

In Re: G. Natesan and ors.

In Re: G. Natesan and ors.

SooperKanoon Citation : sooperkanoon.com/773467

Court : Chennai

Decided On : Oct-01-1948

Reported in : 1949CriLJ917

Judge : Govinda Menon, J.

Appellant : In Re: G. Natesan and ors.

Judgement :

ORDER

Govinda Menon, J.

1. These groups of applications arise out of three calendar cases nos. 91, 92 and 93 of 1946 on the file of the Sub-Divisional Magistrate, Kumbakonam. In o. O No. 91 of 1946 there are nine accused, of whom eight were the directors of a banking company known by the name of the Sankara Ramanuja Sidhantha Paripalana Nidhi Ltd. Kumbakonam and they are being prosecuted for an offence under 8. 282, Companies Act for having wilfully made certain statements false in material particulars knowing the same to be false in the balance sheet of the company for the year ended 31st December 1938. The remaining accused was an auditor of the said company. In C. o. No. 92 of 1946 there are seven accused of whom Six were directors and one the auditor and they are prosecuted for a similar offence under 8. 282 Companies Act in connection with the balance sheet for the year ended 31st December 1939. In o. O. No. 93 of 1946, again there are nine accused

persons of whom eight were the directors and one the auditor and the offence enquired into against them is one under Section 282, Companies Act, relating to the balance sheet for the year which ended with 31st December 1940. Or. M. p. Nos. 1416, 1418 and 1420 of 1948 have been filed by the auditor-accused in the three calendar cases to quash the charge framed against him in each of them. Or. M. P. Nos. 1602, 1504 and 1606 of 1948 are by accused 2 in all the three calendar cases for quashing the charge framed against him under the same Section 282, Companies Act.

[2-3] Crl. M. P, NOS, 1666, 1666 and 1667 of 1948 are the three petitions filed by accused 3 in all the three calendar cases for quashing the charge framed against him under Section 282, Companies Act, for a similar offence, Crl. M. P. NO. 1657 of 1948 is by accused 4 and 7 respectively in O. O. No. 91 of 1946 for quashing the charge framed against them for the offence under the provisions of B. 282, Companies Act, Crl. M. P. No. 1659 of 1948 is by accused 4 in O. o. No. 93 of 1946 for quashing a similar charge and crl. M. p. Noe. 1660 and 1661 of 1948 are by the same individual who was accused 6 and 6 respectively in O. G. Nos. 92 and 93 of 1946 for quashing similar charge framed against him.

4. As all these petitions are connected and intertwined with each other and they arise out of similar transactions it will be more profitable and convenient to deal with all of them by the same order. In fact the learned Counsel appearing in these various cases have agreed on the main outlines of their arguments and the leading argument was by Mr. V. Rajagopalachari on behalf of the auditor accused in the miscellaneous petitions. The other learned Counsel while adopting in all essential aspects the arguments of Mr. V. Rajagopalachari have placed before the Court certain further arguments relating to each of the director petitioners separately. It will be, therefore, useful to give a brief resume of the genesis of the transaction which culminated in the proceedings against the Nidhi concerned of which the various accused were the directors and the auditor.

5. The Sankara Ramanuja Sidhanta Pari-palana Nidhi Ltd., Kumbakonam was a limited liability company doing banking business and incorporated under the Indian Companies Act. During the relevant dates, the various accused persons

were respectively the directors of the company. In April 1941 the business of the company was suspended and on 9th January 1942 as a result of the order passed by this Court in o. p. No. 202 of 1941 it was ordered to be compulsorily wound up. In the meanwhile on 5th October 1941 an interim auditor had been appointed to scrutinise the accounts of the company and he has submitted his report, Ex. p-18 on 5th November 1941. After the winding up of the company and the Official Receiver taking charge of its business, a misfeasance summons under Section 235, Companies Act, by Application No. 2337 of 1944 had been taken out and p. W. 2 in the lower Court was appointed auditor to scrutinise the accounts, the balance Sheets and the various other documents relating ' to the working of the company and submit a report regarding the way in which the affairs of the company had been going on. Exhibit P. 15 is the report dated 14-3-1945 submitted by P.w. 1 and thereafter the matter was referred to the Registrar of Joint Stock Companies for taking action under the appropriate provisions of the Companies Act. The Registrar of the Joint Stock Companies after taking the necessary legal opinion filed the three complaints out of which the three calendar cases arose, under Act. 237 for offences under Section 282, Companies Act. After examining the witnesses tendered for the prosecution in all the three cases which were tried together the learned Sub-Divisional Magistrate has framed the charges which are now sought to be quashed on the ground that the evidence let in does not disclose that any offence has been committed at all.

6. It is unnecessary to set out in any detail what ought to be the contents of a balance sheet for that matter is statutorily found in B. 132, Companies Act, The duties of an auditor with respect to the scrutiny of the accounts etc. of the company are also defined in Section 145, Companies Act. According to the prosecution, the auditor in these cases in signing the various balance sheets wilfully made false statements in material particulars knowing the same to be false and the same is the gravamen of the com. plaint against the directors also. It becomes, therefore, necessary to consider whether there were false statements, or material particulars wilfully made by the accused knowing them to be false. If all or any of three ingredients do not exist the accused cannot be held guilty of an offence under s. 282, Companies Act. The arguments of the learned Counsel ranged over a wide field regarding the duties and powers of an auditor and the

responsibilities of an ordinary director in a banking company for demonstrating that there is no title of evidence regarding any of the ingredients necessary for an offence under Section 283, Companies Act. The counsel for the petitioners invited my attention to the evidence especially of p. vs. 1 and 2. The other witnesses examined, namely, P. Ws. 3 to 5 are merely formal proving the various documents filed in the lower Court, The charges framed deal with three different matters each of which according to the prosecution makes the accused persons guilty of the offence under Section 282.

7. The grab of them is that there are defects and omissions in the classification of loans and securities and their verification. This is explained by elaborating that in the balance sheets of the three years, loans which according to the auditor were unsecured had not been specifically mentioned as such. Secondly, in these balance sheets the debts have not been separately demarcated as good, bad or unrealisable. Thirdly, the balance sheets did not disclose what were the amounts borrowed by the directors from the company or advanced to the directors during the course of the respective years and lastly, it is stated that the accrued but unrealised interest on the various loans has not been disclosed as an asset. The contention of the Public Prosecutor is that these matters have to be specifically and clearly shown in the balance sheet and the failure to do so would make the petitioners guilty of the offence complained against.

8. I shall deal with each of these heads separately and in serial order. Exhibit P-2 is the report of the auditor, p. w. 2 and the evidence of the witness is based entirely upon this document. In schedule 33 at p. 154 of Ex. P-2 it is stated on 7-4-1941 a sum of Rs. 28,737 out of the loans advanced in the year 1938 on the security of the produce of grain was outstanding without being guaranteed by any existing security. Similarly on the same date a sum of Rs. 11,454 is seen as outstanding out of the loans on the produce advanced in the year 1939. Likewise a sum of Rs. 86,959 was seen outstanding on 7-4-1941 out of the produce loans granted in the year 1940, P. W. 2 states that so far as produce loans were concerned he verified all the loans which were in the town and to which he was taken and he treated them as existing assets. He treated as unsecured loans such of them about which there is no evidence that the Nidhi had any control over the produce which formed

the primary security. He came to this conclusion as he did not have any evidence that there was any such security and on asking for the records they were not forthcoming. Since there was nothing to show that the original stock was ever replaced, he came to the conclusion that these outstanding loans were unsecured ones on 7-4-1941. Again he states, that with regard to the produce loans, he examined the promissory notes, pledge receipts and appraising forms and found them satisfactory so far as the documents were concerned. He inspected the physical stocks in the bank, but he did not contact any person who had taken loans on security of stocks outside the town and did not verify those stocks as he was told by the clerk Krishnamachari that there was no necessity to do so but he did not take a statement from the clerk. P. W. 2 also stated that he cannot say that the stock or produce was not in existence on the dates of the balance sheets in question and the reports of the auditors on those balance sheets are not correct. In view of this state of evidence, it is impossible to say that the produce loans outstanding are unsecured. P. W. 2 admits that he did not inspect the various places where produce was stored or stocked to satisfy himself about their existence or not. Unless it is shown by the prosecution that the produce as such did not exist and that the loans were falsely entered as secured, a criminal Court will not be justified in framing a charge on this evidence. In fact after the admission by P. W. 2 that he could not say that the stock or produce was not in existence on the dates of the balance sheets in question or that the report of the auditor on those balance sheets was not correct the lower Court had no jurisdiction to frame a charge that the produce loans were unsecured. It is not shown that on the date of the balance sheets, the produce did not exist as I have stated already. It was the duty of P. W. 2 before he submitted his report containing the allegation that the produce loans were unsecured, to have examined at least one or two of such borrowers and ascertain whether on the date of his investigation the security of the produce did or 'did not exist. The learned Public Prosecutor invites my attention to para. 20 of the report, Ex. p-2, wherein it is stated by P. W. 2 that in the case of produce loans there is no positive evidence that there was a pledge in the real sense of the word, the Nidhi having full possession of the produce. It is also stated that there is no evidence that there was any inspection as to the continued existence of the produce in good condition and the auditor simply came to the conclusion that

because paddy stocked in one and the same place without any movement or other interference for more than a year and a half would not be in good condition, it is necessary to infer that there was no pledge in most of the cases and that the Nidhi probably had a floating charge on the produce, if such produce existed at the time of the advance of the loan. Even if it were a floating charge it was obligatory upon the auditor to have ascertained whether in the godown at the time of his report there existed sufficient quantity of produce to cover the amounts lent by the company to any particular individual. Not having made any attempt to ascertain the existence or otherwise of such produce it is not open to the auditor to say that there was no pledge in the real sense of the term and as I have already remarked, in view of the definite admission made by p. w. a, that he cannot say whether the stock or produce was in existence or not, he is not justified in saying so. This item of charge ought not to have been framed by the lower Court. The auditor was dealing with a set of circum-Balance in April 1941 and according to him he makes a report about what should have been done in 1938, 1939 and 1940. In the absence of any verification by the auditor, the charge as regards the unsecured nature of loans being false in the various balance sheets cannot be sustained. It has not been shown that the statements in the balance sheets are in any respect false, and much less false to the knowledge of the auditor and the directors.

9. Before discussing the legality and validity of the other charges framed against the petitioners it is necessary to advert without much elaboration to the powers and duties of an auditor of a company as well as the directors of such an institution. Section 145, Companies Act, as referred to already, is a statutory enactment defining the powers of an auditor. This provision is to a large extent based upon the observations and dicta contained in the well-known decisions of the English Courts. In *re London and General Bank (no. 2)*, (1895) 2 Ch. 673, Lindley L. J. observes as follows:

It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly

declared, provided he discharges his own duty to the shareholders. 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 is he 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 inquiry 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 kept as to show the true position of a company, the auditor has to frame a balance sheet 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 shew, but also for the purpose of satisfying himself that they shew the true financial position of the company.

This case has been considered in *In re Kingston Cotton Mill Co. (No. 2)*, (1896) 5 Ch. 279 : 65 L. J. ch. 673 and Lindley L. J. in the Court of Appeal affirms and reiterates what was laid down in the earlier case and observes as follows;

I now come to the real question in this controversy, and that is, whether the appellants have been guilty of any breach of duty to the company. To decide this question it is necessary to consider (1) what their duty was: (2) how they performed it, and in what respects (if any) they failed to perform it. The duty of an auditor generally was very carefully considered by this Court in *In re London and General Bank* (No 2), 1895 2 Ch. 673 and I cannot usefully add anything to what will be found there, It was there pointed out that an auditor's duty is to examine the books, ascertain that they are right, and to prepare a balance sheet shewing the true financial position of the company at the time to which the balance sheet refers. But it was also pointed out that an auditor is not an insurer, and that in the discharge of his duty he is only bound to exercise reasonable amount of care and skill. It was further pointed out that in any particular case a reasonable amount of care and skill depends on the circumstances of that case, that If there is nothing which ought to excite suspicion, less care may properly be considered reasonable than could be so considered if suspicion was or 'ought to have been aroused.

These are the general principles which have to be applied to cases of this description. I protest, however, against the notion that an auditor is bound to be suspicious as distinguished from reasonably careful. To substitute the one expression for the other may easily lead to serious error.

The company's articles of association contain special regulations relating to auditors, see Articles 12, 140, but they do not impose upon the auditors any more onerous duties than those I have already mentioned.

The learned Lord Justices in the Court of Appeal accepted the arguments of Mr. Haldane, as he then was, that a mere error of judgment on the part of an auditor is not enough. Lopes L.J. also considers this question in the same strain as Lindley L.J. and observes at page 288 in *In re Kingston Cotton Mills Co. No. 2*, (1896) 1 Ch. 279 : 65 L.J. 678:

They are very fully described in *In re London and General Bank Ltd.*, (1896) 2 Ch. 279 : 65 L.J. 673 to which judgment I was a party. Shortly they may be stated thus. It is the duty of an auditor to bring to bear on the work he has to perform that skill, 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 watchdog but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations provided he takes reasonable care. 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.

Both these cases were again considered in very great detail in *In re City Equitable Fire Insurance Co.* (1925) 1 Ch. 407 : 94 L.J. 445, where Mr. J. as he then was, refers in detail to the observations of Lindley L.J. that an auditor has nothing to do with the prudence or imprudence of making loans with or without security. He must, of course, take care that he does not bring into his balance sheet at face value a debt that is not a good one. At p. 609 Pollock M.B. in confirming the

judgment of the Master J. in the Court of Appeal refers to and accepts the dictum contained in *In re Kingston Cotton Mill Co.*, (1896) 3 Ch 279 : 6 L. J. Ch. 678 and further observes that in the words of Sargeant L.J the duty of an auditor is verification and not detection. The learned Master of the Bench discussed the matter in great detail and came to the conclusion as was done by the Court of appeal 80 years prior to that date. These principles are so well established in English Courts and have been consistently followed in our Courts that there can be no dispute regarding them, Applying these principles to the facts of the present case, on the evidence of P. W. 2, I am not able to find that the auditor accused in this case has in any way failed to act according to the strict confines of the duty imposed upon him. On the other hand, even according to the evidence of P. W. 2, the auditor has done what is expected of him.

10. The next question is whether the balance sheets in question have disclosed the nature of the bad and doubtful debts of the company. According to the articles and memorandum of association as well as the evidence before the lower Court the Sankara Ramanuja Sidhantha Parthapalan Nidhi is a banking company in accordance with the provisions of s. 277 (f), Companies Act. P. W. 1 in his cross examination admits that the Nidhi is doing banking business. Form P which shows the necessary and essential requisites of the balance sheet of a banking company has been amended by Act xxx [30] of 1943 as a result of the observations in some of the decisions of the Bombay High Court.

11. Before the amendment there was a notification dated 16th January 1937 by the Government of India in the same terms as is now contained in Act XXX [30] of 1943, directing alteration in the Form F Sh. ni. That being the case and since it is admitted that this is a banking company in the balance-sheet of which it is not necessary to show such debts I do not think that there was any wilful omission in the balance sheet so far as this item is concerned.

12. The next point for consideration is whether it is obligatory to show in the balance sheet what exactly would be the accrued interest in a particular year. Schedule 14 of ex. p. 9 at p. 81 contains according to P. W. a, the amount of accrued interest for the years 1933 to 1940. It is found therefrom that the balance

sheets of the concerned years, namely, 1938 to 1940 do not show that any interest accrued was taken credit of for determining the dividends payable to the share holders. In this connection it is necessary to consider the admissions made by p. W. 2 in his cross-examination. He says:

accrued interest on the debts need not be shown separately and practice varied. Till the end of 1935 the Nidhi took credit for all interest accrued on debts. Then they made a change of policy and wanted to adopt the going concern basis of cash basis for interest receipts. This basis is sound for the distribution of profit.

Later on, he further admits that the share-holders were informed that the accrued interest on certain loans were not to be taken credit for unless actually credited, and this statement is reiterated in every balance sheet till 31st December 1939. Again this admission goes on to state that it is well known to the share-holders and the public that all accrued interest was not taken to the balance sheet though F. W. 2 states that in his opinion it is not a sound policy. He has necessarily to admit that he could not attack the bona fides of this policy. Further, two of the balance sheets in question have a note appended, that accrued interest has not been taken into consideration. In this state of circumstances, it is very difficult to see how any Court can say that either the directors or the auditor have in any way wilfully concealed any material fact about accrued interest from the balance sheet. In *Newton v. Birmingham Small Arms Co, Ltd*, (1906) 3 Ch. 578 : 75 L. J. Ch. 627, Buckley J. while discussing a similar matter observed as follows:

If the balance sheet be worded as to shew that there is an undisclosed asset, whose existence makes the financial position better than that shewn, each a balance sheet will not in my judgment, be necessarily inconsistent with the Act of Parliament. Assets are often by reason of prudence estimated, and stated to be estimated, at less than their probable real value. The purpose of the balance sheet is primarily to shew that the financial position of the company is at least as good as there stated, not to shew that it is not or may not be better. The provision as to not disclosing the internal reserve fund in the balance sheet is not, I think, necessarily fatal to these special resolutions.

Later on the learned Judge observes that if the auditor reports to the shareholders that in the balance sheet there was such a reserve fund, that would be sufficient. In this case, the note appended showing that the accrued interest has not been taken into consideration in fixing the dividend, is sufficient to bring home to the share holders the existence of such an asset. I am decidedly of opinion that this item of charge has necessarily no basis whatever.

13. It has then to be considered whether the fact that the loans taken by the directors in any particular year, if the same had been paid off during the course of the same year, should be specifically and separately mentioned in the balance sheet. It is not disputed that there is a statement in the balance sheet regarding loans taken by the directors in a given year outstanding at the end of each year; and it is admitted, that whatever was outstanding at the end of the year by way of loans to the directors has been mentioned in each year's balance sheet. P. w. 2 again, admits in cross-examination:

I do not think the balance-sheet is falsified by the non-mention in the balance sheet of the volume of loans issued to the directors at any time during the year. I do not think the omission is due to mala fides .but it was due to ignorance.

In addition he agrees

that the balance sheet is not a history of individual transactions closed during the year, except those of the directors whose history must be mentioned in the balance sheet even if the transaction is closed. Loans to directors ought not to be entered in the left hand column and it is not brought into the total and its non-mention will not affect the correctness of the balance sheet.

My attention has not been drawn by the learned Public Prosecutor to any provision of law or any observation in a decision to the effect, that the loans taken by a director in a particular year, which were repaid by him before the end of the year, should be mentioned as a separate item in the balance-sheet even though the business had been closed. It is no doubt necessary in order that the balance sheet may be a true and correct one, that all the necessary information regarding the financial status of the company and its working has to be given to the

shareholders and that the balance-sheet should contain how much money was outstanding as being loans to the directors at the end of a particular year; but in my opinion it is unnecessary to show the volume of business transacted with a director or directors, if the loans have been duly repaid within the course of the year. It is just possible, that a director or directors may be doing individually and separately business on very large scale, and during the course of such business, large amounts may have to be borrowed from a bank, of which he or they happen to be a director; but if the loans are properly paid off during the course of the year and they are not outstanding when the year ends, it is unnecessary to encumber the balance-sheet by showing details of all closed-up transactions that had taken place during the intervening period, since being the case it is not possible to say that any criminal offence has been committed by the directors or the auditor in not mentioning the details of the loans given to the directors.

14. In discussing the general liability of the directors for the so-called false statements referred to in the charge, it is necessary to consider what exactly the legal position of the directors is, vis-à-vis the company with regard to the criminal liability for their actions. In a recent case reported in *Pulin Chandra Daw v. Emperor* : AIR 1948 Cal 190, Chakravarti J., referred to the decision of the Privy Council reported in *Srinivas Mall v. Emperor*, 11 C. W. N. 100 : A.I.R. 1947 P. O. 135, where their Lordships quoted with approval the proposition laid down in an earlier case that:

Unless the statute, either clearly or by necessary implication, rules out mens rea as a constituent part of a crime, a person should not be found guilty of an offence against the criminal law unless he has got a guilty mind.

The learned Judge after quoting this passage observes as follows:

Be that as it may, it appears to us that the language used by s. 282 itself does import an element of mens rea when it speaks of the relevant statement being known to be false.

The decision in *In re City Equitable Fire Insurance Co. Ltd.*, (1925) 1 Ch. 407 : 94 L. J. 303, discusses the meaning of the term 'wilful' in relation to the actions of

the directors of a company. In *Doss v, Connell*, 1. L. R. (1938) Mad. 592 : A. I..E. 1938 Mad. 121 in considering whether, in the circumstances of a particular case the directors were guilty of wilful negligence Leach O. J. and Varadachariar J. have followed the dictum of Romer J., in *In re City Equitable Fire Insurance Co. Ltd.*, (1926) 1 Ob. 407 : 91 L. J. ch. 415, regarding the duties of directors and as to what amounts to wilful negligence, In adverting to the question whether a director is justified in trusting the officials of the company, this Court referred to the observations of Lindley M. B, in *In re National Bank of Wales Ltd.*, (1899) 2 ch. 629 : 68 L.J ch. 634, in the following terms:

Business cannot be carried on upon principles of distrust. Men in responsible positions must be trusted by those above them, as well as those below them, until there is reason to distrust them. We agree the care and prudence do not involve distrust: but for a director acting honestly himself to be held legally liable for negligence, in trusting the officers under him not to conceal from him what they ought to report to him appears to us to be laying too heavy a burden on honest businessmen.

They have also relied upon the observations of Lord Davey in *Dovey v. John Cory*, 1901 A. C. 477 : 70 L. J. Ch, 753:

I think the respondent was bound to give his attention to and exercise his judgment as a man of business on the matters which were brought before the board at the meetings of which he attended and it is not proved that he did not do so.

It seems to me that these dicta are applicable to the actions of the petitioners herein. The accused in this case are men of position and responsibility and some of them are, I am given to understand, members of the bar enjoying fairly good practice. One cannot attribute any wilful negligence or dishonesty to men in such positions if they depend upon and trust the permanent officials and the managing director of the company so far as the working of the company is concerned. The prosecution has not been able to show any mala fides or want of good faith on the part of any of these accused. All that might be laid at their door is per se the blame-if that could be called a blame at all-that they placed trust upon the

permanent servants of the company. It seems to me that they are not guilty of any false statement of any material particular wil-fully made and knowing the same to be false. Even accepting as fully correct and true the oral and documentary evidence placed before the lower Court, I do not think there are any materials, whatever, on which the charges can be framed under Section 282. Companies Act. This is a case of entire absence of evidence and the learned Sub-Divisional Magistrate was not justified in framing charges on the materials placed before him.

15. I would, therefore, quash all the charges and discharge the accused in the various petitions.

SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com