Paper-13: CORPORATE LAWS AND COMPLIANCE

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

This paper contains 3 questions. All questions are compulsory, subject to instructions provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

Question 1: Answer all questions **[20 Marks]**

(i) A public limited company has only seven shareholders, all the shares being fully paid-up. All the shares of one such shareholder are sold by the court in an auction and purchased by another shareholder. The company continues to carry on business thereafter. Discuss the liabilities of the shareholders of the company under the Companies Act, 1956. [3]

(ii) Describe the following in light of the Companies Act, 2013.
- **A. Global Depository Receipts**
- **B. Key Managerial Personnel**
- **C. Sweat Equity Shares** **[3]**

(iii) The Registrar of Companies issued a certificate of Incorporation actually on 8th January, 2014. However, by mistake, the certificate was dated '5th January, 2014'. An allotment of shares was made on 7th January, 2014. Could the allotment be declared void on the ground that it was made before the company was incorporated, as per Companies Act, 1956? [3]

(iv) The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities the company started a business according to the object clause, which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Answer the question whether company's contention is correct or not, as per Companies Act, 1956. [3]

(v) The Directors of a company registered and incorporated in the name 'Dharti Textile Ltd; desire to change the name of the company entitled 'National Textiles and Industries Ltd.'. Advise as to what procedure is required to be followed under the Companies Act, 1956? [3]

(vi) 'The institution of business exists only if it fulfills the society's expectations'. Comment. [3]

(vii) 'Business ethics helps to promote public reputation'. Comment. [2]

Answer:

(i) Out of the seven shareholders, the remaining six members would be personally liable for the debts of the company since the number of members has reduced below statutory minimum, viz. 7; provided the company continues to carry on business for more than 6 months.
However, only such of the remaining 6 members shall be liable who were cognisant of the fact of reduction in number of members; the members shall be liable only for such of the debts as have been incurred by the company after a period of 6 months [Sec 45 of Companies Act, 1956].

(ii)

A. **Global Depository Receipt -** 'Gobal Depository Receipt' means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorized by a company making an issue of such depository receipts.

B. **Key managerial personnel -** 'Key managerial personnel', in relation to a company, means:
   - The Chief Executive Officer or the managing director or the manager;
   - The company secretary;
   - The whole –time director;
   - The Chief Financial Officer; and
   - Such other officer as may be prescribed.

C. **Sweat Equity Shares -** 'Sweat equity shares' means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

(iii) The date of incorporation of the company is 5th January, 2014, since it is the date specified in the certificate of incorporation. This date is to be considered even though the certificate of incorporation was issued at a later date (Jubilee Cotton Mills Vs Lewis).
The date of allotment of the shares by the company is 7th January, 2014. Hence the allotment of the shares is valid since it has been made by the company after its incorporation.

(iv) The company's contention is not correct since, as per Sec. 35 of Companies Act, 1956, certificate of incorporation is conclusive, but not memorandum, and accordingly any illegal object contained in the object clause of memorandum does not become a legal object because of operation of Sec. 35.
Thus, if the business carried on by the company is an illegal one, the company, its directors, officers shall be liable for penalties as per law, and it shall not be a defense for the company that such business is contained in the memorandum of association.

(v) The steps that are to be followed by Dharti Textile Ltd. As per section 21 of Companies Act, 1956 for name change are enumerated below:

1. Confirm availability of proposed name by filing Form No. 1A with the Registrar along with prescribed fees of ₹ 500.
2. Pass a Special Resolution approving the change of name (if the proposed name is available).
3. File a copy of Special Resolution with the Registrar within 30 days of passing Special Resolution
4. Issue of fresh certificate of incorporation by the Registrar (on receipt of approval of Central Government).
5. Change of name to be effective only when fresh certificate of incorporation is issued by the Registrar.

(vi) According to Gandhiji, "a businessman has to act only as a trustee of the society for whatever he has gained from the society. Everything finally belongs to the society." Society bestows upon businesses the authority to own and use land and natural resources. In return, society has the right to expect that business organisations will enhance the general interests of consumers, employees and community.

Also, if a business organisation does not use its powers in a socially acceptable manner, that power will be lost in the long run. This is called as 'Iron Law of Responsibility'. Thus, the statement "The institution of business exists only if it fulfills the society's expectations" is correct.

(vii) It is in the long term interest of a business organisation to observe business ethics. Observing business ethics serves as a strategic branding tool in differentiating from competitors. It helps an entity to build trust with all its stakeholders. It also results in positive press coverage, thus enhancing its reputation with the public, customers and within the business community. Thus, the statement "Business ethics helps to promote public reputation" is correct.

Question 2: Answer any four questions **[60 Marks]**

Question 2(a):

(i) Star bank wants to acquire the financial assets of Moon Ltd. Is the bank or financial institution bound to give notice of acquisition of financial asset to the obligor? State the provisions in this regard with reference to SARFAESI Act, 2002.

(ii) The Board of directors of M/s. Intelligent Consultants Limited, registered in Chandigarh, proposes to hold the next Board meeting in the month of May, 2014. They seek your advice in respect of the following matters:

A. Can the Board meeting be held in Delhi, when all the directors of the company reside at Chandigarh?
B. Whether the Board meeting can be called on a public holiday and that too after business hours as the majority of the directors of the company have gone to Delhi on vacation.
C. Is it necessary that the notice of the Board meeting should specify the nature of business to be transacted?

Advise with reference to the relevant provisions of the Companies Act,1956.

[6+9 = 15]

Answer:

(i) The provisions relating to giving of notice of acquisition of financial asset by the bank or financial institution are explained below:

1. Notice of acquisition of financial asset to obligor [(Section 6(1)] :
The bank or financial institution may, if it considers appropriate, give a notice of acquisition of financial assets by any securitisation company or reconstruction company, to the concerned obligor and any other concerned person and to the concerned registering authority (including Registrar of Companies) in whose jurisdiction the mortgage, charge, hypothecation, assignment or other interest created on the financial assets had been registered.

2. Duty of obligor to make payments to the securitisation or reconstruction company [Section 6(2)]
Where a notice of acquisition of financial asset under sub-section (1) is given by a bank or financial institution, the obligor, on receipt of such notice, shall make payment to the concerned securitisation company or reconstruction company, as the case may be, and payment made to such company in discharge of any of the obligations in relation to the financial asset specified in the notice shall be a full discharge to the obligor making the payment from all liability in respect of such payment.

3. Money received by lender to be held in trust [Section 6(3)]

Where no notice of acquisition of financial asset under sub-section (1) is given by any bank or financial institution, any money or other properties subsequently received by the bank or financial institution, shall constitute monies or properties held in trust for the benefit of and on behalf of the securitisation company or reconstruction company, as the case may be and such bank or financial institution shall hold such payment or property which shall forthwith be made over or delivered to such securitisation company or reconstruction company, as the case may be, or its agent duly authorised in this behalf.

Hence the above procedures are required to be followed by Star Bank before acquisition of the assets of Moon Ltd.

(ii) Unlike section 166, there is no provision which requires that a Board meeting shall be held -

(a) only on a day that is not a public holiday;
(b) only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated;
(c) only during business hours.

The answer to the given problem is as under:

A. Section 301 requires that the register of contracts shall be placed in each Board meeting. However, the Department of Company Affairs (now Ministry of Corporate Affairs) has allowed the companies to remove the register of contracts to any place provided adequate notice to shareholders is given indicating the precise periods during which they can inspect the register of contracts. Thus, in the instant case the Board meeting can be held in Delhi, even though all the directors of the company reside in Chandigarh and the registered office is also situated at Chandigarh provided adequate notice to shareholders is given and the inspection of register of contracts is allowed to the shareholders.

B. As per section 288, if a Board meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned to the same day, time and place in the next week, or if that day is a public holiday, then to next succeeding day, which is not a public holiday. It means that an adjourned Board meeting can be held only on a day which is not a public holiday. However, there is nothing in the Act which prohibits the holding of an original Board meeting on a public holiday. Similarly, the Act does not require that a Board meeting shall be held only during business hours. However, the articles of the company may provide otherwise.

In the instant case, the directors intend to hold a Board meeting on a public holiday and after business hours. Unless the articles of the company provide otherwise, holding a Board meeting on a public holiday and after business hours is permissible.

C. No form or contents of notice has been specified by the Act. Agenda of a Board meeting is not required to be sent along with the notice of a Board meeting unless the Act requires a specific notice to move a resolution at a Board meeting.

Therefore, the notice of Board meeting need not specify the nature of business to be transacted, unless the articles otherwise require. However, the notice shall state the nature of business to be transacted in the following cases:

a) Appointment of a person as a managing director if he is already a managing director or manager in any other company (Section 316).
b) Appointment of a person as a manager if he is already a managing director or manager in any other company (Section 386).

Question 2(b):

(i) The Board of Directors of Xee Ltd. has agreed in principle to grant loan worth ₹ 38 lakhs to Mee Ltd. on the basis of the following information. Advise Xee Ltd. about the requirements to be complied with under the Companies Act, 1956 for the proposed inter-corporate loan to Mee Ltd.

Sl. No.	Particulars	Amount (₹)
(i)	Authorised share capital	1,00,00,000
(ii)	Issued, subscribed and paid up capital	50,00,000
(iii)	Free reserves	10,00,000

(ii) What are the consequences if a company makes inter-corporate loans and investments in contravention of the provisions of section 372A of Companies Act, 1956?

(iii) Super Limited, a banking company maintained the record of all transactions for a period of 5 years from the date of cessation of the transactions between the clients and the company. Decide whether the Company has fulfilled its obligation under the provisions of the Prevention of Money Laundering Act, 2002.

(iv) Examine the validity of appointment of Mr. Bonny, a minor, as a director of Max (Private) Limited, with reference to Companies Act, 1956.

[6+4+3+2 = 15]

Answer:

(i) Inter-corporate loans, investments etc. are governed by the provisions of section 372A. Firstly to determine whether a special resolution is required for making fresh investments. This can be determined as follows:

Particulars	Amount (₹)
Paid up capital of the company (A)	50,00,000
Free reserves (B)	10,00,000
Aggregate of paid up capital and free reserves (C)	60,00,000
60% of aggregate of paid up capital and free reserves (D)	36,00,000
Higher of (B) or (D), i.e. the ceiling limit for inter-corporate loans, investments etc. without requiring a special resolution	36,00,000
Proposed Loan to Mee Ltd.	38,00,000

Since the proposed Loan exceeds the ceiling given under section 372A, a special resolution is required. The company shall adopt the following procedure for making Loan to Mee Ltd.:

(a) Unanimous approval of the Board shall be obtained by passing a resolution at a Board meeting.

(b) A special resolution shall be passed in the general meeting.
- The notice of special resolution shall state the specific limits, particulars of the company to which loan is proposed to be given, specific source of funding and other relevant details.
- The company shall file a copy of special resolution with the registrar within 30 days of passing the special resolution.

(c) The company shall obtain the prior approval of the Public Financial Institution, if any, from whom it has taken a term loan.

(d) The company can make such investments only if no default in respect of Public deposits

is subsisting.

(e) The rate of interest on loan must not be less than the prevailing bank rate.

The prescribed particulars shall be entered in the register maintained under section 372A(5).

(ii) The provisions relating to contravention of section 372 A can be discussed as under:

1. Contravention of provisions relating to Register of loans etc.

The company and every officer of the company who is in default shall be punishable with fine of ₹ 5,000 plus ₹ 500 for every day till the offence continues.

2. Contravention of other provisions

The company and every officer of the company who is in default shall be punishable with imprisonment upto 2 years or with fine upto ₹ 50,000. However, if the loan is repaid in full, no imprisonment shall be imposed, and where the loan is repaid in part, the imprisonment shall be proportionately reduced. Further, any person who is knowingly a party to any contravention shall be liable to indemnify the company for the repayment of the loan, or the money which has become payable by the company.

(iii) As per section 12, the records of prescribed transactions shall be maintained for a period of 10 years from the date of such transaction (viz. the transaction between the clients and the banking company).

In the given case, Super Limited has maintained the records of transactions only for a period of 5 years from the date of cessation of the transactions. Thus, Super Limited has failed to maintain the records for the period of 10 years as prescribed under section 12. Therefore, Super Limited has defaulted in compliance of section 12.

(iv) Section 274 disqualifies certain persons to act as a director. However, a minor is not covered by this section. Also, there is no other provision in the Companies Act which disqualifies a minor from acting as a director.

However, a person can be appointed as a director only if he has been allotted DIN. A minor is not eligible to obtain DIN. Therefore, a minor cannot become a director in any company, whether public or private.

Question 2(c):

(i) Mr. Devesh was appointed as the managing director of Casual Industries Ltd. for a period of five years with effect from 1.4.2008 on a salary of ₹ 12 lakhs per annum with other perquisites. The Board of Directors of the company, on coming to know of certain questionable transactions, terminated the services of the managing director from 1.3.2011. Mr. Devesh termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of ₹ 5 lakhs on ad hoc basis to Mr. Devesh pending settlement of his dues. Discuss with reference to Companies Act, 2013, whether:

A. The company is bound to pay compensation to Mr. Devesh, and, if so, how much.

B. The company can recover the amount of ₹ 5 lakhs paid on the ground that Mr. Devesh is not entitled to any compensation, because he is guilty of corrupt practices.

(ii) The Board of directors of a beverage company producing several kinds of soft drinks, namely Priya Limited having a paid up capital of ₹ 25 lakhs appointed Nishi Limited as sole selling agent for all its products in India without prior approval of the company in general meeting without any condition that the appointment is subject to the approval of the company in general meeting. Nishi Limited, its directors and their relatives are not holding any shares in

Priya Limited. Discuss whether the appointment of Nishi Limited as sole selling agent is valid. State with reasons and reference to Companies Act, 1956, whether your answer will be different if:

A. Nishi Limited are appointed as sole selling agents only for the State of Maharashtra, or for whole of India; and

B. For only some of the products manufactured by Priya Limited or for the entire range of products.

(iii) Explain as per provisions of Companies Act, 1956, whether companies being amalgamated must be Companies registered under Companies Act, 1956.

[6+6+3 = 15]

Answer:

(i) As per section 202 of the Companies Act, 2013 -

- Compensation can be paid only to a managing director or whole time director or manager.
- The compensation payable shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for 3 years, whichever is shorter.
- Where the director has been guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company, he shall not be paid any compensation.

The answers to the given problem are as under:

A. The company is not bound to pay compensation to Mr. Devesh if he has been found guilty of any fraud or breach of trust. However, it is not proper for the company to withhold the payment of compensation on the basis of allegations, unless there is a proper finding on the involvement of Mr. Devesh in corrupt practices.
The compensation payable shall not exceed ₹ 25 lakhs, i.e. at the rate of ₹ 12 lakhs per annum for unexpired period of 25 months.

B. As per the decision in Bell v Lever Bros [1932] AC 161 House of Lords, the compensation of ₹ 5 lakh already paid by the company to Mr. Devesh cannot be recovered back if the company later comes to know that Mr. Devesh was guilty of serious breaches of duty and corrupt practices which would have entitled the company to end the employment of Mr. Devesh without any compensation. It was also held that the managing director was under no obligation to disclose to the company the breach of duty so as to give an opportunity to the company to remove him without paying any compensation.

(ii) The legal position of Priya and Nishi Ltd.:

A. Appointment of a sole selling agent must be made subject to the condition that his appointment shall be approved by the company in the first general meeting held after his appointment. 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 Cos 758; Department Circular No. 12(11)-CL.- VI/68, dated 6.11.1968].

B. The provisions of section 294 shall apply irrespective of the fact that -

- Appointment of sole selling agent is restricted to a particular area or extends to the whole of India;

- Sole selling agent is appointed in respect of some of the products or the entire range of products of the company.

In the given case, Nishi Ltd. has been appointed by the Board without any condition regarding approval of their appointment in the general meeting. Therefore, the appointment is invalid. It is immaterial as to whether the appointment of sole selling agent is for the State of Maharashtra or extends to the whole of India. Similarly, whether Nishi Ltd. is appointed for some of the products or entire range of the products of the company is immaterial.

(iii) For effecting amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). The benefit of section 394 is available only if the transferee company (i.e. new company) is a company within the meaning of Companies Act, 1956. However, the transferor company may be any body corporate, whether a company within the meaning of the Companies Act, 1956 or not. As such, a foreign company can be a 'transferor company' but not a 'transferee company'. Therefore, a scheme of amalgamation may provide for transfer of foreign companies to Indian Companies. Thus, it is not necessary that the companies being amalgamated must be companies registered under Companies Act, 1956; it is sufficient if the amalgamated company is a company registered under Companies Act, 1956.

Question 2(d):

(i) A Public Company secures residential accommodation for the use of its managing director by entering into a license arrangement under which the company has to deposit a certain amount with the landlord to secure compliance with the terms of the license agreement. Can it be considered as a loan to a director? Discuss with reference to Companies Act, 2013.

(ii) What are Special Courts? What are the powers of Special Courts with respect to offence of money laundering? Discuss with reference to prevention of Money Laundering Act, 2002.

(iii) Referring to the provisions of section 397, of Companies Act, 1956, examine whether the following acts of the company would amount to oppression:

A. Allotment of shares by directors of the company by which existing majority is reduced to minority.

B. Allotment of shares by directors of the company by which existing minority are made to majority

C. A share sale agreement was executed by Vansh, an NRI. The shares and transfer deed was handed over to an escrow agent. The sale was subject to RBI permission. The shares were not transferred for 6 years, since RBI permission was not received. Vansh, after waiting for a long period of time raises the issue and complains of oppression in the capacity of a member. As per the agreement the sale was unconditional. During the above period Vansh did not exercise any right as shareholder, nor did the company treat him as a member.

[5+4+6 = 15]

Answer:

(i) As per section 185 of the Companies Act, 2013, no company shall, directly or indirectly, make any loan to a director.

In the present case, the company has provided the managing director with a housing accommodation. It does not amount to a loan because of the following reasons:

- The company has not given any deposit or advance to the managing director. The amount deposited with the landlord cannot be said to be an 'indirect loan' to the managing

director.

- It is a usual practice to give a security deposit to the landlord with whom a rent or lease agreement is entered into. Thus, the company has made the security deposit on account of bonafide business considerations.
- It is of no concern of the managing director as to the terms on which the company secures residential accommodation for him.

It is the company and not the director who has entered into the lease agreement. Therefore, the company can at anytime use the accommodation for any other purpose and the managing director will have to vacate it, as and when desired by the company.

(ii) The provisions relating to Special Courts are contained in section 43 of the Act, as explained below:

A. Power of CG to designate Special Court(s) [Section 43(1)]:

The Central Government, in consultation with the Chief Justice of the High Court, shall, for trial of offence punishable under section 4 by notification designate one or more Courts of Session as Special Court or Special Courts for such area or areas or for such case or class or group of cases as may be specified in the notification.

In this sub-section, 'High Court' means the High Court of the State in which a Sessions Court designated as Special Court was functioning immediately before such designation.

B. Power of Special Court to try any other offence [Section 43(2)]:

While trying an offence under this Act, a Special Court shall also try an offence, other than an offence referred to in sub-section (1), with which the accused may, under the Code of Criminal Procedure, 1973, be charged at the same trial.

(iii) Issue of further shares amounts to oppression if it is proved that the idea of issuing further shares was to benefit one group to the detriment of the other [Piercy v Mill(s) & Co. (1920) 1 Ch 77]. Further issue of shares must be made for the benefit of the company. If the directors use their fiduciary power of issuing shares for an extraneous purpose like maintenance and acquisition of control over affairs of the company, it would amount to oppression [Needle Industries Case]. It is not open to directors to issue and allot shares in a manner by which an existing majority of shareholders is reduced to minority. If the issue of shares disturbs the existing majority of the shareholders and if it is not bonafide, it will amount to oppression [Re Gluco series (P) Ltd.]

A. Thus allotment of shares by directors of the company by which the existing majority is reduced to minority shall amount to oppression, if the directors acted malafide.

B. Allotment of shares by directors by which the existing minority shareholders are made majority shall amount to oppression, if the directors acted malafide.

C. When a share sale agreement was executed by an NRI and the scrips and transfer deed were handed over to an escrow agent as such sale was subject to RBI permission and full consideration money was received, then such a person after lapse of about 5 years, cannot raise an issue of oppression in the capacity of a member, as the transfer remained in abeyance awaiting RBI permission. On fact, the sale of shares was unconditional and unrestricted, and there was no clause to render the sale agreement infructuous after lapse of any stipulated time. Also, during the long intervening period neither the NRI exercised any right as a share holder nor the company treated him as a member [Rajiv Mehta v Group 4 Securities Hindustan (P) Ltd (1998), 18 SCL 89 CLB]. The facts are similar to the stated case and therefore, it can be said that there is no oppression.

Question 2(e):

(i) Solomon Ltd., a reputed Public Company, had advanced a certain sum of money to one of its Directors, Mr. Gold on certain terms and conditions and fixing the time limit for repayment thereof. Now, Mr. Gold has approached the company with a request to extend the time limit for repayment of the balance loan amounting to ₹ 12,00,000 by another 6 months. Who, as per Companies Act, 2013 is authorized to grant the extension as requested by Mr. Gold?

(ii) Briefly explain the meaning of the term 'investigation' and the kinds of investigations that can be ordered under the Companies Act, 1956?

(iii) The managing director of a company is convicted of an offence involving moral turpitude. He prefers an appeal against conviction. Can he continue as managing director pending disposal of the appeal? Can the appellate Court remove the disqualification or stay the same pending the disposal of the appeal? Discuss in light of Companies Act, 1956.

(iv) Explain briefly the powers of the Central Government to issue directors to the IRDA, as per IRDA Act 1999.

[2+4+5+4 = 15]

Answer:

(i) As per section 180(1) (d) of the Companies Act, 2013, approval of the members by passing a special resolution is required in case a company intends to extend the time for repayment of a debt payable by a director. In the given case, the unpaid amount of the loan of ₹12,00,000 amounts to debt payable by the director, Mr. Gold. And hence extension of time for repayment of debt of ₹12,00,000 requires approval of the members in general meeting by passing a special resolution.

(ii) Investigation of affairs of a company means investigation of all its business affairs, profit and loss account, and assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too.
The object of an investigation is to discover something which is not apparently visible to the naked eye. If the allegations are apparent from the balance sheet of the company, no investigation need be ordered. Prima facie evidence should lead to the conclusion that an investigation is necessary.

Kinds of investigations:
An investigation can be ordered by the Central Government under sections 235, 237 and 247 of the Companies Act, 1956. These investigations can be classified as follows:

- **A.** Investigations into affairs of the company (Sections 235 and 237).
- **B.** Investigation of ownership of the company (Section 247).

(iii) The grounds of vacation of office of a director are contained in section 283. However, a managing or whole time director is subject to additional grounds of vacation of office as contained in section 267.

If a whole time director or a managing director is convicted by a Court of an offence involving moral turpitude, he shall vacate his office (Section 267). Even a day's imprisonment or a mere fine of one rupee will attract this section if the offence involves moral turpitude.
Under section 283, when a director is convicted of any offence involving moral turpitude (resulting in imprisonment of 6 months or more), the order does not become effectual if an

appeal is filed by the director against the order of the Court. The order becomes effectual only when the appeal, as well as the second appeal, if any, is finally disposed off. However, no such privilege has been given under section 267. As such, the order of conviction under section 267 becomes effective as soon as order is pronounced. Thus, filing of an appeal against the conviction order would not save a whole time director or managing director from vacating the office.

The operation of section 267 takes effect as soon as conviction for an offence involving moral turpitude is recorded by a Court. The order of conviction does not on the mere filing of an appeal disappear and it cannot be held that section 267 applies only to a final order of conviction. As such, the managing director cannot continue pending the appeal. Further, he shall be eligible to be again appointed as a managing director only if the appellate Court suspends the order of conviction. As such, where the appellate Court suspends merely the execution of the sentence, the managing director shall remain disqualified for appointment [Rama Narang v Ramesh Narang (1995) 83 Comp Cos 194].

The facts of the present case are similar to the facts of the case discussed above. In the light of the decision given in the above case, it appears that the managing director cannot continue pending the disposal of appeal. However, if specific order is sought for removal of disqualification, the appellate Court may suspend the order of conviction, in which case he shall be eligible to be again appointed as a managing director.

(iv) The provisions of section 18of IRDA Act, 1999 may be explained as follows:

1. Nature of directions and their binding effect [Section 18(1)]
Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:
Opportunity to Authority before giving directions [Proviso to Section 18(1)]. The Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

2. 'Question of policy or not' to be decided by the Central Government [Section 18(2)]
The decision of the Central Government, whether a question is one of policy or not, shall be final.

Question 3: Answer any two questions **[20 Marks]**

Question 3(a):

(i) 'Corporate Governance is about promoting fairness'. Is it truly beneficial?

(ii) Write a short note on SA 8000. **[6+4 = 10]**

Answer:

(i) Corporate Governance deals with promoting corporate fairness, transparency and accountability. It is concerned with structures and processes for decision-making, accountability, control and behavior at the top level of the organizations. It influences how the

objectives of an organization are set and achieved, how risk is monitored and assessed and how performance is optimized. It is truly beneficial and it has the following benefits:

1. Improved Financial Performance: Socially responsible business practices are linked to positive financial performance.

2. Operating Cost Reduction: CSR initiatives can help to reduce operating costs.

3. Brand Image and Reputation: CSR helps a company to increase its brand image and reputation among the public, which in turn increase its ability to attract investors and trading partners. Proactive CSR Practices would lead to a favourable public image resulting in various positive outcomes like consumer and retailer loyalty, easier acceptance of new products and services, market access and preferential allocation of investment funds.

4. Increased Sales & Customer Loyalty: Businesses must first satisfy customer's key buying criteria, i.e., price, quality, safety and convenience.

5. Productivity and Quality: Improved working conditions, reduced environmental impacts or increased employee involvement in decision-making, leads to (a) increased productivity, and (b) reduced errors.

6. Ability to attract and retain employees: Companies perceived to have strong CSR commitments find it easier to recruit and retain employees, resulting in reduction in turnover and associated recruitment and training costs.

(ii) Social Accountability 8000:

- SA 8000 is a comprehensive, global, verifiable performance standard for auditing and certifying compliance with corporate responsibility.
- The heart of the standard is the belief that all workplaces should be managed in such a manner that basic human rights are supported and that management is prepared to accept accountability for this.
- SA 8000 is an international standard for improving working conditions. This standard is based on the principles of international human rights norms as described in International Labour Organisation Conventions, the UN Convention on the Rights of the Child and the Universal Declaration of Human Rights.
- The requirements of this standard apply regardless of geographic location, industry sector, or company size.

Question 3(b):

(i) Explain the importance of 'Ethics' for a finance and accounting professional.

(ii) If you are an accounting professional in a large multinational corporation, what steps would you undertake to create an ethical accounting environment? [5+5 = 10]

Answer:

(i) The importance of 'Ethics' for a finance and accounting professional may be discussed as two-fold:

1. Public Responsibility:

Finance and Accounts is perhaps the only business function which accepts responsibility to act in public interest. Finance and accounting professional's responsibility is not restricted to satisfy the needs of any particular individual or organization. While acting in public interest, it becomes imperative that the finance and accounting professional adheres to certain basic ethics in order to achieve his objectives.

2. To restore Public Confidence:

Various accounting scandals witnessed during the past few years have put a serious question mark on the role of the finance and accounting professional in providing the right information for decision making both within and outside their respective organizations.

As these finance and accounting professionals are in public practice, they should take reasonable steps to identify circumstances that could pose the conflict of interest and thus leading to follow unethical behavior.

(ii) The factors that are to be considered for creating an ethical accounting environment are:

1. **Employee Awareness:**
   - Make the employees aware of their legal and ethical responsibilities.
   - Train and motivate employees towards ethical behaviour.
   - Encourage employees to report cases of violations, frauds, manipulations, misappropriations, etc.

2. **Reporting of Frauds:** For reporting violations, manipulations, misappropriations, etc., -
   - without any fear of being reprimanded or fired,
   - provide facilities to employees.

3. **Whistle Blowers:**
   - A whistle blower is an employee /person who reports frauds, mismanagement or creating good accounting environment in a business enterprise. Fair treatment and appreciation of Whistle Blowers is necessary to check fraud.

Question 3(c):

(i) Write a short note on Memorandum of Understanding and Public Sector Enterprises.

(ii) Discuss the difficulties faced in Governance by state owned businesses. [5+5 = 10]

Answer:

(i) Memorandum of Understanding and Public Sector Enterprises:

After Independence, Public Sector Enterprises (PSEs) were set up in India with an objective to promote rapid economic development through the creation and expansion of infrastructure by the government. With different phases of development, the role of PSEs has changed and their operations have extended to a wide range of activities in manufacturing, engineering, steel, heavy machinery, machine tools, fertilizers, drugs, textiles, pharmaceuticals, petro-chemicals, extraction and refining of crude oil and services such as telecommunication, trading, tourism, warehousing, etc. as well as a range of consultancy services. While there have been many PSEs that have performed very well in competition with private sector enterprises, there are also many PSEs that have performed very poorly. In an economic environment that has changed considerably in the last two decades, the role of PSEs has changed and they have been increasingly guided to reduce their dependence on the Government. They have been listed on

the stock exchange and few of them have been privatized. The Government has provided PSEs the necessary flexibility and autonomy to operate effectively in a competitive environment. However, there are a few issues with the operation and management of PSEs which still persist and need to be attended to. There is a need to develop a mechanism on how government can get an efficient Indian presence in the sectors where the private sector investments are not forthcoming especially in strategic areas where developing capabilities is essential if India has to play its rightful role among the among the nations of the world.

(ii) Difficulties Encountered in Governance in state owned businesses

Routine governance regulations become applicable for public sector companies formed under the Companies Act, 1956 and come under the purview of SEBI regulations the moment they mobilize funds from the public. The typical organizational structure of PSUs makes it difficult for the implementation of corporate governance practices as applicable to other publicly-listed private enterprises. The typical difficulties faced are:

- The board of directors will comprise essentially bureaucrats drawn from various ministries which are interested in the PSU In addition, there may be nominee directors from banks or financial institutions who have loan or equity exposures to the unit. The effect will be to have a board much beyond the required size, rendering decision-making a difficult process.
- The chief executive or managing director (or chairman and managing director) and other functional directors are likely to be bureaucrats and not necessarily professionals with the required expertise. This can affect the efficient running of the enterprise.
- Difficult to attract expert professionals as independent directors. The laws and regulations may necessitate a percentage of independent components on the board; but many professionals may not be enthused as there are serious limitations on the impact they can make.
- Due to their very nature, there are difficulties in implementing better governance practices. Many public sector corporations are managed and governed according to the whims and fancies of politicians and bureaucrats. Many of them view PSUs as a means to their ends. A lot of them have turned sick due to overdoses of political interference, even when their areas of operations offered enormous opportunities for advancement and growth. And when the economy was opened up, many of them lacked the competitiveness to fight it out with their counterparts from the private sector.