

**The Secretary to the Council of the Chartered Accountants of India Vs. B. Shantaram Rao, and ors.**

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**Court :** Karnataka

**Decided On :** Feb-18-1977

**Reported in :** AIR1977Kant124; 1977(1)KarLJ255

**Judge :** B. Venkataswami and ;K. Jagannatha Shetty, JJ.

**Acts :** [Chartered Accountants Act, 1949](#) - Sections 21(5), 21(6) and 22

**Appellant :** The Secretary to the Council of the Chartered Accountants of India

**Respondent :** B. Shantaram Rao, and ors.

**Advocate for Def. :** K.R.D. Karanth, Adv.

**Advocate for Pet/Ap. :** J. Sadashiva, Adv. for ;G.R. Ethirajulu Naidu, Adv.

**Judgement :**

Venkataswami, J.

1. this reference is by the Council of the Institute of Chartered Accountants (hereinafter referred to as Institute), under S. 21 of [Chartered Accountants Act, 1949](#) (hereinafter referred to as the Act), recommending that the respondent one Sri Shantharama Rao, a Chartered Accountant, be removed from the membership of the institute for a period of 3 months.

2. The respondent commenced his practice as an Accountant in or about the year 1934. He has been an auditor of a company by name Messrs. Mangalore Automobiles Ltd., incorporated under the provisions of the Companies Act. In respect of his audit concerning the year's 1963-64, 64-65 and 65-66, certain irregularities were noticed by the Registrar of Companies in Mysore, Bangalore, and the same were brought to the notice of the Institute by his letter-dated 11-12-1971. Since the Registrar failed to furnish the further particulars called for and to comply with the directions issued by the Institute, the said letter itself was treated as information received and disciplinary proceedings were initiated against the respondent, The disciplinary committee of the Institute after affording an opportunity to the respondent to furnish his reply to the charges as specified and holding an enquiry thereon, found the respondent guilty of professional misconduct under Cls. (6) and (7) of Part I of the Schedule to the Act. On receipt of the report of the disciplinary committee, the Council of the Institute considered the same along with all the relevant records, and passed a resolution in accordance with Sec. 21 (5) of the Act, recommending for the removal of the respondent from membership of the Institute for a period of 3 months, by way of punishment, and made the reference in question.

3. The said resolution reads:

'The respondent was guilty of professional misconduct under Cls, (6) and (7) of Part I of the Second Schedule to the [Chartered Accountants Act, 1949](#).

It was decided to recommend to the High Court that the name of the respondent be removed from the

membership of the Institute for a period of 3 months.'

4. The charges leveled against the respondent were those specified in the very letter of the Registrar of Companies, and run thus:

'(a) Accounts for 1963-64:

Inflation in value of closing stock:

It is seen from the slip in pencil attached to the inventory as on 31-2-1964 that to the value of spare parts etc. amounting to Rupees 55,955.80, 20% has been added thereby inflating the value by Rs. 11,191-16. But for this inflation, the profit and loss account would have revealed a loss of Rs. 10,045,80 instead of the profit of Rs. 1,145-36 shown in the printed accounts.

(b) Accounts for 1964-65:

i) Inflation in value of closing stock:

The slip attached to spare parts inventory (in pencil) as on 31-3-1965 reveals that to the value of parts and accessories 50% has been added thereby inflating by Rs. 15,810.78. Similarly 10% has been added to the value of Oil and Grease resulting in an inflation of Rs. 9.95.

ii) Revenue Expenditure capitalised:

In the accounts for 1964-65, out of the total expenditure on account of issue of spare parts to buses amounting to Rs. 47,466.25 shown under the head 'Garage Expenses Accessories' a sum of Rs. 45,161.77 was capitalised by Wider to 'Buses Account'. Though most of the expenses out of the sum transfer to are of revenue nature this capitalisation has been resorted to show profit in the accounts instead of loss

But for the above, two manipulations, the profit and loss account for 1964-65 would have shown a net loss of Rs. 51,583,91 instead of a profit of Rs. 9,388.59 exhibited in the printed accounts.

(c) Accounts for 1965-66.

Apart from the above manipulation, depreciation has been provided in all the years only at a very low rate at an average of about 5% in order to, avoid showing losses This is evidenced by the fact that as against the written down value of the buses of W. 1,77,000/- shown in the books as on 1-4-1965 written down value as per the income tax assessment order was only Rs. 37,681/-.'

5. The disciplinary committee of the Institute after enquiring into the charges, particularly in the light of the vague, explanations furnished by the respondent both in the written replies and the evidence, summarised its findings thus:

'To sum up, in regard to the valuation of closing stock. the respondent was grossly negligent in the performance of his duties in having adopted an arbitrary valuation Secondly, in accepting the capitalisation of a large sum of expenditure, which was in the nature of revenue; he was again grossly negligent in the performance of his duties. Thirdly, although the Company did not provide for depreciation as required by S. 205 and S. 350 of the Companies Act 1956 and although he was aware that the Company had under provided depreciation, he did not bring out this fact in his report and thereby failed to disclose a material fact known to him which was not disclosed in a financial statement but disclosure of which was necessary to make the financial statement not misleading. '

6. On behalf of the respondent-Accountant, Sri K. R. D. Karanth, learned counsel, while not seriously disputing the factual contentions reached by the disciplinary committee, fairly enough, urged two contentions: (1) that the proved charges would not amount to professional misconduct falling within the scope and ambit of Cls, (0)

and (7) of the Schedule, as concluded by the Council of the Institute; and (2) that in any event, having regard to, the special facts and circumstances, which shall be set out later the punishment awarded was excessive and disproportionate to the gravity of the charges proved.

7. Before proceeding to examine the above contentions it is relevant to, briefly advert to certain enunciations concerning the duties of auditors of Companies and their responsibility- toward shareholders of such Companies, with reference to some of the authorities cited

8. The Supreme Court in the case of Institute of Chartered Accountants of India v. P. K. Mukherjee, : [1968]3SCR330 , has observed thus:

' x x In our opinion, the legal Position of the auditor in the present case is similar to that of the auditor under the Indian Companies Act 1956. In such a case the audit is intended -for --- the- protection--' the shareholders and the auditor is expected to examine the accounts maintained by the Directors with a view to inform the shareholders of the true financial position of the Company. The Directors occupy a fiduciary position in relation to the shareholders and in auditing the accounts maintained by the Directors the auditor acts in the interest of the shareholders who are in the position of beneficiaries. In London Oil Storage Co. Ltd. v. Sear, Hasluck and Co. Dicksee on Auditing, 17th Edn. p. 632 Lord Alverstone stated as follows: 'He must exercise such reasonable care as would satisfy a man that the accounts are genuine assuming that there is nothing to arouse his suspicion of honesty and if he does that he fulfils his duty, if his suspicion is aroused, his duty is to probe the thing to the bottom and tell the directors of it and get what information he can.'

9. In Re London and General Bank (No. 2), (1895-2 Ch. 673) Lindley L. J. has observed:

'\* \* \* His business is to ascertain and state the true financial position of the company at the time of the audit and his duty is confined to that; but then comes the question how he is to ascertain that position? The answer is, by examining the books of the company. But he does not discharge his duty by doing this without enquiry and without taking any trouble to see that the books themselves show the company's true position, he must take reasonable care to ascertain that they do so; unless he does this his audit would be worse than an idle farce. Assuming the books to be so kept as to show the true position of a company, the auditor has to frame the balance- showing that position according to the books and to certify that the balance-sheet presented is correct in that sense. But his first duty is to examine the books not merely for the purpose of ascertaining what they do show but also for the purpose of satisfying himself that they show the true financial position of the company. An auditor, however, is not bound to do more than exercise reasonable care and skill in making enquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; He does not even guarantee that his balance-sheet is accurate according to the books of the company. If he did he would be responsible for error on his part; even if he were himself deceived -without any want of reasonable care on his part say, by the fraud or concealment of a book from him. His obligation is not so onerous as this. x x x'

10. Again In Re Kingston Cotton Mill Co. (1896-2 Ch. 279) Lopes L. J. observed:

' x x x It is the duty of an auditor to bring to bear on the work he has to perform that skill and care and caution which a reasonably competent, careful, and cautious auditor would use, What is reasonable skill, care' and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. If there is anything calculated to excite suspicion he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful.'

11. Keeping in view the above principles, we shall now turn to the contentions urged. On the first contention, it is to be seen that clauses (6) and (7) of the Schedule provide for two instances of what shall be deemed to be professional misconduct on the part of Chartered Accountants. They read:

'A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he-

(6) Fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity;

(7) Is grossly negligent in the conduct of his professional duties;

12. We have earlier referred to the charges leveled against the respondent and findings thereon. It is seen there from that the disciplinary committee had clearly found that the respondent had not only been grossly negligent in the performance of his duties but also failed to disclose a material fact known to him in that the financial statement had under-provided for depreciation in order to inflate the assets which would have the effect of misleading the shareholders in regard to the true state of affairs of the Company. We have also been taken through the evidence of the respondent- We are satisfied that no reasonable or satisfactory explanation has been furnished by him in this regard on the other hand, the explanations furnished are quite vague and evasive. Indeed, the evidence offered by him shows that he had not troubled himself to make any enquiry into these matters consistently with his duties and responsibilities towards the company's shareholders and thus has been guilty of a breach of duty owed to such shareholders. We are, therefore, clearly ad the view that the respondent is guilty of Professional misconduct within the meaning -of S. 22 read with Cls. (6) and (7) of the Schedule of the Act.

The contention, therefore, cannot prevail.

13. We now turn to the recommendation concerning punishment to be imposed under S. 21 0) of the Act. The Council of the Institute has recommended that a punishment of removal of the n of the respondent hum the rolls for a period of 3 months only. We have no doubt that such punish- was clearly warranted having regard to the nature of the charges leveled and the vague and unsatisfactory explanations offered by the respondent, the high standard of conduct expected of the members of such an important body as the Institute of Chartered Accountants. But at the same time we cannot ignore several extenuating circumstances clearly present in the case.

14. It is seen from the record before us that the audits in question were concerned with the years 1963 to 1966. For several years previous; to these he has been an auditor, of the Company concerned and the practice as regards -under-provision of depreciation in regard to valuation of stock -was the -same as' the years in point and the, same had not been found fault -with at any time. The complaint of the Registrar of Companies was made only on 11-12-1971 and the Proceedings have been banging on the Respondent since then. From the record, we have not been able to see anything, which would indicate that the respondent -was actuated by any motive of securing financial gain. It does not also appear the 'he was guilty of any act involving moral turpitude. He has been a practitioner since the year 1934 and is now stated to be on the verge of retirement from the profession. In this regard, he has stated in his evidence before the disciplinary committee, thus:

' \* \* I am very old member. I will tell you, I am one of the oldest members. The charges are framed against me, the faults that I have done - is rather very embarrassing to me.

Again,

'Until now I am not involved in any dispute. I started practicing in 1934. Now when I am on the verge of retirement the attack comes to me.'

15. Having regard to all these circumstances, we think ends of justice will be served if the respondent-Accountant is severely reprimanded under S. 21(2) of the Act, which we hereby do, for his gross Negligence and misconduct in the discharge of his functions as an auditor.

16. The Reference stands disposed of accordingly. We make no order as to costs.

17. Reference disposed accordingly.

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