

PAPER – 2 : BUSINESS LAWS, ETHICS AND COMMUNICATION

PART – I

*Answer **all** the questions*

Question 1

- (a) *Z rented out his house situated at Mumbai to W for Rs. 10,000 per month. A sum of Rs. 5 lacs, the house tax payable by Z to the Municipal Corporation being in arrears, his house is advertised for sale by the Corporation. W pays the Corporation, the sum due from Z to avoid legal consequences. Referring to the provisions of the Indian Contract Act, 1872 decide whether W is entitled to get the reimbursement of the said amount from Z.*

(5 Marks)

- (b) *State with reasons whether the following statements are correct or incorrect:*

- (i) *Employees' can relinquish their right to receive minimum bonus by an agreement with employer.*
- (ii) *Ratification of agency is valid even if knowledge of the principal is materially defective.*

(2 x 1 = 2 Marks)

- (c) *Pick out the correct answer from the following and give reasons:*

- (i) *X sells the goodwill of his retail store to Y for Rs. 5 lacs and promises not to carry on the same business forever and anywhere in India. Is the agreement :*

1. *Valid*
2. *Void*
3. *Voidable*
4. *Illegal*

(3 x 1 = 3 Marks)

- (ii) *A without B's authority let outs B's flat to C. Afterwards B accepts rent of the flat from C. It is an agency by :*

1. *Holding out*
2. *Estoppel*
3. *Ratification*
4. *Necessity*

- (iii) *P, obtains a cheque drawn by M by way of gift. Here P is a :*

1. *holder in due course*
2. *holder for value*
3. *holder*
4. *None of the above*

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Answer

- (a) Section 69 of the Indian Contract Act, 1872 provides that "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other".

In the given problem W has made the payment of lawful dues of Z in which W had an interest. Therefore, W is entitled to get the reimbursement from Z.

- (b) (i) **Incorrect:** According to Section 31A of the Payment of Bonus Act, 1965 any such agreement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of their right to receiving minimum bonus.
- (ii) **Incorrect :** Section 198 of the Indian Contract Act, 1872 provides that for a valid ratification, the person who ratifies the already performed act must have undefective and clear knowledge of the facts of the case. If the principal's knowledge is materially defective, the ratification is not valid and hence no agency.
- (c) (i) **Void :** As per Section 27 of the Indian Contract Act, 1872, an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of good, will not be carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.
- (ii) **An agency by ratification:** The acceptance of rent by B amounts to implied ratification by B of A's act of letting out flat to C.
- (iii) **Holder :** Yes, P can be termed as a holder because he has a right to possession and to receive the amount due in his own name.

Question 2

- (a) *UMC, Limited has only 7 shareholders having fully paid-up shares. On 30th April, 2009, all the shares of X (a shareholder of the company) are sold to Y (another shareholder of the company) in an auction by the order of the court. Z , (a shareholder of the company) was in USA for a business trip from January and thus he was not aware of the developments. The company continues to carry on its business thereafter. In December, 2009, the company borrowed a sum of Rs. 5 lacs from the Unique Bank. Later, the company was wound up and the assets of the company were not sufficient for the payment of its liabilities. The Bank filed a suit against Y and Z for recovery of the said loan from them. Decide the liabilities of Y and Z under the provisions of Companies Act, 1956. Would your answer be the same, if the said loan was taken in the month of March, 2009?* (5 Marks)
- (b) *State with reasons whether the following statements are correct or incorrect:*
- (i) *Issue of debentures with voting rights is not permissible.*
- (ii) *A private company is required to hold the statutory meeting.*

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- (c) *Pick out the correct answer from the following and give reasons:*
- (i) *Contracts entered into by a company after its incorporation and before it is entitled to commence business are called:*
1. *provisional contracts*
 2. *pre-incorporation contracts*
 3. *both 1 and 2*
 4. *None of the above*
- (ii) *The underwriting commission on shares must not exceed:*
1. *2.0 percent of the issued price of shares*
 2. *2.5 percent of the issued price of shares*
 3. *5.0. percent of the issued price of shares*
 4. *5.5 percent of the issued price of shares*
- (iii) *Which one of the following requires ordinary resolution ?*
1. *to change the name of the company*
 2. *to alter the articles of association*
 3. *to reduce the share capital*
 4. *to declare dividends*

Answer

- (a) The problem relates to reduction of membership below the statutory minimum. Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. If at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to Section 45 of the Act every such member who was aware of this fact would be personally and severally liable for all debts contracted by the company during the period and may be severally sued for all debts contracted after six months.

Accordingly in the given problem:

- (i) Y is personally liable for the payment of loan to the Unique Bank because the members of the UMC Limited continued to carry on the business of the company with that reduced membership beyond the six months period and Y knows this fact.
- (ii) Z is not responsible for any debt because he is not aware about the reduced membership.
- (iii) If the said loan was taken in March 2009, only the company is responsible for the payment of the loan. No members shall be personally liable for the repayment.

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- (b) (i) **Correct.** Reason: Given under Section 117 of the Companies Act, 1956, that no company can issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of any particular classes of business.
- (ii) **Incorrect.** Reason: Given under Section 165 of the Companies Act, 1956, that every Public Company limited by shares or limited by guarantee and having a share capital must hold a general meeting of the members of the company, which may be called the statutory meeting. Thus, Private Companies are not required to hold such a meeting.
- (c) (i) **Provisional Contracts.** Reason: As per Section 149 (4) of the Companies Act, 1956, contracts entered into by a company after its incorporation and before it is entitled to commence business are provisional only and are not binding on the company until the trading certificate is issued.
- (ii) **5.0 percent of the issued price of shares.** Reason: As per Section 76 of the Companies Act, 1956, the amount of commission should not exceed, in the case of shares, 5 percent of the price at which the shares have been issued or the amount or rate authorised by the articles, whichever is less.
- (iii) **To declare dividends.** Reason: The Companies Act, 1956 requires that the following matters, inter alia, have to be resolved by the company by a special resolution: (i) to change the name of the company (Section 21) (ii) to alter the articles of association (Section 31) and (iii) to reduce the share capital (Section 100). While for declaration of dividends, ordinary resolution is sufficient.

Question 3

J accepted a bill of exchange and gave it to K for the purpose of getting it discounted and handing over the proceeds to J. K having failed to discount it, returned the bill to J. J tore the bill in two pieces with the intention of cancelling it and threw the pieces in the street. K picked up the pieces and pasted the two pieces together, in such manner that the bill seemed to have been folded for safe custody, rather than cancelled. K put it into circulation and it ultimately reached L, who took it in good faith and for value. Is J liable to pay the bill under the provisions of the Negotiable Instruments Act, 1881 ? (5 Marks)

Answer

The problem is based upon the privileges of a 'holder in due course', Section 120 of the Negotiable Instruments Act, 1881, provides that no drawer of a bill shall in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally drawn. A holder in due course gets a good title of the bill.

Therefore, in the given problem, J is liable to pay for the bill. L is a holder in due course, who got the bill in good faith and for value (Ingham v Primrose).

Question 4

In 2009, the Electronics Corporation, a Public Sector establishment under the Department of Science and Technology, Government of Rajasthan starts to sell mobile sets manufactured by it, in addition to T.V. sets, so as to compete with private sector establishments of mobile sets

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in the market. The income from sale of mobile sets is 30 percent of the gross income of the Corporation. The employees of the Corporation went on strike to demand 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 10 percent of the gross income of the Corporation? (5 Marks)

Answer

The provisions of the Payment of Bonus Act, 1965 do not ordinarily apply to an establishment in public sectors. But Section 20 of the Payment of Bonus Act, 1965 provides that "if in any accounting year, an establishment in public sector may sell any goods produced or manufactured by it or it may render 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 establishment in public sector, then the provisions of the Payment of Bonus Act, 1965 shall apply in relation to establishment in private sector".

In the given problem, the demand of the employees is tenable in first case but it is not tenable in second case.

Question 5

R, a 57 years old district judge was appointed by the Central Government as Presiding Officer of the Employees' Provident Funds Appellate Tribunal for a period of five years. After three years, he (R) resigns from his office and ceases to work with immediate effect without handing over the charge to his successor, who was not appointed by the Government till that date. Examine the validity of R's action to cease work under the provisions of the Employee's Provident Funds and Miscellaneous Provisions Act, 1952. (5 Marks)

Answer

Section 7 F of the Employee's Provident Funds and Miscellaneous Provisions Act, 1952 provides that the Presiding Officer of an Employee's Provident Funds Appellate Tribunal may by notice in writing under his hand addressed to the Central Government, resign his office provided that the Presiding Officer shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

Hence, R's action is invalid as per above provisions. He should obtain permission from the Central Government to resign from his office.

Question 6

S is employed in Golden ice-cream factory, a seasonal establishment. The factory was in operation for four months only during the financial year 2009-10. S was not in continuous service during this period. However, he has worked only for sixty days. Referring to the provisions of the Payment of Gratuity Act, 1972 decide, whether S is entitled to gratuity payable under the Act. Would your answer be the same in case S works for 100 days?

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Answer

Section 2 A of the Payment of Gratuity Act, 1972 provides that where an employee, employed in a seasonal establishment, is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy-five per cent of the number of days on which the establishment was in operation during such period.

In the given problem, as per above provision, the factory was in operation for 4 months i.e, 120 days and S has to work for not less than 75% of the numbers of days on which the establishment was in operation that means atleast S has worked for 90 days. As in the problem S has worked for 60 days that are less than 90 days therefore he shall not be eligible for getting any gratuity in first case.

In the second case, since the S has worked for 100 days that are more than 90 days therefore, he is entitled for gratuity.

Question 7

J held 100 partly paid up shares of LKM Limited. The company asked him to pay the final call money on the shares. Due to some unavoidable circumstances he was unable to pay the amount of call money to the company. At a general meeting of the shareholders, the chairman disallowed him to cast his vote on the ground that the articles do not permit a shareholder to vote if he has not paid the calls on the shares held by him. J contested the decision of the Chairman. Referring to the provisions of the Companies Act, 1956 decide, whether the contention of J is valid? (5 Marks)

Answer

Section 181 of the Companies Act, 1956 lays down the grounds on which right of a shareholder to vote at the general meeting may be excluded. These are :

- (a) Non-payment of calls by a member;
- (b) Non-payment of other sums due against a member;
- (c) Where company has exercised the right of lien on his shares.

The article of association of the company also confirms one of the grounds stated in above section.

Hence J's contention is not valid and the decision of the chairman is valid.

Question 8

The object clause of the Memorandum of Association of RST Limited authorises it to publish and sell text-books for students. The company, however, entered into an agreement with Q to supply 100 laptops worth Rs. 5 lacs for resale purposes. Subsequently, the company refused to make payment on the ground that the transaction was ultravires the company. Examine the validity of the company's refusal of payment to Q under the provisions of the Companies Act, 1956. (5 Marks)

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Answer

In terms of Companies Act, 1956, the powers of the company are limited to:

- (i) powers expressly given by the Memorandum (which is popularly known as 'express' power) or conferred by the Companies Act 1956, or other statute and ;
- (ii) powers reasonably incidental or necessary to the company's main purpose (termed as 'implied' powers). The Act further provides that the acts beyond the powers of a company are ultra vires and void and cannot be ratified even though every member of the company may give his consent. [*Ashbury Railway Carriage Company vs Riche*].

The object clause enables shareholders, creditors or others to know what its powers are and what is the range of its activities and enterprises. The objects clause therefore is of fundamental importance to the shareholder, creditors and others.

In the given problem RST Limited is authorised to publish and sell textbooks for students. It has no power to enter into an agreement with Q to supply 100 laptops. Such act can never be treated as express or implied power of the company. Q is deemed to be aware of the lack of powers of RST Limited. In the light of above, Q cannot enforce the agreement or liability against RST Limited. Hence the refusal of the company for the payment to Q is valid. It is also supported by the *Ganga Metal Refining Company (Private) Limited CIT case (1963)38 CC*.

Question 9

K, a member of MNO Limited, appoints L as his proxy to attend the general meeting of the company. Later he (K) also attends the meeting. Both K (the member) and L (the proxy) voted on a particular resolution in the meeting. K's vote was declared invalid by the chairman stating that since he has appointed the proxy and L's vote has been considered as valid. K objects to the decision of the Chairman. Decide, under the provisions of the Companies Act, 1956 whether K's objection shall be tenable? (5 Marks)

Answer

The given problem is based on *Cousins vs International Brick Company Limited*. In the above case, the court held that a proxy is appointed to attend a meeting on an implied condition that he will attend if the person appointing the proxy is himself unable to attend the meeting. But if the person appointing also attends the meeting and casts the vote the proxy's stand will be cancelled. This is because the right of the shareholder to vote in person is paramount to the right of the proxy.

Hence, in the given problem, the decision of chairman is invalid. Here K's vote was valid, L's vote was invalid. Therefore K's objection is tenable.

Question 10

Explain the 'MCA 21 Program' introduced by the Government of India to develop computerized environment for company law. How does it serve the interest of all the stakeholders of a company, corporate professionals and the public at large? (5 Marks)

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Answer

MCA 21 project is an innovative project and initiative of the Ministry of Corporate Affairs carried out under the national e-governance programme of the Government with a comprehensive online portal to enable e-filing. This project covers all the services provided by the Registrar of Companies (ROC) starting from the incorporation of a new company. The project would provide e-services including names, registration of new companies, filing of various return and statutory documents under the Companies. The system would also enable online filing and access for statutory documents like memorandum of association, articles of association, certificate of incorporation etc.

The project serves the interest of all the key stakeholders corporate professional and the public at large as follows:

- Expeditious incorporation of companies
- Simplified and ease of convenience in filing of Forms>Returns/Statutory documents
- Better compliance management
- total transparency through e-Governance
- Customer centric approach
- Increased usage of professional certificate for ensuring authenticity and reliability of the Forms>Returns.
- Building up a centralized database repository of corporate operating enhanced service level fulfillment.
- Inspection of public documents of companies anytime from anywhere.
- Registration as well as verification of charges anytime from anywhere
- Timely redressal of investor grievance and to get easy access to relevant records by the public.
- Availability of more time for MCA employees for monitoring and supervision.

Professionals need no longer to visit the officers of ROC and would be able to interact with the Ministry using MCA 21 portal from their offices or home. They are able to provide efficient services to their client companies. Financial Institutions may easily find charges registration and verification. Proactive and effective compliance of relevant laws and corporate governance by the employees.

PART – II

*Answer **all** the questions*

Question 11

- (a) *What is meant by Corporate Governance? Explain the benefits of Good Corporate Governance.* (5 Marks)
- (b) *Explain the concept of Green Accounting System.* (5 Marks)

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Answer

- (a) Meaning According to J. Wolfensohn, President of the World Bank, "Corporate Governance is about 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 organizations. It influences how the objectives of an organisation are set and achieved, how risk is monitored and assessed and how performance is optimized.

Corporate Governance can also be defined "as the formal system of accountability and control for ethical and socially responsible organisational decisions and use of resources."

Benefits of good Corporate Governance:

1. Protection of investor interests and strong capital markets,
 2. Studies show clear evidence that good governance is rewarded with a higher market valuation.
 3. Ensure commitment of the board in managing the company in a transparent manner.
- (b) Green Accounting System is a new concept. It focused on addressing such deficiencies in conventional accounts with respect to the environment. If the environmental costs were properly reflected in the prices paid for goods and services then companies and ultimately the consumer would adjust market behavior in a way that would reduce damage to environment, pollution and waste production. Price signal will also influence behavior to avoid exploitation or excessive utilization of natural resources. Such measures would facilitate the approach of "Polluter Pay Principle". Removing subsidies that encourage environmental damage is another measure.

Question 12

Explain the various safeguards that should be adopted for overcoming threats faced by an accounting and finance professional. (5 Marks)

Answer

The following safeguards may reduce the threats faced by an accounting and finance professional to an acceptable level.

- I. Some of the safeguards created by the profession, legislation or regulation are as follows:
 - (i) Educational, training and experience requirements for entry into the profession.
 - (ii) Continuing professional development requirements.
 - (iii) Corporate governance regulations.
 - (iv) Professional standards.
 - (v) Professional or regulatory monitoring and disciplinary procedures.

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- (vi) External review by a legally empowered third party of the reports, returns, communications or information produced by concerned professionals.
- II. Safeguards in the work environment are as follows:
 - (i) The employing organization's systems of corporate oversight or other oversight structures.
 - (ii) The employing organisation's ethics and conduct programs.
 - (iii) Recruitment procedures in the employing organisation emphasizing the importance of employing high caliber competent staff.
 - (iv) Strong internal controls.
 - (v) Appropriate disciplinary processes.
 - (vi) Leadership that stresses the importance of ethical behavior and the expectation the employees will act in any ethical manner.
 - (vii) Policies and procedures to implement and monitor the quality of employee performance.
 - (viii) Timely communication of the employing organisation's policies and procedures, including any changes thereto, to all employees and appropriate training and education on such policies and procedures.

Question 13

State with reasons whether the following statements are correct or incorrect:

- (i) *Corporate Social Responsibility is closely linked with the principles of sustainable development.*
- (ii) *A good environmental practice improves corporate performance.*

(2½ x 2 = 5 Marks)

Answer

- (i) **The statement is correct.** Corporate Social Responsibility (CSR) 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. It is an integrated combination of policies, programs, education, and practices that 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.

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- (ii) **The statement is correct.** Environmental consideration have become a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organisational set up. A good environmental practice improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more saving; for example the process of recycling the waste. Thus environmental considerations play a key role in corporate strategy. Markets of new millennium will be able to create wealth if they respond to the challenges of sustainable development, as unsustainable products will become obsolete.

PART – III

Answer all the questions

Question 14

- (a) *Explain the functions of interpersonal communication.* (5 Marks)
- (b) *The statutory meeting of PQR Limited was held on 20th January, 2010 at its registered office at Kolkata. As a secretary of the company, draft the minutes of the statutory meeting of the shareholders of the company.* (5 Marks)

Answer

- (a) Interpersonal communication is important because of the following functions it achieves:
- (i) **Gaining Information:** One reason we engage in interpersonal communication is to gain knowledge about another individual. We attempt to gain information about others so that we can interact with them more effectively. We can predict better how they will think, feel and act if we know who they are. We gain this information passively, by observing them; actively, by having others engage them; or interactively, by engaging them ourselves.
 - (ii) **Building Understanding:** Interpersonal communication helps us to understand better what someone says in a given context. Words can mean very different things depending on how they are said or in what context. Content messages refer to the surface level meaning of a message. Relationship Messages refer to how a message is said. The two are sent simultaneously, but each affects the meaning assigned to the communication and helps us to understand each other better.
 - (iii) **Establishing Identity:** We also engage in interpersonal communication to establish an identity based on our relationships and the image we present to others.
 - (iv) **Interpersonal Need:** We also engage in interpersonal communication to express interpersonal need. William Schutz has identified three such needs: inclusion, control and affection. Inclusion is the need to establish identity with others. Control is the need to exercise leadership and prove one's abilities. Affection is the need to develop relationships with people.
- (b) Minutes of the Statutory Meeting
- Minutes of the proceeding of the statutory meeting of PQR Limited held on 20th January 2010 at 11.00 a.m. at the Registered Office of the company at Bada bazaar Kolkata.

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Mr. A Chairman
Mr. B Director
Mr. C Director
Mr. C Director
Mr. D Secretary

and 120 members and 30 proxies.

The secretary read the notice convening the meeting.

The Chairman welcomed the members and reviewed the activities of the company since its incorporation.

The chairman informed the members that a list of members of the company has been placed on the table for the inspection of members.

With the permission of the members, the Chairman took as read the Statutory Report.

Adoption of Statutory Report.

Proposed by Mr. B

Seconded by MR. C

“Resolved that the Statutory Report sent to the members with the notice of the meeting be and is hereby approved.”

All the pre-incorporation and provisional contracts were approved by the members of the company.

The meeting came to an end with a vote of thanks by the members and Chairman declared the meeting as closed.

Date

Secretary

Chairman

Question 15.

The Board of Directors of RSP Limited agrees with X to hire his (X's) flat at NOIDA on lease for ten years @ Rs. 20,000 per month for marketing office of the company. You are a senior executive of the Board and the Board asks you to prepare the lease deed for the agreement. Draft a lease deed. (5 Marks)

Answer

Format of a Commercial Rental Lease Deed

This Lease deed is made on this the day of 01 March 2010, between, X s/o Y, aged about 45 years, residing at Noida (hereinafter called the LESSOR); which expression shall, whenever the context so requires or admits mean and include his heirs, executors, Administrators and permitted assignees of the one part;

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And RSP Limited, Noida and herein after called the LESSEE Whereas, the lessor is the absolute owner of the property Noida (more fully described in the schedule hereunder and hereinafter referred to as 'Schedule Property') and Whereas, the Lessee is desirous of taking on lease the Schedule property for a period of 10 years and, whereas, the Lessor is agreeable for the same.

Now therefore this deed witnessed that in pursuance of aforesaid agreement and in consideration of the rent hereinafter contained, the Lessor hereby demises by way of lease who Lessee the Schedule Property for a period of from today, on the following terms and conditions:

1. That the lessee has undertaken to pay the lessor a monthly rent of Rs. 20,000/- (Rupees twenty thousand only) for the Scheduled Property on or before the 10 day of the following calendar month, and 10 months rent of Rs. 2.00 lac only deposit by the lessee on the date of execution of this lease; the receipt where of the lessor hereby acknowledges and agrees to repay the same without interest at the time of vacating the Scheduled Property, after deducting for damages, if any.
2. The lease shall commence from the 1st April 2010 and shall be in force for a period of 10 years.
3. The lessee shall use the Scheduled Property only for official purpose and shall not assign or sublease or use the Scheduled Premises for any unlawful purposes or alter the Scheduled Property without the consent of the lessor in writing.
4. During the lease period, the lessee shall pay the electricity and water charges to the respective departments promptly and obviate disconnection at any time.
5. The lessee shall deliver back in good condition as it was on the day of the occupation, the possession of the Scheduled Premises to the Lessor immediately upon the expiry of the said terms and conditions or on earlier termination.

Schedule:

1500 Squares of house bearing No. 56 at Noida measuring East to West 50 meter North to South 30 meter and bounded on: East by: Road, West by: Road, North by: Plot No. 55, South by: Plot No. 57.

In witness whereof the parties hereto have their respective hands and seals to this Agreement on the day, month, year first written above.

Witness

1. -----

Signature of Lessor

2. -----

Signature of Lessee

Question 16.

State the contents that are required for drafting an Annual Report of a Company.

(5 Marks)

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Answer

The following are the main contents are required for drafting an annual report of a company.

1. Leadership team: Including top management, management team.
2. Directors' report.
3. Financial statements- Balance sheet and Profit and Loss Account. Including auditor's report.
4. Corporate social responsibility.
5. Graphs-Independent financials/ Projection of Financial growth of company etc.