

PAPER – 2 : BUSINESS LAWS, ETHICS AND COMMUNICATION

Question No. 1 is compulsory.

Attempt any **five** questions from the remaining **six** questions.

Question 1

- (a) 'Ramesh' and 'Suresh' were engaged in business having same nature. 'Ramesh' stands surety for 'Suresh' for any amount which 'Kamlesh' may lend to 'Suresh' from time to time during the next 6 months subject to a maximum of ₹ 85,000. 3 months later, 'Ramesh' revokes the guarantee, when 'Kamlesh' had lent to 'Suresh' ₹ 35,000. Decide whether 'Ramesh' is discharged from all the liabilities to 'Kamlesh' for any subsequent loan under the provisions of the Indian Contract Act, 1872. Would your answer differ in case 'Suresh' makes a default in paying back to 'Kamlesh' the money already borrowed i.e. ₹ 35,000?

(5 Marks)

- (b) MN Ltd. is engaged in the manufacture of consumer goods and has got a good brand value. Over the years, it has built a good reputation and its Balance Sheet as at March 31, 2017 shows the following position:

Authorized Share Capital (25,00,000 equity shares of face value of ₹ 10/- each)	₹ 2,50,00,000
Issued, subscribed and paid-up capital (10,00,000 equity shares of face value of ₹ 10/- each, fully paid-up)	₹ 1,00,00,000
Free Reserves	₹ 3,00,00,000

The Board of Directors are proposing to declare a bonus issue of 1 share for every 2 shares held by the existing shareholders. The Board wants to know the conditions and the manner of issuing bonus shares under the provisions of the Companies Act, 2013. Advise.

(5 Marks)

- (c) "Ethics programs are not helping to manage values associated with quality management, strategic planning and diversity management." Do you agree? Give reasons. **(5 Marks)**
- (d) Negotiation is said to be an art of finding a mutually acceptable agreement between parties. What are the various approaches through which the process of negotiation can be made acceptable? **(5 Marks)**

Answer

- (a) **Revocation of continuing guarantee:** The problem asked in the question is based on section 130 of the Indian Contract Act, 1872 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways:

1. **By Notice:** A continuing guarantee may at any time be revoked by the surety as to future transactions, by giving notice to the creditor.
2. **By death of surety:** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Section 131)

So far as the transactions before revocation are concerned, the liability of the surety for previous transactions (i.e. before revocation) remains.

Thus, applying the above provisions in the given case,

- 'Ramesh' is discharged from all the liabilities to 'Kamlesh' for any subsequent loan.
- Answer in the second case would differ i.e. 'Ramesh' is liable to 'Kamlesh' for ₹ 35,000 on default of 'Suresh' since the loan was taken before the notice of revocation was given to 'Kamlesh'.

(b) Issue of Bonus Shares: According to Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of -

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares: No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

- (a) it is authorised by its Articles;
- (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- (f) it complies with such conditions as may be prescribed.

But the company has to ensure that the bonus shares shall not be issued in lieu of dividend.

Hence, after following the above compliances on issuing bonus shares under the Companies Act, 2013, MN Ltd. may proceed for a bonus issue of 1 share for every 2 shares held by the existing shareholders.

- (c) "Ethics programs are not helping to manage values associated with quality management, strategic planning and diversity management".

No. This is an incorrect statement.

Reason: Ethics programs help identifying the preferred values and ensuring that organizational behaviours are aligned with those values. This includes recording the values, developing policies and procedures to align behaviours with preferred values and then providing training to all personnel about the policies and procedures. This overall effort is very useful for several other programs in the workplace that require behaviours to be aligned with values, including quality management, strategic planning and diversity management.

For example, total quality management initiatives include high priority on certain operating values, e.g. trust among stakeholders, performance, reliability, measurement and feedback.

- (d) **Negotiation:** Negotiation is a common way of settling issues between two or more disagreeing parties. When handled skillfully, negotiation can improve the position of one or even both but when poorly handled; it can leave a problem still unsolved and perhaps worse than before.

Approaches: Negotiation can be approached in four ways. Each of these approaches produces a different outcome.

Win-Lose Orientation: This is the approach taken by competitive communicators. The win-lose orientation is based on the assumption that only one side can reach its goals and that any victory by that party will be matched by the other's loss. Despite the fact that it produces losers as well as winners, a win-lose orientation can sometimes be the best approach to negotiating. For example, in a one-time commercial transaction (the sale of a car, for instance), concern for helping the other party may take a back seat in getting the best possible deal, without violation of ethical values.

Lose-Lose Orientation: With a lose-lose orientation, a conflict plays out in a way that damages both parties to such a degree that everyone feels like a loser. Nobody starts out seeking a lose-lose outcome, of course, but sometimes when people feel that a negotiating partner is blocking them, they wind up seeking revenge. For example, if customers feel cheated, they are likely to tell others about their dissatisfaction, costing the company future business.

Compromise: Sometimes it seems better to compromise than to fight battles in a competitive manner and risk a lose-lose outcome. There are cases in which compromise is the best obtainable outcome-usually when disputed resources are limited or scarce. For example, if two managers, both of whom need a separate full-time secretary but

budget restrictions make this impossible, they may have to compromise by sharing one secretary.

Win-Win Orientation: A win-win approach differs significantly from the preceding negotiating styles. It is a collaborative approach to negotiation and assumes that solutions can be reached that satisfy the needs of all the parties. Most importantly, it looks beyond the conflicting means of both parties (my way versus your way) and focuses on satisfying the ends each is seeking. The key is to avoid taking polar positions (arguing over means) and instead to identify the ends or goals of both parties.

Question 2

- (a) (i) *In 2016, Axis Electronics Corporation, an establishment in public sector starts to sell mobile sets manufactured by it, in addition to Air conditioners, so as to compete with private sector establishments of mobile sets in the market. The income from sale of mobile sets is 28 percent of the gross income of the Axis Electronics Corporation. The employees of the Corporation went to strike for demand of bonus.*

Decide, whether the demand of the employees is tenable under the provisions of the payment of Bonus Act, 1965. Would your answer be different if the income from sale of mobile sets is only 18 percent of the gross income of the Corporation?

(4 Marks)

- (ii) *Artha Steels Ltd. decided to forfeit the amount of gratuity of its employees 'A' and 'C' on account of disorderly conduct and other acts which caused loss to the property belonging to the Company.*

'A' and 'C' committed the following acts:

- (i) *'A' refused to surrender the occupied land belonging to the Company.*
 (ii) *'C' after superannuation continued to occupy the quarter of the Company for six months.*

Against the decision of the Company, 'A' and 'C' applied to the appropriate authorities for relief. The Company contented that the right to gratuity is not a statutory right and the forfeiture of the 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.

(4 Marks)

- (b) *Explain how the following measures can help in managing ethics in the work place:*

- (i) *Codes of Conduct and Ethics*
 (ii) *Appointing an Ombudsperson*

(2 + 2 = 4 Marks)

- (c) *Write short notes on the following:*

- (i) *The Caux Round Table (CRT)*
 (ii) *Euphemisms*

(2 + 2 = 4 Marks)

Answer

- (a) (i) Sub Section (1) of Section 20 of the Payment of Bonus Act, 1965 provides that, if in any accounting year, an establishment in public sector sells any goods produced or manufactured by it or if it renders any services in competition with an establishment in private sector and if the income from such sale or service or both is not less than 20% of the gross income of such establishment, then, the provisions of this Act shall apply in relation to such establishment in public sector as they apply in relation to a like establishment in private sector.

Sub Section (2) of Section 20 of the Payment of Bonus Act, 1965 provides that, save as otherwise provided in sub-section (1), nothing in this Act shall apply to the employees employed by an establishment in public sector.

In the instant case, Axis Electronics Corporation, an establishment in public sector starts selling mobile sets manufactured by it, in addition to Air conditioners, so as to compete with private sector establishments of mobile sets in the market.

In the first case, the income from sale of mobile sets is 28% of the gross income of Axis Electronics Corporation. The employees of the Corporation went on strike for demand of Bonus. The demand of the employees is tenable in this case due to the fact that income from sale of mobile sets is not less than 20% of the gross income of the establishment.

In the second case, the income from sale of mobile sets is only 18% of the gross income of the corporation; hence, demand of the employees is not tenable since income from sale of mobile sets is less than 20% of the gross income of the establishment.

- (ii) As per the provisions of section 4(1) of the Payment of Gratuity Act, 1972, gratuity is payable to an employee on termination of his employment after he has rendered continuous service for not less than five years, -

- (a) on his superannuation, or
- (b) on his retirement or resignation, or
- (c) on his death or disablement due to accident or disease:

Provided that the completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.

Forfeiture of Gratuity: In accordance with the provisions of Section 4(6) of the Payment of Gratuity Act, 1972, if the services of any employee have been terminated for any act, willful omission, or negligence causing any damage or loss to or destruction of property belonging to the employer, the gratuity shall be forfeited to the extent of the damage or loss so caused.

Further, if the services of such an employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment, the gratuity payable to the employee may be wholly or partially forfeited.

The correctness of the decision taken by Artha Steel Ltd. in the given case, regarding forfeiture of gratuity to its employees A and C may be tested in the light of Section 4(6) of the Payment of Gratuity Act, 1972 as referred above.

- (i) A, as per the given facts, refused to surrender the occupied land belonging to the company. This reflects unauthorized occupation or holding of land and deliberate appropriation of the company's property by him. This may be termed as disorderly conduct on the part of A. Hence, his gratuity may be forfeited by the company as per the provisions of section 4(6) the Payment of Gratuity Act, 1972.
- (ii) C had wrongfully continued to occupy the company's quarter for six months after superannuation. C may have caused a deliberate loss to the company by his wrongful occupation for 6 months as the quarter could not be provided to another employee and the company may have incurred the cost of rent in such case. Hence, the company is entitled to charge rent from him and after adjusting other dues the remaining amount of gratuity if any, should be paid.

In a similar case to the situation given in the question, [*Wazir Chand vs. Union of India, 2001, LLR172 (SC)*], the court has taken view that there is no illegality in those rental dues being adjusted against the death-cum-retirement dues of the appellant.

- (b) (i) **Codes of Conduct and Ethics:** A code of ethics specifies the ethical rules of operation in an organization. Codes of conduct specify actions in the workplace and codes of ethics are general guides to decisions about those actions. Examples of topics typically addressed by codes of conduct include: preferred style of dress, avoiding illegal drugs, following instructions of superiors, being reliable and prompt, maintaining confidentiality, not accepting personal gifts and so on.
- (ii) **Appointing an ombudsperson:** The ombudsperson is responsible to help and coordinate in the development of the policies and procedures to institutionalise moral values in the workplace. This establishes a point of contact where employees can go to ask questions in confidence about the work situations they confront and seek advice.
- (c) (i) **The Caux Round Table (CRT)** promotes principled business leadership and the belief that business has a crucial role in identifying and promoting sustainable and equitable solutions to key global issues affecting the physical, social and economic environments. The CRT is comprised of senior business leaders from Europe, Japan and North America, and is based in Caux, Switzerland. The CRT has

produced "Principles for Business," a document which seeks to express a worldwide standard for ethical and responsible corporate behaviour for dialogue and action by business and leaders worldwide. The principles include the social impact of company operations on the local community, a respect for rules and ethics, support for multilateral trade agreements that promote the "judicious liberation of trade," respect for the environment and "avoidance of illicit operation," including bribery, money laundering, and other corrupt practices.

- (ii) **Euphemisms:** By definition, a euphemism is using a less offensive expression instead of one that might cause distress. For example using the expression "passed away" instead "died" is one of the more common examples. This usage is understandable. However, people frequently use these terms to obscure the truth. For example a purchasing agent has a far easier time accepting a "consideration fee" than a "bribe." Petty office theft gets passed off as merely "permanently borrowing" the item instead of "stealing."

Question 3

- (a) (i) 'A' gives to 'M' a continuing guarantee to the extent of ₹ 8,000 for the fruits to be supplied by 'M' to 'S' from time to time on credit. Afterwards 'S' became embarrassed and without the knowledge of 'A', 'M' and 'S' contract that 'M' shall continue to supply 'S' with fruits for ready money and that payments shall be applied to the then existing debts between 'S' and 'M'. Examining the provision of the Indian Contract Act, 1872, decide whether 'A' is liable on his guarantee given to M.

(4 Marks)

- (ii) Distinguish between 'Contract of Indemnity' and 'Contract of Guarantee'. (4 Marks)

- (b) What are the matters to be considered by a finance and accounting professional when he is required to resolve an ethical conflict in the application of fundamental principles?

(4 Marks)

- (c) What are the factors influencing ethical communication? Explain them.

(4 Marks)

Answer

- (a) (i) **Discharge of surety by variance in terms of contract:** The problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 133. The section provides that any variance made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

In the given problem, 'M' and 'S' entered into arrangement by entering into a new contract without knowledge of the Surety 'A'. Since, the variance made in the contract is without the surety's consent in the existing contract, as per the provision, 'A' is not liable on his guarantee for the fruits supplied after this new arrangement. The reason for such a discharge is that the surety agreed to be liable for a contract

which is no more there now and he is not liable on the altered contract because it is different from the contract made by him.

(ii) **Distinction between Contract of indemnity and Contract of Guarantee:** The difference between the two types of contracts is as follows:

- (1) **Number of parties:** In a contract of indemnity there are only two parties namely the indemnifier [promisor] and the indemnified [promisee]. In a contract of guarantee there are three parties, creditor, principal debtor and the surety.
- (2) **Extent of liability:** The liability of the indemnifier is primary and independent. The liability of the surety is secondary; the primary liability is that of the principal debtor.
- (3) **Time of liability:** The liability of the indemnifier arises only on the happening of a contingency. In the case of guarantee, liability is already in existence but specifically crystallizes when principal debtor fails.
- (4) **Time to Act:** The indemnifier need not necessarily act at the request of indemnified. In case of guarantee surety must act by extending guarantee at the request of debtor.
- (5) **Right to sue third party:** In case of contract of indemnity, indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour. On the other hand in the case of contract of guarantee surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.

(b) **Conflict Resolution:** While evaluating compliance with the fundamental principles, a finance and accounting professional may be required to resolve a conflict on the application of fundamental principles. The following needs to be considered, either individually or together with others, during a conflict resolution process:

- (i) Relevant facts
- (ii) Ethical issues involved
- (iii) Fundamental principles related to the matter in question
- (iv) Established internal proceedings and
- (v) Alternative course of action

Having considered these issues, the professional should determine the appropriate course of action that is consistent with the fundamental principles identified. The professional should weigh the consequences of each possible course of action. If the matter remains unresolved, the professional should consult other appropriate persons within the firm or employing organization for help in obtaining resolution.

(c) **Factors influencing ethical communication: Following are the factors that influence ethical communication:**

1. **Every Communication Decision has some Ethical Aspect to it, Acknowledged or Not:**

There are countless complexities involved in the communication process, but communicators initially face three simple choices: to speak, to listen, or to remain silent. Each choice implies an ethical decision.

In a message the sender chooses to disclose information, motives, or feelings to others. That choice inevitably involves an ethical element. Clearly, some messages should not be sent, such as those involving "insider information." To do so give certain people an unfair advantage in the marketplace. But should one share a rumour about an organizational change with a colleague? Such actions are common and appear to be less objectionable than insider trading.

The timing and mode of communication add another layer of complexity to the ethical dimension.

Remaining silent might seem like the safest way to avoid ethical dilemmas. But even here there is no safe heaven. Remaining silent in the face of unlawful behavior or a potentially harmful situation presents a serious ethical decision. Silence signals consent or perhaps tacit agreement.

2. **The Ethical Nature of Communication must be Considered within the Context of Who, What, When, and Where:**

Suppose fellow employees discussed a project they were working on. This may seem perfectly ethical on the surface. After all, such discussions actually foster effective interdepartmental relationships; a worthy goal indeed. The problem may be that the discussion took place in a crowded restaurant and a competitor overheard the conversation. When the employees are confronted, they may reply, "What did we say that was wrong? We were not talking to a competitor." But this is, of course, the wrong question. The issue does not concern what was said or even who they were talking to. The ethical issue revolves around where the conversation took place. Herein lies the complexity of ethical issues - evaluations must be made on more than one dimension. Ethical communicators are not concerned with just who or what or where or when, but with all four dimensions simultaneously.

Question 4

- (a) (i) *A Limited has an Authorized Capital of 10,00,000 equity shares of the face value of ₹ 100/- each. Some of the shareholders expressed their opinion in the Annual General Meeting that it is very difficult for them to trade in the shares of the Company in the share market and requested the Company to reduce the face value of each share to ₹10/- and increase the number of shares to 1,00,00,000. Examine*

whether the request of the shareholders is possible and if so, how the Company can alter its share capital as per the provisions of the Companies Act, 2013. (4 Marks)

- (ii) *What do you mean by 'Pari Passu' clause in a debenture? State the particulars that are required to be filed with the Registrar of Companies in case such debentures are secured by way of a charge on certain immovable assets of the Company. (4 Marks)*
- (b) *Explain the concept of Corporate Social Responsibility and its meaning to different people. (4 Marks)*
- (c) *Explain the elements that can be used to influence an organisational culture. (4 Marks)*

Answer

- (a) (i) **Power of Limited Company to Alter its Share Capital:** As per section 61 of the Companies Act, 2013, a limited company having share capital may, if so authorised by its articles, may alter its memorandum in its general meeting so as to divide all or any of its share capital of a larger amount than its existing shares or sub-divide the whole or any part of its shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived.

In the given instance, shareholders of A Limited in the Annual General Meeting, requested the company to reduce the face value of each shares (i.e. from ₹ 100 to ₹ 10) and increase in the number of shares, then is fixed by the memorandum (i.e., from 10 lacs to 1 crore). According to the above stated provision, it is possible on the part of the company to alter its share capital by sub-dividing its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, provided it is authorised by its articles. The company has to alter its memorandum in its general meeting as per the procedure contained in the provisions of section 13 of the Companies Act, 2013.

- (ii) **'Pari Passu':** Pari Passu clause in a debenture means that all the debentures of that particular series are to be paid rateably, if, therefore, security is insufficient to satisfy the whole debts secured by the series of debentures, the amounts of debentures will abate proportionately. If this clause is not included, the debentures will rank in priority for payment in accordance with the date of issue, and if they are all issued on the same date they will be payable according to their numerical order. A company, however, cannot issue a new series of debentures so as to rank 'pari passu' with any prior series unless the power to do so is expressly reserved and contained in the document of offer.

Registration of charge: Under section 77 (1) of the Companies Act, 2013, it shall be the duty of every company creating a charge on its property or assets or any of its undertakings, whether tangible or otherwise to register the particulars of the charge signed by the company and the charge-holder together with the instruments,

if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed with the Registrar within thirty days of its creation.

In terms of Rule 3 of the *Companies (Registration of Charges), Rules 2014* for the registration of charge in respect of debentures the following documents should be submitted to the Registrar:

- (a) The particulars of charge;
- (b) Instrument for the creation or the modification of the charge;
- (c) Application in prescribed Form

- (b) **Corporate Social Responsibility (CSR):** It is a concept that organizations, have an obligation to consider the interests of customers, employees, shareholders, communities, and ecological considerations in all aspects of their operations. This obligation is seen to extend beyond their statutory obligation to comply with legislation. CSR is closely linked with the principles of Sustainable Development, which argues that enterprises should make decisions based not only on financial factors such as profits or dividends, but also based on the immediate and long-term social and environmental consequences of their activities, especially taking into consideration the needs of future generations. It is an integrated combination of policies, programs, education, and practices which extend throughout a corporation's operations and into the communities in which they operate, about how companies voluntarily manage the business processes to produce an overall positive impact on society.

CSR can mean different things to different people:

- ◆ for an employee it can mean fair wages, no discrimination, acceptable working conditions etc.
- ◆ for a shareholder it can mean making responsible and transparent decisions regarding the use of capital.
- ◆ for suppliers it can mean receiving payment on time.
- ◆ for customers it can mean delivery on time, etc.
- ◆ for local communities and authorities it can mean taking measures to protect the environment from pollution.
- ◆ for non-governmental organisations and pressure groups it can mean disclosing business practices and performance on issues ranging from energy conservation and global warming to human rights and animal rights, from protection of the rainforests and endangered species to child and forced labour, etc.

For a company, however, it can simply be seen as responding to the needs and concerns of people who can influence the success of the company and/or whom the company can impact through its business activities, processes and products.

(c) **Elements influencing organisational Culture:** There are number of elements that can be used to describe or influence Organizational Culture. Some of these are:

- ◆ *The Paradigm:* What the organization is about; what it does; its mission; its values.
- ◆ *Control Systems:* The processes in place to monitor what is going on.
- ◆ *Organizational Structures:* Reporting lines, hierarchies, and the way that work flows through the business.
- ◆ *Power Structures:* Who makes the decisions and how power is distributed across the organization.
- ◆ *Symbols:* These include the logos and designs, but would extend to symbols of power, such as car parking spaces and executive washrooms!
- ◆ *Rituals and Routines:* Management meetings, board reports and so on may become more habitual than necessary.
- ◆ *Stories and Myths:* build up about people and events, and convey a message about what is valued within the organization.

Communicating the corporate culture effectively is paramount. For example, at General Electric (GE), corporate values are so important to the company, that Jack Welch, the former legendary CEO of the company, had them inscribed and distributed to all GE employees at every level of the company.

Question 5

- (a) (i) 'K' is an employee of 'Sumit'. He fraudulently obtains from Sumit a cheque crossed 'not negotiable'. He later transfers the cheque to 'D' who gets the cheque encashed from XYZ Bank, which is not the drawee bank. Sumit comes to know about the fraudulent act of 'K', sues XYZ Bank for the recovery of money. Examine with reference to the relevant provisions of the Negotiable Instruments Act, 1881, whether Sumit will be successful in his claim? Would your answer be still the same in case 'K' does not transfer the cheque and gets the cheque encashed from XYZ Bank himself? **(4 Marks)**

- (ii) 'E' is the holder of a bill of exchange made payable to the order of 'F'. The bill of exchange contains the following endorsements in blank:

First endorsement 'F'

Second endorsement 'G'.

Third endorsement 'H' and

Fourth endorsement 'I'

'E' strikes out, without I's consent, the endorsements by 'G' and 'H'. Decide with reasons whether 'E' is entitled to recover anything from 'I' under the provisions of Negotiable Instruments Act, 1881. **(4 Marks)**

- (b) *The paid-up share capital of SAB Private Limited is ₹ 1 crore, consisting of 8 lacs Equity Shares of ₹ 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of ₹10 each, fully paid-up. JVN Private Limited and SARA Private Limited are holding 3 lacs Equity Shares and 50,000 Equity Shares respectively in SAB Private Limited. JVN Private Limited and SARA Private Limited are the subsidiaries of PQR Private Limited. With reference to the provisions of the Companies Act, 2013 examine whether SAB Private Limited is a subsidiary of PQR Private Limited? Would your answer be different if PQR Private Limited has 8 out of 9 Directors on the Board of SAB Private Limited?*

(4 Marks)

- (c) *Mr. 'X' is the Chief Financial Officer of a Public Limited Company and the management of the Company orders him to do certain changes in the financial statements against the prescribed Accounting Standards which was refused by him. Mr. 'X' is against those changes. In the light of the above situation, explain the pressures which are normally faced by the finance and accounting professionals in an organization in the compliance of fundamental principles of ethics.*

(4 Marks)

Answer

- (a) (i) According to Section 130 of the Negotiable Instruments Act, 1881 a person taking cheque crossed generally or specially bearing in either case the words 'Not Negotiable' shall not have or shall not be able to give a better title to the cheque than the title the person from whom he took it had. In consequence, if the title of the transferor is defective, the title of the transferee would be vitiated by the defect.

Thus, based on the above provisions, it can be concluded that if the holder has a good title, he can still transfer it with a good title, but if the transferor has a defective title, the transferee is affected by such defects, and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value.

Since 'K' in the given case, had obtained the cheque fraudulently, he had no title to it and cannot give to the bank any title to the cheque or money; and the bank would be liable for the amount of the cheque for encashment. (*Great Western Railway Co. v. London and Country Banking Co.*)

The answer in the second case would not change and shall remain the same for the reasons given above.

Thus, 'Sumit' in both the cases shall be successful in his claim from XYZ Bank.

- (ii) According to section 40 of the Negotiable Instruments Act, 1881, where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. Any

party liable on the instrument may be discharged by the intentional cancellation of his signature by the holder.

In the given question, E is the holder of a bill of exchange of which F is the payee and it contains the following endorsement in blank:

First endorsement, 'F'

Second endorsement, 'G'

Third endorsement, 'H'

Fourth endorsement, 'I'

'E', the holder, may intentionally strike out the endorsement by 'G' and 'H'; in that case the liability of 'G' and 'H' upon the bill will come to an end. But if the endorsements of 'G' and 'H' are struck out without the consent of 'I', 'E' will not be entitled to recover anything from 'I'. The reason being that as between 'H' and 'I', 'H' is the principal debtor and 'I' is surety. If 'H' is released by the holder under Section 39 of the Act, 'I', being surety, will be discharged. Hence, when the holder without the consent of the endorser impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder.

Thus, if 'E' strikes out, without I's consent, the endorsements by 'G' and 'H', 'I' will also be discharged.

(b) In terms of section 2 (87) of the Companies Act 2013 "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Explanation.—For the purposes of this clause,—

- (a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors.

In the present case, JVN Pvt. Ltd. and SARA Pvt. Ltd. together hold less than one half of the total share capital. Hence, PQR Private Ltd. (holding of JVN Pvt. Ltd. and SARA Pvt. Ltd) will not be a holding company of SAB Pvt. Ltd.

However, if PQR Pvt. Ltd. has 8 out of 9 Directors on the Board of SAB Pvt. Ltd. i.e. controls the composition of the Board of Directors; it (PQR Pvt. Ltd.) will be treated as the holding company of SAB Pvt. Ltd.

- (c) Ordinarily, a finance and accounting professional should support the legitimate and ethical objectives established by the employer and the rules and procedures drawn up in support of those objectives. Nevertheless, where compliance with the fundamental principles is threatened, a finance and accounting professional must consider a response to the circumstances. As a consequence of responsibilities to an employing organization, a finance and accounting professional may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A finance and accounting professional may face pressure to:

- ◆ Act contrary to law or regulation.
- ◆ Act contrary to technical or professional standards.
- ◆ Facilitate unethical or illegal earnings management strategies.
- ◆ Lie to, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:
 - ◆ The auditors of the employing organization; or
 - ◆ Regulators;
 - ◆ Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with.

For example: The financial statements; Tax compliance; Legal compliance; or Reports required by securities regulators.

Question 6

- (a) *ABC Ltd. having a networth of ₹ 80 crores and turnover of ₹ 30 crores wants to accept deposits from public other than its members. Referring to the provisions of the Companies Act, 2013, state the conditions and the procedures to be followed by ABC Ltd. for accepting deposits from public other than its members.* **(8 Marks)**
- (b) *State whether the following statements are correct or incorrect.*
- (i) *Debenture with voting rights can be issued only if permitted by the Articles of Association.*
 - (ii) *A bearer of a share warrant of a Company is not a member of the Company unless the Articles of Association so provide.*
 - (iii) *An insolvent may be a member of the Company.*
 - (iv) *A partnership firm may hold shares in a Company by holding shares in the individual names of the partners as joint holders.* **(1 x 4 = 4 Marks)**

- (c) *Ram Prasad is a retired teacher and due to his ill health he lives with his nephew at Delhi. He has a house at Delhi which he wants to gift to his nephew. Draft a Gift Deed for Ram Prasad.* **(4 Marks)**

Answer

- (a) **Acceptance of deposit from public:** According to section 76 of the Companies Act, 2013, a public company, having net worth of not less than 100 crore rupees or turnover of not less than 500 crore rupees, can accept deposits from persons other than its members subject to compliance with the requirements provided in sub-section (2) of section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe.

Provided that such a company shall be required to obtain the rating (including its networth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits.

Provided further that every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders in accordance with such rules as may be prescribed.

Since, ABC Ltd. has a net worth of ₹ 80 crores and turnover of ₹ 30 crores, which is less than the prescribed limits, hence, it cannot accept deposit from public other than its members. If the company wants to accept deposits from public other than its members, it has to fulfill the eligibility criteria of net worth or Turnover or both and then the other conditions as stated above.

- (b) (i) Incorrect
(ii) Correct
(iii) Correct
(iv) Correct

- (c) **GIFT DEED**

THIS DEED OF GIFT made on thisday ofBETWEEN Ram Prasad aged about.....years, son of resident of(hereinafter called "the Donor") of the one part AND, aged about.....years, son of, resident of(hereinafter called "the Donee") of the other part:

WHEREAS the Donor is the absolute owner in possession of the house (particulars to be specified) at Delhi.

AND WHEREAS the Donor has no issue and the Donee is the nephew of the Donor with whom the Donor has been living with.

AND WHEREAS the Donor out of natural love and affection for his said nephew, (the Donee), is desirous of making a gift of the said house to the Donee:

NOW THEREFORE THIS DEED WITNESSES as follows:

1. That in consideration on natural love and affection of donor for the Donee, the donor hereby voluntarily transfers to the Donee free from all encumbrances whatsoever ALL the said house with ALL rights of easement, privileges appurtenant thereto TO HOLD the same unto the donee absolutely.
2. That the Donor or his heirs shall have no interest in the said house hereafter.
3. That the Donee hereby accepts the said transfer made by the Donor.
4. That the value of the said house is lacs only.

IN WITNESS WHEREOF the parties hereto have signed this deed at in presence of the witnesses on the date and year first hereinabove written.

Signed and Delivered

By with the named 'Donor'

In the presence of.....

1.
2.

Signed and Delivered:

By the named Donee.

In the presence of.....

1.
2.

Question 7

Answer **any four** of the following:

- (a) With reference to the provision of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 explain the following:
- (i) Liability of an employer in case of transfer of an establishment to another person.
 - (ii) Whether the payment of contribution to provident fund of an employee, to be made by his employer, who has become insolvent, a preferential payment? **(2 + 2 = 4 Marks)**

- (b) *Shyam Dairy Ltd., a dairy products manufacturing company wants to set-up a new processing unit at Jaipur. Due to paucity of funds, the existing shareholders are not willing to fund for expansion. Hence, the Company approached XYZ Ltd. for subscribing to the shares of the Company for expansion purposes. Can Shyam Dairy Ltd. issue shares only to XYZ Ltd. under the provisions of the Companies Act, 2013? If so, state the conditions.* **(4 Marks)**
- (c) *To remove the Managing Director, 40% members of Tiger Farms Limited submitted requisition for holding an extra-ordinary general meeting. The Company failed to call the said meeting and hence the requisitionists held the meeting. Since the Managing Director did not allow the holding of the meeting at the registered office of the Company, the said meeting was held at some other place and a resolution for removal of the Managing Director was passed.*
Examine the validity of the said meeting and the resolution passed therein under the provisions of the Companies Act, 2013. **(4 Marks)**
- (d) *Intimidation threats may occur when an accounting professional may be prohibited from acting objectively by threats, actual or perceived. Give two examples of each such threats when the accounting professional is working as:*
- (i) *An Auditor;*
 - (ii) *An Employee in a Company* **(2 + 2 = 4 Marks)**
- (e) *Explain the principles of “Interpersonal Communication” with reference to:*
- (i) *Situational Context*
 - (ii) *Cultural Context* **(2 + 2 = 4 Marks)**

Answer

- (a) (i) **Liability in case of transfer of establishment:** Section 17-B of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 deals with the liability of transferor and transferee in case of transfer of establishment in regard to the money due under: (a) the Act; or (b) the Scheme; (c) Pension Scheme. In the case of transfer of the establishment brought in by sale, gift, lease, or any other manner whatsoever, the liability of the transferor and the transferee is joint and several, but is limited with respect to the period up to the date of the transfer. Also the liability of the transferee is further limited to the assets obtained by him from the transfer of the establishment.
- (ii) **Preferential payment of contribution of provident fund of an employee:** According to section 11 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, if the employer is adjudged an insolvent or if the employer is a company and an order for winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or the employer's contribution must be included among the debts which are to be paid in priority to all

other debts under Section 49 of the Presidency-Towns Insolvency Act, Section 61 of the Provincial Insolvency Act, Section 530 of the Companies Act, 1956 (now section 327 of the Companies Act, 2013), in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment provided the liability therefor has accrued before this order of adjudication or winding up is made.

This provision is substantial as it declares that PF dues shall be made a first charge on the assets of the establishment and shall be paid in priority to other debts.

(b) Issue of Further Shares: According to Section 62 (1) of the Companies Act, 2013 if at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares should be offered to –

- (i) the existing equity shareholders of the company as at the date of the offer, in proportion to the capital paid up on those shares.
- (ii) employees under a scheme of employees' stock option subject to a special resolution passed by the company and subject to such conditions as may be prescribed.
- (iii) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (i) or clause (ii), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

Since, in the given case Shyam Dairy Ltd. approached XYZ Ltd. for subscribing to the shares of the company for its expansion and XYZ Ltd. is neither an existing equity shareholder of the company nor an employee, Shyam Dairy Ltd., if it is authorised by a special resolution, may issue shares to XYZ Ltd. either for cash or for a consideration other than cash, subject to the condition that the price of such shares is determined by the valuation report of a registered valuer.

(c) Calling of Extra Ordinary General Meeting: Section 100 (2) of the Companies Act, 2013 makes it obligatory on the Board of Directors to convene an extra ordinary meeting of members if requisitioned by the stipulated number of members. In case of a company having share capital, such number of members who hold, on the date of requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting is the stipulation. Since 40% of members (presumed to have 40% voting right) submitted the requisition for the meeting, the board of directors has violated the provisions of law by not calling the meeting.

However, section 100 (4) of the Companies Act, 2013 provides that if Board fail to proceed to call a meeting within 21 days from the date of receipt of a valid requisition and to convene meeting within 45 days of the receipt of the requisition, the requisitionists may themselves call a meeting within 3 months of the date of the requisition.

Moreover, where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in *R. Chettiar v. M. Chettiar* that the meeting may be held anywhere else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the above desired provisions are duly complied with, the meeting held by the requisitionists and the resolution passed for removing the Managing Director of Tiger Farms Limited shall be valid.

- (d) (i) **Intimidation threat for finance and accounting professionals working as auditors:**
 - (a) Being threatened with dismissal or replacement;
 - (b) Being threatened with litigation;
 - (c) Being pressured to reduce inappropriately the extent of work performed in order to reduce fees;
- (ii) **Intimidation threat for finance and accounting professionals working as employees:**
 - (a) Threat of dismissal or replacement of the finance and accounting professional or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported for external use as well as for decision making purposes.
 - (b) A dominant personality attempting to influence the decision making process, for example with regard to the exclusion of irrelevant costs from projected cost estimates.
- (e) (i) **Situational context** deals with the “psycho-social-where” one is communicating. For example, an interaction that takes place in a classroom will be very much different from one that takes place in a Board room.
- (ii) **Cultural context** includes all the learned behaviours and rules that affect the interaction. If you come from a culture (foreign or within your own country) where it is considered rude to make long, direct eye contact, you will out of politeness avoid eye contact. If the other person comes from a culture where long, direct eye contact signals trustworthiness, then we have in the cultural context a basis for misunderstanding.