

# INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA A

v.

P. K. MUKHERJI AND ANR.

February 26, 1968

[J. C. SHAH, V. RAMASWAMI AND G. K. MITTER, JJ.] B

*Chartered Accountants Act 38 of 1949—S. 21 and Schedule, items (o), (p) and (q)—Chartered accountant appointed by company under Provident Fund Rules to audit accounts of the Fund—Writing to company disapproving certain transactions in contravention of Rules but not commenting on them in his report on the accounts—If guilty of professional misconduct—Whether owed duty only to company who appointed him or also to beneficiaries of provident fund.* C

A joint stock company had an employees provident fund scheme which was being managed by a board of trustees. The first respondent, a chartered accountant, was appointed by the board of directors of the company to audit the accounts of the Provident Fund for the years 1953 and 1954. During 1954 the trustees of the Fund made certain advances of over rupees six lakhs to the company in contravention of the Rules of the Fund. The company issued various cheques in repayment of the advances but, at the request of the company, the cheques were not cashed and were kept by the trustees. After receiving the cheques the trustees made book entries showing repayment of the advances though the cheques were uncashed. On May 25, 1955, the first respondent wrote to the company disapproving the advances as not being in accordance with the Rules as well as the fact that the cheques issued by the company in repayment were not cashed promptly. At a meeting of the Trustees on May 27, 1955 it was regretted that the cheques, were not cashed at the company's request and resolved that they should be returned to the company and interest charged from the date of issue of the cheques. D

The first respondent signed the statements of accounts of the Provident Fund for 1953 on May 14, 1954 and for 1954 on June 30, 1955 and certified them as "checked with the books and accounts produced and found correct". The second respondent filed a complaint against him with the Institute of Chartered Accountants of India alleging that as the auditor, he had failed to disclose in his certificate on the statement of accounts that advances were made to the company in contravention of Rules of the Fund or to draw attention to the fact that a large amount of cash was shown as cash in hand in the statements of accounts also in contravention of the Rules. After an enquiry under s. 21 of the Chartered Accountants Act, 1949, the Disciplinary Committee of the Institute found the first respondent guilty of professional misconduct under items (o), (p) and (q) of the Schedule to the Act and the Council of the Institute confirmed this finding and referred the case to the High Court for final orders. The High Court set aside these findings and absolved the first respondent of the charges of misconduct. E F

On appeal to this Court, G

HELD : Allowing the appeal :

(i) On June 30, 1955, when the first respondent signed the statement of accounts for 1954 he fully knew that a loan had been granted by the trustees to the company in violation of the Rules; and further, that cheques. H

- A received in repayment were not cashed and, indeed, were not intended to be cashed, and were issued by the Company for a false indication of adjustment at the end of the accounting year. In these circumstances it was the duty of the first respondent to point out in the statement of accounts that a major part of the cash in hand represented uncashed cheques, that the cheques were apparently given by the company for repayment of the loan and that the transaction was in violation of the Rules of the Provident Fund. His failure in not pointing out these facts constituted professional misconduct falling within cl. (c) of the Schedule to the Act. [336 A, E-G]

- (ii) It was no defence for the first respondent to say that he had disclosed the irregularity to the company by his letter dated May 5, 1955 and that he owed a duty only to the company which appointed him to audit the accounts of the Provident Fund but not to the beneficiaries of the Fund. On the contrary it was a breach of duty on his part not to have made a disclosure to the beneficiaries of the Provident Fund in the statement of accounts. The primary object of auditing the Fund was to apprise the beneficiaries of the true financial position of the accounts and investments made from time to time and in such a case the auditor is under a clear duty towards the beneficiaries "to probe into the transaction" and to report on their true character. [338 A-B]

- D CIVIL APPELLATE JURISDICTION : Civil Appeal No. 426 of 1965.

Appeal by special leave from the judgment and order dated December 5, 1962 of the Calcutta High Court in Matter No. 78 of 1959.

- E *H. R. Gokhale, R. K. P. Shankardas, H. K. Puri and K. K. Jain* for the appellant.

*M. C. Chagla, S. V. Gupte and K. Baldev Mehta*, for respondent No. 1.

*E. Udayarathnam*, for respondent No. 2.

The Judgment of the Court was delivered by

- F **Ramaswami, J.** This appeal is brought, by special leave, from the judgment of the Calcutta High Court dated December 5, 1962 in matter No. 78 of 1959.

- G Ananda Bazar Patrika Limited is a Joint Stock Company, hereinafter referred to as the 'Company' and has got an employees' Provident Fund Scheme which was being managed by a Board of Trustees. Respondent No. 1 is a Chartered Accountant and was appointed by the Board of Directors of the Company to audit the accounts of the Provident Fund for the years 1953 and 1954. It appears that in the year 1954 the Trustees of the Fund had made certain advances amounting to about Rs. 6,21,864/- to the Company in contravention of the Rules of the Fund. The Director of the Company issued various cheques in repayment of the advance, but at the request of the management of the Company the cheques were kept with the Trustees of the Fund uncashed and not credited in the account of the Fund. After receipt of the cheques

the Trustees of the Fund made book entries showing the repayment of the loan so granted to the Company, though in fact none of these cheques had been cashed when such entries were made. In his letter dated May 25, 1955 respondent No. 1 wrote to the Company as follows :

"It appears that certain loans were granted by the Trustees of the Fund to the Company in 1954 which although adjusted within the accounting year; does not appear to be in accordance with the Provident Fund Rules. We disapprove such transaction and believe it will not recur in future. Cheques issued by you to the Fund should also be cleared promptly."

After receipt of the letter from respondent No. 1 a meeting of the Board of Trustees was held on May 27, 1955 when a resolution was passed to the following effect :

"This meeting records with regret that the cheques amounting to Rs. 6,21,864/- could not be presented to the bank on the verbal request of the management of the Anand Bazar Patrika Ltd., this meeting considering all the relevant facts resolves that all the cheques be returned to the Company to the debit of the loan account bearing an interest of 6% per annum with effect from the date of issue of the cheques."

Respondent No. 1 signed the statement of Accounts ending December 31, 1953 on May 14, 1954 and the statement of Accounts ending December 31, 1954 on June 30, 1955. The statement was signed by the Trustees of the Fund and respondent No. 1 after signing the statements gave the following certificate :

"Checked with the books and accounts produced and found correct."

Though respondent No. 1 pointed out in his letter dated May 25, 1955 that loans were granted and adjustment was made during the accounting year, he did not disclose this fact in his note when he signed the statement of account on June 30, 1955 knowing fully well that the cheques were not only uncashed but were returned to the Company in pursuance of the resolution of the Trustees dated May 27, 1955. Respondent No. 1 also failed to point out in the statement of account that adjustment of loans was made by showing in a very vague manner cash in hand (Cheques and cash) as Rs. 6,21,864 and the proportion of the cheques to the cash was not specified. Later on Kishori Lal Dutta, respondent No. 2, President of the Employees' Union filed a complaint against respondent No. 1 before the Institute of Chartered Accountants of India, hereinafter referred to as the 'Institute'. It was alleged in

- A the complaint that (1) the loan granted to the Company was in contravention of Rule 12 of the Provident Fund Rules and the auditor failed to disclose this in the statement of account, and (2) the auditor failed to invite attention to the fact that huge amount was shown as cash in hand in the financial statement for the years 1953 and 1954 in contravention of Rule 11 of the Fund.
- B The complaint was referred by the Council of the Institute to the Disciplinary Committee for an inquiry under s. 21 of the Chartered Accountants Act (Act 38 of 1949), hereinafter called the 'Act', read with regulation made thereunder. The Disciplinary Committee made a report on September 13, 1958. The Disciplinary Committee found that the loans were admittedly granted by the Trustees in contravention of the Provident Fund Rules and respondent No. 1 should have brought out this fact in his report and that respondent No. 1 was guilty of not disclosing the fact that a large amount of loan was given out of the fund of the Provident Fund to the Company and that the cheques received in payment of these loans and shown as cash in hand "Cheques and cash" were not encashed at least upto the day on which he wrote the letter to the Directors *i.e.*, May 25, 1955 and the non-disclosure of this material information was an act of misconduct on the part of respondent No. 1. The Disciplinary Committee held that the loans were given in contravention of the Rules of the Provident Fund and failure to report on the default in clearing the cheques received in repayment of the loans amounted to a failure to report on a material mis-statement known to respondent No. 1. Accordingly the Disciplinary Committee held that respondent No. 1 was guilty of misconduct under items (o), (p) and (q) of the Schedule to the Act. The Council of the Institute agreed with the report of the Disciplinary Committee and held respondent No. 1 guilty of professional misconduct. Under s. 21 of the Act the matter was referred to the Calcutta High Court for final orders. By its judgment dated December 5, 1962 the High Court set aside the findings of the Disciplinary Committee as confirmed by the Council of the Institute and absolved respondent No. 1 of the charges of misconduct.
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- G It is necessary at this stage to examine the scheme of the material provisions of the Act. Section 2(1)(b) of the Act defines a "Chartered Accountant" as meaning "a person who is a member of the Institute and who is in practice." Section 6 lays down that no member of the Institute shall be entitled to practise unless he has obtained from the Council a certificate of practice. Section 8 deals with disabilities. Any person who incurs any one of the disabilities enumerated in sub-cl. (i) to (vi) of s. 8 shall not be entitled to have his name entered in or borne of the Register. Sub-clause (vi) deals with the disability in case where the chartered accountant is found on an inquiry to be guilty
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of conduct which renders him unfit to be a member of the Institute. Under s. 20(2) it is provided that the Council shall remove from the Register the name of any member who has been found by the High Court to have been guilty of conduct which renders him unfit to be a member of the Institute. Chapter V deals with the question of misconduct. It consists of ss. 21 and 22. Section 21 deals with the procedure of enquiries relating to misconduct of members of the Institute. It reads thus :

"21. (1) Where on receipt of information or on receipt of a complaint made to it, the Council is of opinion that any member of the Institute has been guilty of conduct which, if proved, will render him unfit to be a member of the Institute, or where a complaint against a member of the Institute has been made by or on behalf of the Central Government, the Council shall cause an inquiry to be held in such manner as may be prescribed, and the finding of the Council shall be forwarded to the High Court.

(2) On receipt of the finding, the High Court shall fix a date for the hearing of the case and shall cause notice of the day so fixed to be given to the member of the Institute concerned, the Council and to the Central Government, and shall afford such member, the Council and the Central Government an opportunity of being heard before orders are passed on the case.

(3) The High Court may, thereafter, either pass such final orders on the case as it thinks fit or refer it back for further inquiry by the Council and upon receipt of the finding after such inquiry, deal with the case in the manner provided in sub-section (2) and pass final orders thereon.

....."

Section 22 defines misconduct. It reads thus :

"For the purposes of this Act, the expression 'conduct which, if proved, will render a person unfit to be a member of the Institute' shall be deemed to include any act or omission specified in the Schedule, but nothing in this section shall be construed to limit or abridge in any way the power conferred on the Council under sub-section (1) of section 21 to inquire into the conduct of any member of the Institute under any other circumstances."

Clauses (o), (p) and (q) of the Schedule read as follows :

"A chartered accountant shall be deemed to be guilty of conduct rendering him unfit to be a member of the institute, if he—....."

A (o) fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading;

B (p) fails to report a material misstatement known to him to appear, in a financial statement with which he is concerned in a professional capacity;

(q) is grossly negligent in the conduct of his professional duties;"

Rules 11 and 12 of the Ananda Bazar Patrika Provident Fund provide as follows :

C "11. The Manager shall from time to time pay into the Bank approved by the trustees to the credit of an account to be styled 'The Ananda Bazar Patrika Provident Fund Account' all moneys received by him. All moneys to the credit of such account shall be dealt with only in accordance with these rules and regulations and  
D any or all portion of such moneys shall be withdrawn from such account only by cheques bearing the signatures of the Manager and one of the trustees."

E "12. All moneys not immediately required for the purpose of the fund shall from time to time be invested by the trustees at their discretion in any of the following securities, that is to say, of the rupee securities of the Government of India or any securities, the interest on which is or shall be guaranteed by the Government of India or in bonds, debentures, securities of or issued by Public municipal or local body or authority in India, with a power for the trustees at their discretion from  
F time to time to vary or to transpose such investment or for others of any nature hereinbefore authorised. So however, that the securities in which the contributions made by the subscribers, after the date of recognition of the Provident Fund and the interest on the accumulated balance of such contributions are invested are payable both in respect of capital and of interest in India."

G Rule 28 states :

"The accounts of the Fund shall be audited yearly by an auditor appointed by the Company."

H The question to be considered in this appeal is whether respondent No. 1 was guilty of professional misconduct falling within cls. (o), (p) or (q) of the Schedule to the Act. It is the admitted position in this case that respondent No. 1 signed the statement of account for 1954 on June 30, 1955. At the time when he signed

the statement he was aware that loans were granted by the trustees of the Fund to the Company in 1954 and cheques had been issued in repayment of the loan. This is apparent from the letter of respondent No. 1 dated May 25, 1955 addressed to the Company in which he pointed out that the loans granted by the trustees do not appear to be in accordance with the Provident Fund Rules and the cheques issued by the Company should be cleared promptly. As a sequel to this letter the trustees passed a resolution on May 27, 1955 that the cheques amounting to Rs. 6,21,864/- and odd were not presented to the Bank on the verbal request of the Company and that the cheques should be returned to the Company and the amount should be debited to the loan account bearing interest at 6% p.a. with effect from the issue of the cheques. It is manifest therefore that on June 30, 1955 when respondent No. 1 signed the statement of accounts he fully knew that a loan had been granted by the trustees to the Company in violation of Rules 11 and 12 and further that cheques received in repayment of the loan were not cashed and, indeed, were not intended to be cashed. In other words, the cheques were issued by the Company not with the intention of repayment of the loan by their being cashed but they really represented acknowledgement of the loan by the Company. In fact, the cheques had been returned to the Company uncashed by virtue of the resolution of the Board of trustees dated May 27, 1955 before the statement of account was signed by respondent No. 1. To put it differently, the cheques were apparently issued by the Company not so much for repayment of the loan as for a false indication of adjustment at the end of the accounting year. We are of opinion that in these circumstances it was the duty of respondent No. 1 to point out in the statement of account that a major part of the cash in hand represented uncashed cheques and that the cheques were apparently given by the Company for repayment of the loan and the transaction was in violation of Rules 11 and 12 of the Provident Fund Rules. We accordingly consider that the failure of respondent No. 1 in not pointing out these facts in the statement of accounts for the year 1954 constituted professional misconduct falling within cl. (o) of the Schedule to the Act. It is not necessary for us to express any opinion on whether the case also falls within cls. (p) and (q) of the Schedule.

On behalf of respondent No. 1 Mr. Chagla put forward the argument that since the cheques had already been given by the Company the loans stood cleared and, in any event, respondent No. 1 had already informed the Company of the irregularity in his letter dated May 25, 1955. It was therefore contended that there was no professional misconduct on the part of respondent No. 1. We are unable to accept this argument as correct. It is true that the cheques had been given by the Company before the close of

- A the year 1954 but respondent No. 1 knew that the cheques were not really intended to be encashed by the trustees. Respondent No. 1 also knew of the resolution of the trustees dated May 27, 1955 that the cheques were to be returned to the Company and the amount was ordered by the trustees to be entered and carried over to the loan account. It was also maintained by Mr. Chagla
- B that respondent No. 1 owed a duty only to the Company which appointed him to audit the accounts of the Provident Fund and there was no duty owed by respondent No. 1 to the beneficiaries of the Fund. It is not possible for us to accept this argument. Respondent No. 1 owed a duty to all the subscribers of the Provident Fund who were in the position of beneficiaries. It is not
- C correct to say that respondent No. 1 owed a duty only to the Company which had appointed him to perform the auditing. The contributors to the Provident Fund had a beneficial interest in the Fund and the primary object of auditing the Fund was to appraise them of the true financial position of the accounts and investments made from time to time. Respondent No. 1 therefore owed a duty to the contributors to the Provident Fund for making a true report
- D to them of the financial position. In other words, the auditing was intended for protection of the beneficiaries and the auditor was expected to examine the accounts maintained by the trustees with a view to inform the beneficiaries of the true financial position. The auditor is, in such a case, under a clear duty towards the beneficiaries "to probe into the transactions" and to report on their true character. In our opinion, the legal position of the auditor
- E 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 of 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
- F 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. Seear, Hasluck & Co.*,<sup>(1)</sup> Lord Alverstone stated as follows :

- G "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." (*Vide* also the observations in—'*In re : London General Bank (No. 2)*'<sup>(2)</sup>—'*In re : Kingston Cotton Mill Co. (No. 2)*'<sup>(3)</sup> and—'*In re : City Equitable Fire Insurance Co. Ltd.*'<sup>(4)</sup>).
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(1) Dicksee on Auditing., 17th Edn., p. 632.

(3) (1896) 2 Ch. 279.

(2) (1895) 2 Ch. 673.

(4) (1925) Ch. 407.



It was therefore no defence for respondent No. 1 in this case to say that he had disclosed the irregularity to the Company by his letter dated May 25, 1955. On the contrary it was a breach of duty on his part not to have made a disclosure thereof to the beneficiaries of the Provident Fund in the statement of accounts for the year 1954 which he signed on June 30, 1955.

For these reasons we hold that the charge of professional misconduct is established against respondent No. 1 falling under cl. (o) of the Schedule to the Act. The only question which now remains is the final order to be passed against respondent No. 1. In our opinion, the conduct of respondent No. 1 is wholly unworthy of a Chartered Accountant who is expected to maintain a high standard of professional conduct. The proper punishment would have been the removal of the respondent No. 1's name from the Register for a limited period but in view of the fact that the proceedings have been pending against respondent No. 1 for a long time, we think that the ends of justice will be served in this particular case if respondent No. 1 is severely reprimanded for his misconduct under s. 21(2) of the Act. We also direct respondent No. 1 to pay the cost of the appellant in this Court and in the High Court. We accordingly set aside the order of the High Court dated December 5, 1962 and allow this appeal with costs.

R.K.P.S.

*Appeal allowed.*