum of their hard-earned money to the care of banks. It is found that in India, the depositor's contribution was well over 15.5 times the shareholders' stake in banks as early as in March 2001. This is bound to be much more now. (ii) The depositors are very large in number and are scattered and have little say in the administration of banks. In other corporates, big lenders do exercise the right to direct the management. In any case, the lenders' stake in them might not exceed 2 or 3 times the owners' stake.

Banks deal in people's funds and should, therefore, act as trustees of the depositors. A regulator the worlds over have recognised the vulnerability of depositors to the whims of managerial misadventures in banks and, therefore, have been regulating banks more tightly than other corporates.

To sum up, the objective of governance in banks should first be protection of depositors' interests and then be to "optimise" the shareholders' interests. All other considerations would fall in place once these two are achieved.

As part of its ongoing efforts to address supervisory issues, the Basel Committee on Banking Supervision (BCBS) has been active in drawing from the collective supervisory experience of its members and other supervisors in issuing supervisory guidance to foster safe and sound banking practices. The committee was set up to reinforce the importance for banks of the OECD principles, to draw attention to corporate governance issues addressed by previous committees, and to present some new topics related to corporate governance for banks and their supervisors to consider.

Banking supervision cannot function effectively if sound corporate governance is not in place and, consequently, banking supervisors have a strong interest in ensuring that there is effective corporate governance at every banking organisation. Supervisory experience underscores the necessity of having the appropriate levels of accountability and checks and balances within each bank. Put plainly, sound corporate governance makes the work of supervisors infinitely easier. Sound corporate governance can contribute to a collaborative working relationship between bank management and bank supervisors.

(d) CSR is an integral part of Sustainable Development (SD). Exactly where it fits in is vigorously debated, mainly because the concept of sustainable development also has many different interpretations.

The basic idea to incorporate the sustainability aspect into business management should be grounded in the ethical belief of give and take to maintain a successful company in the long-term. As the company is embedded in a complex system of interdependences in- and outside the firm, this maintaining character should be fulfilled due to the company's commitment in protecting the environment or reducing its ecological footprint and due to the general acceptance of its corporate behavior by society in and outside of the firm. It is recommended that CSR is to be used as social strand of the SD-concept which is mainly built on a sound stakeholder approach. CSR focus especially on the corporate engagement realizing its responsibilities as a member of society and meeting the expectations of all stakeholders.

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CSR advocates moving away from a 'shareholder alone' focus to a 'multi-stakeholder' focus. Sustainable Development is 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

A business organisation which employs eco-friendly business practices is, no doubt, socially responsible as it takes into account the interest of its stakeholders, viz. the environment and the society at large. As a corollary, a business organisation which is socially responsible would, no doubt, employ eco-friendly business practices.

Only a business organisation which is conscious of its duty towards the environment, would employ eco-friendly business practices and adopt the principles of sustainable development.

Thus, it is correct to say that "Corporate Social Responsibility is closely linked with the principles of sustainable development".

(e) As in other countries, the development of Corporate Governance in the UK was initially the findings of a trilogy of codes: the Cadbury Report (1992), the Greenbury Report (1995), and the Hampel Report (1998). The recommendations of these reports, which helped in development of corporate governance in U.K. are explained as under:

Cadbury Report (1992)
The recommendations covered: the operation of the main board; the establishment, composition, and operation of key board committees; the importance of, and contribution that can be made by, non-executive directors; the reporting and control mechanisms of a business. The Cadbury Report recommended a code of Best Practice with which the boards of all listed companies registered in the UK should comply, and utilized a "comply or explain" mechanism. This mechanism means that a company should comply with the code but, if it cannot comply with any particular aspect of it, then it should explain why it is unable to do so. This disclosure gives investors' detailed information about any instances of non-compliance and enables them to decide whether the company's non-compliance is justified.

Greenbury Report (1995)
Central to the Greenbury report recommendations were strengthening accountability and enhancing the performance of directors. These two aims were to be achieved by (i) the presence of a remuneration committee comprised of independent non-executive directors who would report fully to the shareholders each year about the company's executive remuneration policy, including full disclosure of the elements in the remuneration of individual directors; and (ii) the adoption of performance measures linking rewards to the performance of both the company and individual directors, so that the interests of directors and shareholders were more closely aligned.
Since that time (1995), disclosure of directors' remuneration has become quite prolific in UK company accounts.

Hampel Report (1998)
The Hampel Report, like its precursors, also emphasized the important role that institutional investors have to play in the companies in which they invest (investee companies). It is highly desirable that companies and institutional investors engage in dialogue and that institutional investors make considered use of their shares, in other words, institutional investors should consider carefully the resolutions on which they have a right to vote and reach a decision based on careful thought, rather than engage in 'box ticking'

(f) Corporate social responsibility refers to a method of running a company that seeks to address not only profitability, but also the environmental and social consequences of the business. While most corporate social responsibility concerns are directed at very large businesses, even small and medium-sized businesses that employ a large number of local residents or participate in environmentally problematic industries can face pressure to adopt corporate social responsibility.
Costs - Cons

Cost represents one of the biggest arguments against adopting corporate social responsibility as a policy. Programs to reduce environmental impact often require expensive changes in equipment or ongoing costs without any clear way to recoup those losses. The decision to maintain domestic production facilities or call centers or to buy from domestic producers rather than outsource or move production overseas can drive up costs for a business. Additionally, there is no clear evidence that adhering to a policy of corporate social responsibility generates a significant increase in sales or profit.

Improved Company Reputation - Pros

Embracing a policy of corporate social responsibility, paired with genuine action, can serve to build or improve the reputation of a business. If a company's behavior creates a negative backlash that leads to lost profitability -over environmental issues, for example -- corporate social responsibility becomes a method to repair reputation damage and restore profitability. In other cases, adopting such a policy works as part of a business‟ essential brand, and consumers often demonstrate more loyalty to brands that can demonstrate a commitment to environmental concerns.

Shareholder Resistance - Cons

Some investors do look to acquire stock in socially responsible corporations, but, on the whole, investors purchase stock on the expectations of turning a profit. While some companies, such as Toyota and GE, have profited from corporate social responsibility, companies that adopt such policies often prove as likely to lose money. Given the spotty track record of corporate social responsibility in demonstrating profit increase, investors may resist attempts by executives to move a company in that direction.

Better Customer Relations - Pros

One of the hallmarks of corporate social responsibility is staying involved in the communities where the business operates. This community involvement goes a long way toward building trust between customers and the business. If a business builds trust with its customers, they tend to give the business the benefit of the doubt if something goes wrong, rather than assuming malicious intent or raw negligence. Customers also tend to stick with businesses they trust, rather than actively seeking out new companies, which helps keep a business profitable over the long haul.