PAPER - 5 : BUSINESS LAWS AND ETHICS

SUGGESTED ANSWERS

SECTION - A

1.

(i) (A)

(ii) (A)

(iii) (C)

(iv) (B)

(v) (D)

(vi) (C)

(vii) (B)

(viii) (A)

(ix) (C)

(x) (C)

(xi) (A)

(xii) (D)

(xiii) (A)

(xiv) (A)

(xv) (C)

SECTION - B

2. (a)

1. Discharge by performance (Sections 37 & 38 of The Indian Contract Act 1872):

Performance is the usual mode of discharge of a contract. Performance may be:

(a) **Actual performance:** Actual performance is the fulfillment of the obligations arising from a contract by the parties to it, in accordance with the terms of the contract.

(b) **Attempted performance:** Offer of performance is also known as attempted performance or tender of performance. A valid tender of performance is equivalent to performance.

2. Discharge by agreement (Sections 62 & 63 of The Indian Contract Act 1872):

The parties may agree to terminate the existence of the contract by any of the following ways:

1. **Novation:** Substitution of a new contract in place of the existing contract is known as "Novation of Contract". It discharges the original contract. The new contract may be between the same parties or between different parties. Novation can take place only with the consent of all the parties.

   Example: A owes money to B under a contract. It is agreed between A, B and C that B should accept C as his debtor, instead of A. The old debt of A and B is at an end and a new debt from C to B has been contracted. There is novation involving change of parties.
2. **Alteration:** Alteration means change in one or more of the terms of the contract. In case of novation, there may be a change of the parties, while in the case of alteration, the parties remain the same. But there is a change in the terms of the contract.

3. **Rescission:** Rescission means "cancellation". All or some of the terms of a contract may be cancelled. Rescission results in the discharge of the contract.

   Example: A promises to deliver certain goods to B at a certain date. Before the date of performance, A and B mutually agree that the contract need not be performed. The contract stands discharged by rescission.

4. **Remission:** Remission means acceptance of a lesser performance than what is actually due under the contract. There is no need of any consideration for remission.

   Example: A has borrowed ₹500 from B. A agrees to accept ₹250 from B in satisfaction of the whole debt. The whole debt is discharged.

5. **Waiver:** Waiver means giving up or foregoing certain rights. When a party agrees to give up its rights, the contract is discharged.

   Example: A promises to paint a picture of B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

2. (b)

Bailment

Section 148 defines the term 'bailment' as the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The bailment consists of:

- **Bailor** – the person delivering the goods is called the 'bailor'; and
- **Bailee** – the person to whom the goods are delivered is called the 'bailee'.

If a person, already in possession of the goods of other contracts to hold them as a bailee, he thereby becomes the bailee and the owner becomes the bailor of such goods, although they may not have been delivered by way of bailment.

The following are ingredients of the bailment–

- There must be a delivery of specific goods by one person to another;
- The delivery must be for some purpose;
- The delivery must be upon a contract that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the bailor.

Difference between pledge and bailment

Section 172 of the Act defines a pledge to be the bailment of goods as security for payment of debt or performance of a promise whereas Section 148 provides that a bailment is the delivery of goods by one person to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the persons delivering them.

Alternate Answer

Basis of Distinction	Bailment (Section 148)	Pledge (Section 172
Definition	Delivery of goods from one person to another for a specific purpose, to be returned when accomplished.	Delivery of goods specifically as a **security** for the payment of a debt or performance of a promise.
Parties Involved	The parties are called the Bailor (giver) and the Bailee (receiver).	The parties are called the Pawner/Pledgor (giver) and the Pawnee/Pledgee (receiver).
Primary Purpose	Can be for safekeeping, repair, manufacturing, carriage, or temporary use.	Strictly limited to securing a loan, debt, or financial obligation.
Right to Sell Goods	The Bailee cannot sell the goods; they can only retain them or sue for unpaid fees.	The Pawnee can sell the goods after giving a reasonable notice if the Pawner defaults.
Right to Use Goods	The Bailee can use the goods if authorized by the terms of the bailment contract.	Pawnee has absolutely no right to use the pledged goods under any circumstances.

3. (a)

Conversion from private limited company into Limited Liability Partnership:

Para 1(b) of the third schedule defines the term 'convert' in relation to a private company converting into an LLP, as a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the private company to the LLP in accordance with the third schedule.

A company may apply to convert itself into a LLP if and only if

- there is no security interest in its assets subsisting or in force at the time of application; and
- the partners of the LLP to which it converts comprise all the shareholders of the company and no one else.

Upon the conversion of a private company into an LLP, the company and its shareholders, the LLP and the partners of the LLP shall be bound by the provisions of this schedule that are applicable to them.

The company has to apply with the Registrar by filing the following documents:

- A statement by all its shareholders in Form No. 18 and fees containing the following particulars–
  - The name and registration number of the company;
  - The date on which the company was incorporated; and
- Incorporation document and statement.

On the receipt of the above said documents, the Registrar shall register the documents subject to the provisions of the Act and the rules made there under. The Registrar may require the documents to be verified as he considers fit. The Registrar shall issue a certificate of registration in Form No. 19 as the Registrar may determine stating that the LLP is, on and from the date specified in the certificate.

The LLP shall inform the concerned Registrar of Companies within 15 days of the date of registration about the conversion and of the particulars of LLP in Form along with the fees.
If the Registrar is not satisfied with the particulars or other information furnished the Registrar may refuse to register. Against this order, an appeal may be made before the Tribunal.

3. (b)

International Law with respect to negotiable instrument in international law

Chapter XVI deals with the negotiable instrument in international law.

Section 134 provides that in the absence of a contract to the contrary, the liability of the maker or drawer of a foreign promissory note, bill of exchange, or cheque is regulated by the law of the place where he made the instrument and the respective liabilities of the acceptor and endorser by the law of the place where the instrument is made payable.

Example: A bill of exchange was drawn by A in California, where the rate of interest is 25% accepted by B, payable in Washington where the rate of interest is 6%. The bill is endorsed in India and is dishonored. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only; but if A is charged as drawer, A is liable to pay interest @ 25%.

Section 135 provides that where a promissory note, bill of exchange or a cheque is made payable in a different place from that in which it is made or endorsed, the law of the place where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient.

Example: A bill of exchange is drawn and endorsed in India but accepted payable in France, is dishonoured. The endorsee causes it to be protested for such dishonour and given notice in accordance with the law of France, though not in accordance with the rules herein contained in respect of bill which are not foreign. The notice is sufficient.

Section 136 provides that if an instrument is made, drawn, accepted or endorsed outside India, but in accordance with the law of India, the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or endorsement made thereon within India.

Section 137 provides that the law of any foreign country regarding promissory notes, bill of exchange and cheques shall be presumed to be the same as that of India unless and until the contrary is proved.

4. (a)

The new definition of wage under the Code specifically excludes –

1. any bonus payable under any law for the time being in force;
2. the value of any house-accommodation, or of the supply of light, water, medical attendance or other amenity;
3. house rent allowance;
4. remuneration payable under any award or settlement between the parties or order of a court or Tribunal;
5. any overtime allowance;
6. any commission payable to the employee;
7. any gratuity payable on the termination of employment;
8. any retrenchment compensation or other retirement benefit payable to the employee or any ex-gratia payment made to him on the termination of employment.
9. Any conveyance allowance or the value of travelling concession
10. Contribution paid by the employers to any pension and provident fund and interest accrued there on.
11. any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment;

4. (b)

Section 6 of the Payment of Gratuity Act, 1972 provides for filing nomination for receiving the gratuity after the death of the employee. The following are the points to be noted in respect of nomination–

1. Each employee, who has completed one year of service, shall make nomination in Form – F;
2. He may distribute the amount of gratuity payable to him under this Act amongst more than one nominee;
3. If an employee has a family at the time of making a nomination, the nomination shall be made in favor of one or more members of his family, and any nomination made by such employee in favor of a person who is not a member of his family shall be void;
4. If at the time of making a nomination the employee has no family, the nomination may be made in favor of any person or persons but if the employee subsequently acquires a family, such nomination shall forthwith become invalid and the employee shall make, within such time as may be prescribed, a fresh nomination in favor of one or more members of his family;
5. A nomination may, subject to above, be modified by an employee at any time, after giving to his employer a written notice in such form and in such manner as may be prescribed, of his intention to do so;
6. If a nominee predeceases the employee, the interest of the nominee shall revert to the employee who shall make a fresh nomination, in the prescribed form, in respect of such interest;
7. Every nomination, fresh nomination or alteration of nomination, as the case may be, shall be sent by the employee to his employer, who shall keep the same in his safe custody.

5. (a)

Resolutions and agreement:

Section 117 of the Companies Act, 2013 provides that a copy of every resolution or any agreement mentioned below together with the explanatory statement, if any, annexed to the notice calling the meeting in which the resolution is proposed, shall be filed with the Registrar within 30 days of the passing or making thereof in Form No. MGT - 14 with such fees as may be prescribed.

The copy of every resolution which has the effect of altering the articles and the copy of every agreement shall be embodied or annexed to every copy of articles issued after passing of the resolution or making the agreement.

This provision is applicable to the following-

(i) special resolutions,

(ii) resolutions which have been agreed to by all the members of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions,

(iii) any resolution of the Board of Directors or agreement executed by a company, relating to appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director,

(iv) resolutions or agreements which have been agreed to by any class of members but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a special majority or otherwise in some particular manner and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members,

(v) resolutions requiring a company to be wound up voluntarily passed in pursuance of Section 59 of the IBC, 2016,

(vi) resolutions passed in pursuance of sub-section (3) of section 179 provided that no person shall be entitled under section 399 to inspect or obtain copies of such resolutions,

(vii) any other resolution or agreement as may be prescribed and placed in the public domain.

5. (b)

Matters enquired by Statutory Auditors:

As per the **section 143 of the Companies Act 2013**:

For the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:–

1. whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
2. whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
3. where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debenture and other securities have been sold at a price less than that at which they were purchased by the company;
4. whether loans and advances made by the company have been shown as deposits;
5. whether personal expenses have been charged to revenue account;
6. where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statement with that of its subsidiaries and associate companies.

6. (a)

Case Study on Managerial Remuneration:

Provisions of the act:

As per Section 197 of the Companies Act, the total managerial remuneration payable by a public company to its directors—including the managing director, whole-time director, and manager—in respect of any financial year shall not exceed 11% of the net profits of the company.

Accordingly, a public company may pay remuneration to its directors, including executive and non-executive directors, within this 11% limit. This limit can only be exceeded with the prior approval of the members of the company by an ordinary resolution.

The remuneration payable to a director includes any amount paid for services rendered by him in any other capacity. Therefore, even if a director is paid for special services apart from directorial duties, such amounts must also be included in the total remuneration for the purpose of computing the 11% limit under Section 197(1).

However, there is an exception: if a director renders professional services, the remuneration paid for such services is not included in the 11% limit, provided that the following two conditions are met:

1. The services rendered are of a professional nature; and
2. In the opinion of the Nomination and Remuneration Committee, the director possesses the requisite qualifications for practicing the profession.

Conclusion and opinion:
In the present case, the service rendered by Mrs. Riya is professional in nature, and she possesses the necessary professional degrees from a competent authority. Therefore, her bill of ₹5 lakhs for the service shall not be included in the 11% limit as prescribed under Section 197(1) of the Act.

Hence, the bill may be honoured, treating Mrs. Riya's professional services as an exception under the law.

6. (b)
Rights of the shareholder under the Companies Act 2013:
A person who is a shareholder of a company has many rights under the Act. Some of them are:

(i) The right to vote at all meetings [Sec.47];

(ii) The right to requisition an extraordinary general meeting of the company [Sec.100];

(iii) The right to receive notice of a general meeting [Sec.101];

(iv) The right to appoint proxy and inspect proxy register [Sec.105];

(v) In the case of a body corporate which is a member, the right to appoint a representative to attend a general meeting on its behalf [Sec.113]; and

(vi) The right to require the company to circulate resolution [Sec.111].

(vii) To have certificate of share held ready for delivery to him within two months from the date of allotment [Sec.56]

(viii) To transfer shares subject to the provisions of the Act and Article of Association [Sec.44].

(ix) To inspect the Register of members and Register of debenture-holders and get extracts therefrom [Sec.94].

(x) To obtain, on request, minutes of proceedings at general meetings as also to inspect the minutes [Sec.119].

(xi) To apply to the Tribunal to have any variation of shareholders rights set aside [Sec.48].

(xii) To participate in the removal of directors by passing an ordinary resolution [Sec.169]

7. (a)
Ethics and relationship between ethics and laws:

1. Ethics is a set of rules that define right and wrong conduct. The term 'ethics' derived from Latin word 'ethos' which means character. Ethics is a social science which deals with concepts such as right and wrong, moral and immoral, good and bad behavior of dealing with one another.
2. Ethics is the basic concepts and fundamental principles of decent human conduct. It includes the study of universal values such as the essential quality of all men and women, human or natural rights, obedience to the law of land, concern for health and safety and increasingly, also for the natural environment.
3. Laws and ethics both serve similar purposes of guiding human conduct to make it conducive to civilized social existence. They enforce a sense of right and wrong. Laws refer to the set of codified

norms which are enforced by the state. They act as external obligations. On the other hand, ethics refer to the set of norms which guide our internal compass and judgements.

4. While laws apply uniformly to all, ethics can vary from person to person, and they change more frequently than laws. In case of a breach of law, the state is within its right to punish. Hence, they work as a medium of retributive justice. On the other hand, ethics are generally not enforceable.
5. The relationship between laws and ethics is a complex one. Many laws are representative of ethics of the time and have been shaped by what is considered ethical. The idea that everyone is equal before law is derived from the value that human is born equal. At the same time, laws have shaped ethics. They have been used to counter regressive doctrines.

6. From the above we can say that laws alone are not enough to promote ethical behaviour. Laws can never be so exhaustive to cover each and every scenario possible. Hence, there will always be scope for discretion. In such scenarios, ethical behaviour should come from within.

7. There are many scenarios where laws cannot exist, as we cannot have strict laws to scrutinize every small act of corruption. Even with laws, some unethical practices continue to exist such as violence against women. Laws and ethics are equally important and go hand in hand.

7. (b)

Value Chain”

Value chain is a visualization of complete business as a sequence of activities in which usefulness is added to the products or services produced and sold by an organization.

Management accountants provide decision support for managers in each activity of value chain.

The design of management accounting system has to take into consideration the decision needs of the managers. Also, it has to take into consideration the new themes and challenges that manager face currently which are as under:

1. **Customer focus:** The challenge for managers is to invest sufficient resources to enhance customer satisfaction. But every action of the organization has to result enhanced profitability for the organization.

2. **Key Success Factors:** These are non financial factors which have an effect on the economic viability of the organization. Cost, quality, time and innovation are important key success factors.

   Management accounting systems need to have provisions for tracking the performance of the organization and its divisions as well as competitors on these success factors.

3. **Continuous improvement:** Continuous improvement or kaizen is a popular theme. Innovation related to this area in costing is kaizen costing.

4. **Value Chain and Supply Chain Analysis:** Value chain as a strategic framework for analysis of competitive advantage was promoted by Michael Porter. Management accountants have to become familiar with the framework and provide information to implement the framework by strategic planners.

8. (a)

Case Study on Misconduct of agent:

Facts of the case & provisions of the act:

Section 220 of the Indian Contract Act, 1872, provides that an agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business in which he has misconducted.

In the present case, Mr. Ajay appoints his agent, Mr. Bijay, to recover ₹20,00,000 from Mr. Sujay and invest the same. Mr. Bijay recovers the full amount from Mr. Sujay and invests ₹18,00,000 in Fund-A, a secure investment, and ₹2,00,000 in Fund-B, a risky investment, which he ought to have known to be bad. Investing in Fund-B, despite being aware of its risky nature, amounts to misconduct on the part of Mr. Bijay, which he could have avoided. This act results in a loss of ₹25,000 to Mr. Ajay.

Conclusion and opinion:

(A) As an agent, investing ₹2,00,000 in Fund-B, which he ought to have known to be bad, clearly constitutes misconduct. Therefore, Mr. Bijay is entitled to remuneration for recovering ₹20,00,000 from Mr. Sujay and for properly investing ₹18,00,000 in Fund-A.

(B) However, he is not entitled to any remuneration for investing ₹2,00,000 in Fund-B, and he must compensate Mr. Ajay for the loss of ₹25,000.

8. (b)

The auditor's report under the Companies Act shall also state–

1. whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;
2. whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
3. whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
4. whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
5. whether, in his opinion, the financial statements comply with the accounting standards;
6. the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
7. whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;
8. any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
9. whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
10. such other matters as may be prescribed.