STATUTORY AND JUDICIAL PERSPECTIVES ON INVESTOR'S PROTECTION IN INDIA: WITH SPECIAL REFERENCE TO INSPECTION, INVESTIGATION AND AUDIT

By

RADHESHYAM PRASAD

(500015877)

COLLEGE OF LEGAL STUDIES

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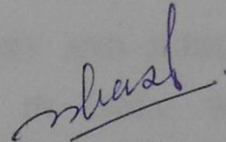
UNDER THE GUIDANCE OF

Dr. Ramjeet Singh Yadav
Advocate, Allahabad High Court
External Guide

Dr. Tabrez Ahmad
Professor
College of Legal Studies
Internal Guide

DECLARATION

"I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person nor material which has been accepted for the award of any other degree or diploma of the university or other institute of higher learning, except where due acknowledgment has been made in the text."



Date: 17 Jun 2015

Radheshyam Prasad
Research Scholar
SAP-500015877
College of Legal Studies
University of Petroleum &
Energy Studies, Dehradun

Dr. Tabrez Ahmad
Professor
College of Legal Studies
University of Petroleum and Energy Studies
Dehradun

Dr. Ramjeet Singh Yadav
Advocate
Allahabad High Court
Allahabad

CERTIFICATE

This is to certify that the thesis on "**STATUTORY AND JUDICIAL PERSPECTIVES ON INVESTOR'S PROTECTION IN INDIA: WITH SPECIAL REFERENCE TO INSPECTION, INVESTIGATION AND AUDIT,**" submitted by Mr. Radheshyam Prasad to **University of Petroleum and Energy Studies, Dehradun,** for the partial fulfillment for the award of degree of **Doctor of Philosophy in Law** is an original work carried by him under our joint supervision and guidance.

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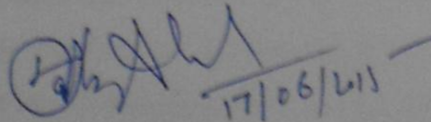

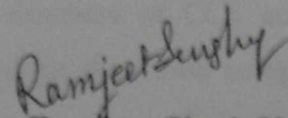

Dr. Tabrez Ahmad
Professor
Internal Guide
Date: Jun 2015

Dr. Ramjeet Singh Yadav
Advocate
External Guide
Date: 17 Jun 2015

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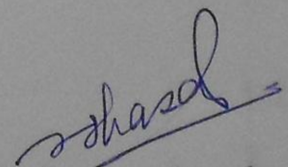

Dehradun

Date: 17 Jun 2015

Radheshyam Prasad

Research Scholar

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ABBREVIATIONS

AGM	:	Annual General Meeting
AIR	:	All India Reporters
All	:	Allahabad
AOA	:	Article of association
Art.	:	Article
Bom.	:	Bombay
BSE	:	Bombay Stock Exchange
C.A.	:	Chartered Accountants
C.J.	:	Chief Justice
Cal	:	Calcutta
Comp. Cas.	:	Company cases
DIP	:	Disclosure and investor protection
e.g.	:	exampli gratia(for example)
ed.	:	Edition
Gau	:	Gauhati
GOI	:	Government of India
H.P	:	Himachal Pradesh
i.e.	:	id est (that is)
Ibid	:	Bide (at the same place)
Infra	:	Below
J&K	:	Jammu and Kashmir
Kar	:	Karanataka
Ker	:	Kerla
MOA	:	Memorandum of association
M.P	:	Madhya Pradesh
Mad	:	Madras
NSE	:	National Stock Exchange
Ori	:	Orissa
p.	:	Page No.
P.C	:	Privy Council

s.	:	section
SC	:	Supreme Court
SCC	:	Supreme Court Cases
SCJ	:	Supreme Court Journal
SCR	:	Supreme Court Reports
SEBI	:	Securities Exchange Board of India
SFIO	:	Serious Frauds Investigation Office
Supra	:	Above
U.K.	:	United Kingdom
U.O.I	:	Union of India
vs.	:	versus
viz.	:	namely
Vol.	:	Volume
W.B	:	West Bengal

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V.B Rangaraj v. *V.B. Gopalkrishnan,* [(1992) 73 Comp. Cas. 201 (SC)] 57

Vakharia v. *Supreme General Film Exchange Co. Ltd.,* (1948) 18 Com. Cases 34 123

Vijay Kumar Narang v. *Prakash Coach Builders (P) Ltd.,* (2005) 128 Comp. Cas.976, CLB 28

Wood v. *Odissa Waterworks,* [(1889) 42 Ch. D. 636] 57

World India (P) Ltd v. *WPI Group Inc.,USA,* [2013] taxmann.com 238 57

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EXECUTIVE SUMMARY

In the modern industrial and commercial age, company has become one of the most important organizations in all business organizations. It plays a great role in the growth of national as well as international economy. India is a developing country which requires a healthy corporate atmosphere so that investment can be made by domestic as well foreign investors. As we know that capital is the backbone to run the companies and security market, so any kind of liquidity crunch will force the companies to become sick and it ultimately leads to its winding up. This will seriously impact the economic growth of the country. Many companies have been incorporated and today also their numbers are increasing fast by leaps and bounds. Company is an organization which is deemed as legal person. Though it is an artificial person but it has capacity to exercise all the powers and the functions as provided to a corporation and is liable for the act done on behalf of it.

There are large numbers of the persons such as shareholders, stakeholders, creditors, employees, customers, other investors etc. whose interest are attached with the company. It is not possible for all them to take part in the conduct and management of the affairs of the company, so few selected persons amongst the members of the company conducts and manages the routine affairs of the company which is known as Board of directors. The power for the general management of the company is vested in Board. They may exercise all such general management power but subject to the provisions made in Companies Act, Memorandum of Association (MOA), Article of Association (AOA) and resolutions passed either in the general and annual general meeting of the company.

However, it is found that there is the separation of powers between the ownership and management in the company. Yet the shareholders or members of the company are empowered to control and regulate the affairs of the company by the resolution passed

in the general meeting of the company, but it is not possible for the Board to take consent of all the members of the company for the routine day to day function of the company Therefore, several provisions have been made in the Companies Act, 2013 (in Companies Act 1956 also)to take all major decisions by the shareholders or the members in the general meeting of the company through a resolution passed either by simple majority or special majority as the case may be.

Generally, an investor has three objectives while investing his surplus money, namely safety of the investment of hard earned money, liquidity position of invested money, and a good return with least or at no risk on investment in selected securities. Therefore any investor needs protection of his investment. Protection of the interest of investors is paramount duty of a company through its Board of directors, who have invested in the company and in fact it is one of the main features of corporate governance. It also paves the way for long term sustainability of the company in modern period. There are several provisions enshrined to protect the rights of the investors but still many scams, serious frauds in capital market, fraudulent and unfair trade practices relating to securities markets insider trading, sudden stake selling, cartelization etc are occurring which has shaken the confidence of investors. They feel insecure to invest money in the capital market. Due to that a kind of fear is created in the mind of foreign investors to invest in Indian market. India is a developing country and capital is the backbone to run the companies and security market. Any kind of liquidity crunch will force the companies to become sick and it ultimately lead to winding up. That will seriously impact the economic growth of the country.

The following **legislations** protect the interest of investors and govern the capital securities markets in India:

(a) **The Companies Act, 2013**, which sets the code of conduct for the corporate sector in relation to issuance, allotment, and transfer of securities, and disclosures to be made in public issues.

(b) **Security and Exchange Board of India (SEBI) Act, 1992**, which regulates the security market and protect the investors.

(c) **The Securities Contracts (Regulation) Act, 1956**, which provides for the regulation of transactions in securities through control over stock exchanges.

(d) **The Depositories Act, 1996-** This provides for electronic maintenance and transfers of ownership of demat (dematerialized) shares. This Act provides for the establishment of depositories like NSDL and CDSL to curb the irregularities in the capital market and protect the interests of the investors and paved a way for an orderly conduct of the financial markets through the free transferability of securities with speed, accuracy and transparency.

(e) **The Prevention of Money Laundering Act, 2002**- object of this Act to prevent money-laundering and to provide for confiscation of property derived from money-laundering.

Scope- All Companies are governed by the Companies Act 2013. The public limited companies are, mostly, incorporated by raising capital from the general public by means of public issue. It is compulsory for all those companies to be listed in a recognized stock exchange and governed by the SEBI Act 1992. Therefore, the scope of this research is to carry out an in depth critical analysis of the protections of investors of public listed companies, available in the Companies Act 2013 and SEBI Act 1992, in the form of inspection, investigation and audit and to suggest suitable measures to be taken to prevent corporate frauds.

There is provision of inspection of books of account, other books and papers under Section 206, 207, 208, 220, 223 and 224 of the Companies Act, 2013 to check the fair working of a company. Sections 210 to 229 deal with the investigation of the affairs of a company if there is allegation that the company is not functioning as per the provisions of Companies Act.

The Central Government has also established the Serious Frauds Investigation Office (SFIO) under section 211, a specialized, multi-disciplinary organization to deal with

the speedy investigation of cases of serious and complex nature of corporate frauds. There is also provision of audit of the books of accounts and various papers to verify the correct nature of expenditure.

Sections 138 to 148 of the Companies Act, 2013 deal with audit and auditors. These three are important means to protect the interests of the investors so these have been dealt in detail with the help of important judicial pronouncements.

The courts of India ensure the functioning of the companies, accordance to the provisions of laws of land. Through several judicial pronouncements, it is also protecting the interests of the investors.

How far these statutory and judicial pronouncements are able to protect the interests of various major or minor investors in a public listed company, are the main focus of this research work. The entire work has been divided into following six chapters-

Chapter 1: **Introduction**- This chapter contains introduction about the subject matter, aim and objective of the study along with the methodology adopted in the research are also spelt out. The meaning, definition and objectives of an investment and various legislations which protect the interests of investors are also dealt briefly in this chapter.

Chapter II: Various protections available to Investors under the Companies Act, 2013 and the Security & Exchange Board of India Act, 1992

This chapter deals with the definition of investor, various kinds of investors such as shareholder, members, debenture holder, depositories etc, how to become the member of the company and various protections available to them under Companies Act, 2013 & the Security and Exchange Board of India Act 1992. Under the Companies Act, the protections available during incorporation and post incorporation of a company, protections through inspection, inquiry, investigation and audit of the documents and records, prevention of oppression and mismanagement & criminal and civil liabilities in case of contravention of the provisions of the Companies laws are discussed.

SEBI Act was implemented in 1992 with the prime objective to regulate the capital market of the country. The Preamble of this Act describes the basic functions of the Securities and Exchange Board of India as

"*...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.*"

SEBI is responsible to the needs of three groups, which constitute the market: the issuers of securities, the investors, the market intermediaries. SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. SEBI is empowered to check and control the occurrence of fraud in the capital market. Where the Board has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any of the provisions of the SEBI Act or the rules or the regulations made or directions issued by the Board there under, it may at any time by order in writing, direct Investigating Authority to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board. These roles of SEBI in protection of the investor's interest are also discussed in this chapter.

Chapter III: Inspection as a means of Protection of Investors

Inspection of documents of company related with investors, shareholders, creditors etc by company registrar, Reserve bank of India, officers appointed by the Central Government, board of director, committee of inspection are discussed in this chapter. Periodic inspection of important document of a company is necessary to know the fairness and transparent functioning of the company which is important for the protection of various investors. SEBI is also empowered to inspect any book, or

register, or other documents or records of any listed public company to examine the fairness, are dealt in this chapter.

Chapter IV: Investigation as a means of protection of investors

The Central Government is empowered to investigate the affairs of a company when circumstances so require. Such an investigation can be initiated by the administrative agency or its own initiative or upon the receipt of complaint from group of oppressive shareholders or any an order of court or at the company embodied in the special resolution. The inspectors are also appointed to investigate the affairs of a company on report by the Company Registrar. They submit the investigation reports to the Central Government, for further follow up action. This is again an important means to protect the interests of the investors, dealt in this chapter.

The Central Government has established the Serious Frauds Investigation Office (SFIO), a specialized, multi-disciplinary organization to deal with cases of corporate frauds in the Act of 2013. In this chapter, appointment, functions, powers of the inspector, role of the SFIO in serious fraud cases, follow up actions and various other provisions related with investigation are also dealt and how investigation serves as an important means to protect the investors is discussed in this chapter.

Chapter V: Audit as a means of protection of investors

This chapter deals with the meanings of audit, qualification for the appointment of auditors the minimum numbers of auditors for a company for audit work, their remunerations, power, functions, statutory duties, duty to exercise standard of care and skill, various criminal and civil liabilities and tenure etc. Audit has revealed many corporate frauds and may serve as important means of protection of investors.

Chapter VI: Conclusion and Suggestions : In this chapter, the research work is concluded and evaluated the provisions related with inspection of the documents, audit of books and papers and investigation of the affairs of the company, as embodied in

the Companies Act, 2013 and SEBI Act, 1992. On the basis of critical analysis, improvements in this area are also suggested. These are-

1. Inspector should be empowered to initiate investigation

Inspector prepares the inspection report after completion of inspection and submits to the Central Government. Now it is on the discretion of the Central Government to order for further investigation into the affairs of the company (section 210). Meantime, such default company will get time to destroy, mutilate, alter, falsified or secreted of such suspected documents. Therefore inspectors should be empowered to start investigation *suo moto* immediately along with the submission of inspection report to Central Government in order to prevent occurrences of serious fraud. Therefore, insertion of subsection (2) is suggested in Section 208 of the Companies Act, 2013, in this regard. Draft proposal of subsection (2) is indicated in ***bold italic*** font

208. Report on inspection made

(1) The Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

(2) When there is reasonable ground to belief that serious nature of fraud has occurred, the Registrar of inspector shall start investigation suo motu along with submission of inspection report to the Central Government and recommendation of investigation as mentioned in sub section (1).

2. In the Act, even there is no provision, as such, by which the **SFIO can *suo moto* investigate** into a case where an alleged serious fraud has been committed. The SFIO lacks a proactive approach in this regard. The SFIO has to wait for the Central Government's order for the reference to be made to it. So, if there appears

to be any fraud SFIO is toothless for taking any action against that particular company on its own motion. Therefore, SFIO should also be empowered to investigate *suo motu* like in the UK where the director of the Serious Fraud Office can *suo moto* investigate into a case.

4. SFIO should also be given power to **initiate prosecution** or imposing penalties when finds that the company is involved in fraud, like Serious Fraud Office (SFO) of U.K., which is an independent department which investigates and also prosecutes serious and complex fraud and corruption cases.

5. Inspector/SFIO should conduct fair investigation of any alleged corporate fraud with taking utmost care and vigilance then they should submit the detail report (preliminary or final) to the Central Government, in order to avoid huge loss to investors of stock listed company. Any recklessness conduct of inspector may cause adverse impact on the stock/share price of the company in the capital market and this may lead into huge loss to *bonafide* long term investors of the company.

6. **The appointment of the officers of the SFIO is on transfer and deputation basis** which may be changed and permanent appointment may be made solely for the purpose of this agency. The efficiency of the agency may also be impeded due to frequent transfers of its personnel. It is submitted that in order to maintain continuity a permanent and tenure based structure should be made. The members of SFIO should not be transferred to other government departments.

7. Severe civil liabilities should be imposed to auditors or auditing firm in cases of their involvement in corporate fraud if overlooked the account or abetted in the occurrence of fraud. An auditor also performs his duties as an agent of the shareholders, so he is expected to safeguard their interests. He must exercise his reasonable care and diligence in the performance of his duties. If he fails to do so and in consequence the principal suffers any loss, he may be liable to compensate loss caused to the company resulting from his negligence. If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section

145, of the Companies Act, 2013, he will be held liable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees under S.147 (2) of the Act. It is suggested to increase the maximum civil liability of an independent auditor up to rupees twenty five lakh and in case of an audit firm up to rupees one crore.

8. Criminal liability of an auditor to be made severe- If an auditor has contravened provisions of audit as incorporated in the companies Act knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punished with imprisonment for a term which may extend to one year and with fine as prescribed in Section 147 of the Companies Act. In order to make more deterrent effect, it is suggested that the punishment may be increased for a term which may be extended to three years in place of term of one year.

9. Provision of statutory duty of auditors towards third parties/society is lacking in the Companies Act, 2013. They have contractual relationship with the management of appointing company. Under privity of the contract, they are not answerable to any third party including the shareholders of the company. Therefore it is suggested that provision should be made in the Act, for the auditors of public companies to meet the requirement of its shareholders. This will bring transparency in the system and also create accountability of an auditor to the investors of the company.

10. Duration of Appointment of an independent auditor and an audit firm should be same- Section 139 (2) of the Act has prescribed for compulsory rotation of the auditors for the listed companies and certain class or classes of companies. Under this section, such companies shall not appoint an individual as auditor for more than one term of five consecutive years whereas an audit firm shall not be appointed for than two terms of five consecutive years. After the expiry of the period as aforesaid the auditors are required to be rotated. It is suggested that Audit firm should also be appointed for five years instead of two terms of five consecutive years, in order to ensure auditor’s independence and also to prevent any kind of nexus that may develop between the company and auditors of audit firm.

CHAPTER I

INTRODUCTION

"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."

Sir Adrian Cadbury[1]

"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere."

Arthur Levitt[2]

"The individual investor should act consistently as an investor and not as a speculator."

Ben Graham[3]

"It's not how much money you make, but how much money you keep, how hard it works for you, and how many generations you keep it for."

Robert Kiyosaki[4]

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1. Commission Report Corporate Governance 1992, U.K.
2. Former Chairperson, US Securities Exchange Commission
3. Called as father of value investing
4. An American investor and businessman

1.1 STATEMENT OF PROBLEM

These famous quotes by the famous corporate personalities need to be given due consideration in the light of occurrences of several scams, scandals and many other unethical corporate practices not only in India but all over the world, where the investors feel insecure and helpless. In the modern industrial and commercial age, company has become one of the most important organizations in all business organizations. It plays a great role in the growth of national as well as international economy. India is a developing country which requires the healthy corporate atmosphere so that investment can be made by domestic as well foreign investors. As we know that capital is the backbone to run the companies and security market, so any kind of liquidity crunch will force the companies to become sick and it ultimately leads to its winding up. This will seriously impact the economic growth of the country. Many companies have been incorporated and today also their numbers are increasing fast by leaps and bounds.

Company is an organization which is deemed as legal person. Though it is an artificial person but it has capacity to exercise all the powers and the functions as provided to a corporation and is liable for the act done on behalf of it. There are large numbers of the persons such as shareholders, stakeholders, creditors, employees, customers, other investors etc. whose interest are attached with the company. It is not possible for all them to take part in the conduct and management of the affairs of the company, so few selected persons amongst the members of the company conducts and manages the routine affairs of the company which is known as Board of directors. The power for the general management of the company is vested in Board. They may exercise all such general management power but subject to the provisions made in Companies Act, Memorandum of Association (MOA), Article of Association (AOA) and resolutions passed either in the general and annual general meeting of the company.

However, it is found that there is the separation of powers between the ownership and management in the company. Yet the shareholders or members of the company are empowered to control and regulate the affairs of the company by the resolution passed in the general meeting of the company, but it is not possible for the Board to take consent of all the members of the company for the routine day to day function of the company Therefore, several provisions have been made in the Companies Act, 2013 (in Companies Act 1956 also) to take all major decisions by the shareholders or the members in the general meeting of the company through a resolution passed either by simple majority or special majority as the case may be.

Protection of the interest of investors is paramount duty of a company through its Board of directors, who have invested in the company and in fact it is one of the main features of corporate governance. It also paves the way for long term sustainability of the company in modern period.

There are several provisions enshrined in above legislations to protect the rights of the investors but still many scams and serious frauds in capital market are taking place like insider trading, sudden stake selling, cartelization etc. which have shaken the confidence of investors. They feel insecure to invest money in the capital market. Due to that a kind of fear is also created in the mind of foreign investors to invest in Indian market. India is a developing country and capital is the backbone to run the companies and security market. Any kind of liquidity crunch will force the companies to become sick and it ultimately lead to winding up. That will seriously impact the economic growth of the country.

Inspection is a useful instrument and the preliminary step for finding out the true and fair view of the state of company's affairs accordance with the provision of the Companies Act. The object of inspection is not only to keep a watch on the performance of companies but also to evaluate precisely the level of efficiency in the conduct of the affairs of the company concerned. Inspection facilitates to reveal the

concealment of income by falsification of accounts, misuse of fiduciary responsibilities by management for personal aggrandizement, misapplication of funds while the industry itself is in a state of perpetual crisis. It helps the Government to ascertain the quantum of profits which have accrued but not adequately accounted for taxation purposes. Knowledge about the management of the business of the company with intent to defraud the creditors, shareholders and the avenue, otherwise the fraudulent or unlawful purposes would enable the Government to take effective emergent remedial measures, before company goes into liquidation and thus it protects the interests of the investors of the company.

Every company maintains the register of their members indicating separately for each class of equity and preference shares holders, debenture holders and other security holders at the registered office of the company or at any such places as prescribed by section 88 and 128 of the Companies Act, 2013. It is also necessary by every company to prepare annual return every year as prescribed by the section 92 of the Act, duly signed by a director and the company secretary and to be kept at the registered office of the company. These all registers, copies of annual returns and other records are kept open for inspection by any member, debenture-holder, other security holder or beneficial owner during business hours without payment of any fees. They can also take extracts from any register or records without payment of any fees.[5]

The Central Government is empowered to appoint inspectors to investigate the affairs of such companies, which are not complying the provision of the Companies Act, 2013, either, on its own if it is of the opinion that such investigation is required on the report of the Registrar or Inspector under section 208(i.e. report on inspection made) or in public interest.[6] The Central Government may also appoint inspectors to investigate the affairs of a company either on the request of the concerned company on

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5. S.94(3) of the Companies Act, 2013
6. S.210 of the Companies Act, 2013

the basis of a special resolution or on the direction of the Court/Tribunal or from such members of the company having requisite numbers of shares as specified in section 213 of the Companies Act, 2013.[7] The Central Government has established the Serious Frauds Investigation Office (SFIO), a specialized, multi-disciplinary organization to deal with cases of corporate frauds in the Act of 2013.

Audit is a formal examination and verification of financial accounts and records of any organisation. It has become an essential requirement for good corporate governance as it plays a major role in ensuring transparency and accountability in the corporate financial administration, thus auditors are often referred to as gatekeepers. A company carries on business with capital provided by persons who are not in control of the use of the money supplied by them. They would, therefore, like to see their investments are safe, being used for intended purposes and the annual accounts of the company present a true and fair view of the state of affairs of the company. For this purpose, the accounts of the company must be checked and audited by a duly qualified and independent person who is neither employed in the company nor is in any way indebted or otherwise obliged to the company.[8] The contract under which the work of a company's auditor is with the company should be as a separate person. Like anyone who renders professional services for reward, a company's auditor owes the company an implied contractual duty of care in and about the manner in which the audit is performed.[9]

Therefore an in depth critical analysis of the protections of investors available in the Companies Act, 2013 and SEBI Act 1992, in the form of inspection, investigation and audit and also with the help of some decided court's cases will be carried out. How far these statutory and judicial pronouncements are able to protect the interests of

7. subsection (2) *Ibid*
8. Majumdar, A.K and Kapoor, *Company Law and Practice*, 15th ed, Taxmann, Page No. 819
9. *Equitable Life Assurance Society* v. *Ernst and Young* (2003), EWCA Civ. 1114 (2003)

various major or minor investors, will be main focus of this research work. The further scope of improvement for better protection of investors, if any, will also be suggested.

1.2 MEANING AND DEFINITION OF INVESTMENT

Investment means purchase of financial assets with an expectation of good future returns. It is a conscious act of an individual or any entity that involves deployment of money in securities or assets issued by any financial institution with a view to obtain the target return over a specified period of time.

Target return on an investment may include the following-

(a) Increase in the value of the securities or assets, and/or

(b) Regular income must be available from the securities or assets.

In the financial sense investments include the purchase of bonds, stocks or real estate property.

It may be defined as "An asset or item which is purchased with the hope that it will generate income or appreciate in the future. In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or appreciate and be sold at a higher price."[10]

1.3 OBJECTIVES OF INVESTMENT

Generally, an investor desires to have safety of his money invested, liquidity of his investments and a good return with least or at no risk. Therefore any investor needs protection of his investment and it has following objectives-

(a) safety of invested of hard earned money,

10. http://www.investopedia.com/terms/i/investment.asp. accessed on 5 May 2015.

(b) liquidity position of invested money, and

(c) return on investment in selected securities.

Protection of the interest of investors is paramount duty of a company through its Board of directors, who have invested in the company and in fact it is one of the main features of corporate governance. It also paves the way for long term sustainability of the company in modern period.

1.4 LEGISLATIONS WHICH PROTECT THE INVESTORS INTEREST

There are several legislations in which various provisions have been enshrined to protect the rights of the investors but still many scams, serious frauds in capital market, fraudulent and unfair trade practices relating to securities markets insider trading, sudden stake selling, cartelization etc are occurring which has shaken the confidence of investors. They feel insecure to invest money in the capital market. Due to that a kind of fear is created in the mind of foreign investors to invest in Indian market. India is a developing country and capital is the backbone to run the companies and security market. Any kind of liquidity crunch will force the companies to become sick and it ultimately lead to its winding up. That will also seriously impact the economic growth of the country.

The following are the main legislations which protect the interest of investors and govern the capital securities markets in India.

1.4.1 THE COMPANIES ACT, 2013

The Companies Act prescribes rules for formation of a company and also sets the code of conduct for the corporate sector in relation to issuance, allotment, and transfer of securities, and disclosures to be made in public issues. Under section 408 and 410 of the Companies Act, 2013 the Central Government has constituted a National

Company Law Tribunal (hereinafter referred to as Tribunal) and a National Company Law Appellate Tribunal (hereinafter referred to as Appellate Tribunal), to exercise and discharge such powers and functions as may be conferred on it by the Act or any other law for the time being in force. The Appellate Tribunal hears appeals against the orders of the Tribunal and an appeal may lies to the Supreme Court against its order. The Tribunal is a quasi-judicial body in the administration of the provision of the Act of 2013. The Company Act, 2013 provides various protections to investors which have been dealt in detail in chapter II.

1.4.2 SECURITY AND EXCHANGE BOARD OF INDIA (SEBI)

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the securities market of India. It promotes orderly and healthy development in the stock market but initially it was not able to exercise complete control over the stock market transactions. Its status was as a watch dog of the securities market, to observe the activities. Consequently, it was found ineffective in regulating and controlling them. Therefore, in May 1992, it was granted legal status by the Parliament by the Securities Exchange Board of India (SEBI) Act, 1992. It is, now, a body corporate having a separate legal existence and perpetual succession. It's Headquarter in Mumbai and having nine regional offices across the country, at present.

The main function of SEBI is the protection of the investors' interest and the healthy development of Indian financial markets. Accordingly, it has made several regulations to check and control the securities market. It is entrusted with quasi-legislative, quasi-judicial and quasi-executive power. A detail study on how the SEBI protects the interests of investors has been carried out in chapter II.

1.4.3 THE SECURITIES CONTRACTS (REGULATION) ACT, 1956

This Act provides for the regulation of transactions in securities through control over stock exchanges, i.e., National Stock Exchange (NSE) and Bombay Stock Exchange

(BSE). It provides for direct and indirect control of virtually all aspects of the securities trading including the running of stock exchanges which aims to prevent undesirable transaction in securities. It gives the Central Government regulatory jurisdiction over-

(a) stock exchanges through a process of recognition and continued supervision,

(b) contracts in securities, and

(c) listing of securities on stock exchanges.

As a condition of recognition, a stock exchange complies with the requirements prescribed by the Central Government. The stock exchange frame their own listing regulations in consonance with the minimum listing criteria set out in Securities Contracts Regulation Rules, 1956.

1.4.4 THE DEPOSITORIES ACT, 1996

This Act provides for the establishment of depositories like NSDL and CDSL to curb the irregularities in the capital market and protect the interests of the investors and paved a way for an orderly conduct of the financial markets through the free transferability of securities with speed, accuracy and transparency. This Act also provides for electronic maintenance and transfers of ownership of demat(dematerialized) shares. The procedure relating to depositories is mainly governed by the regulations and bye laws that are framed by the SEBI and the depositories under the power provided by the Depositories Act.

1.4.5 THE PREVENTION OF MONEY LAUNDERING ACT, 2002

This Act defines offence of money laundering as whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering. It prescribes

obligation of banking companies, financial institutions and intermediaries for verification and maintenance of records of the identity of all its clients and also of all transactions and for furnishing information of such transactions in prescribed form to the Financial Intelligence Unit-India (FIU-IND). It empowers the Director of FIU-IND to impose fine on banking company, financial institution or intermediary if they or any of its officers fails to comply with the provisions of the Act as indicated above. This Act empowers certain officers of the Directorate of Enforcement to carry out investigations in cases involving offence of money laundering and also to attach the property involved in money laundering. Therefore the main object of this Act is to prevent money-laundering and to provide for confiscation of property derived from money laundering.

1.4.6 FOREIGN EXCHANGE MANAGEMENT ACT (FEMA), 2002

FEMA is a regulatory mechanism that enables the Reserve Bank of India (RBI) and the Central Government to pass regulations and rules relating to foreign exchange in tune with the Foreign Trade policy of India. This Act regulates the exchange (i.e., buying and selling) of foreign currency and other debt instruments by businesses, individuals and governments, happens in the foreign exchange market. Apart from being very competitive, this market is also the largest and most liquid market in the world as well as in India. It constantly undergoes changes and innovations, which can either be beneficial to a country or expose them to greater risks. The management of foreign exchange market becomes necessary in order to mitigate and avoid the risks.

In the present research work, it is proposed for the detail study of the statutory provisions and related relevant judicial pronouncements on the investor's protection with special reference to inspection, investigation and audit under the Companies Act, 2013 and the SEBI Act, 1992. Further, these provisions will be analyzed to know how far these are effective in providing protection to investors.

1.5 RESEARCH QUESTIONS

The following are the research questions framed, for which solutions will be searched in this research work.

RESEARCH QUESTION 1: WHETHER THE INSPECTION OF COMPANY'S DOCUMENTS WILL SERVE TO CHECK FRAUDULENT OR UNLAWFUL CONDUCT OF THE COMPANY IN ORDER TO PROTECT THE RIGHTS AND INTERESTS OF INVESTORS?

Every company keeps and maintains the register of their members indicating separately for each class of equity and preference shares holders, debenture holders and other security holders at the registered office of the company or at any such places as prescribed by section 94 of the Companies Act, 2013. It is also necessary by every company to prepare annual return every year as prescribed by the section 92 of the Act, duly signed by a director and the company secretary and to be kept at the registered office of the company. These all registers, copies of annual returns and other records are kept open for inspection by any member, debenture-holder, other security holder or beneficial owner during business hours without payment of any fees. They can also take extracts from any register or records without payment of any fees. In case of refusal, such officers are held liable and penalties are imposed on them.

In ***Indra Prakash Karnani* v. *Registrar of Company*,**[11] it was held that the court has also jurisdiction to order for inspection and a director who commits any default under the section and is convicted for it, shall vacate his office from the date of conviction and shall remain disqualified from directorship for five years. Section 206, 207, 208, 220, 223 and 224 of the Companies Act, 2013 deals with inspection of books of account, other books and papers also by the Company Registrar or inspector appointed

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11. (1985) 57 Comp Cases 662 Cal

for this purpose and making of reports but they are not empowered for investigation of affairs of the company, *suo motu*. If the company has acted fraudulently or unlawful manner then there are chances to destroy, mutilated, alter, falsified or secreted of such documents. They are merely report making authority. The Registrar or inspector shall, after the inspection of the books of account or an inquiry submits a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving reasons in support. Now it is on the discretion of the Central Government to order for further investigation into the affairs of the company (section 210). Therefore, such default company will get time to destroy, mutilated, alter, falsified or secreted of such documents so to prevent such occurrences it is necessary that inspectors should be empowered to start investigation along with the submission of report to Central Government. This will help in protection of the rights and interests of investors, in better ways.

RESEARCH QUESTION 2: WHETHER INVESTIGATION INTO AFFAIRS OF COMPANY WILL HELP SERVE TO CHECK FRAUDULENT OR UNLAWFUL CONDUCT OF THE COMPANY IN ORDER TO PROTECT THE RIGHTS AND INTERESTS OF INVESTORS?

Investors are the real owners of a Company but the power of management of the Company is vested in the Board of Directors. This may sometimes lead to abuse of power by a few. Hence the Central Government reserves its right to investigate the affairs of the companies, especially in cases of an alleged fraud or even the oppression of the minority shareholders. There are three types of investigation mentioned in the Companies Act 2013:-

(i) An Investigation into the affairs of the Companies [Section 210]
(ii) An Investigation into company’s affairs in other cases[Section 213]
(iii) An Investigation into the ownership of the Companies [Section 216]

The Central Government is empowered to appoint inspectors to investigate either on its own if it is of the opinion that such investigation is required on the report of the Registrar or Inspector under section 208 or in public interest or on the request of the company on the basis of a special resolution or on the direction of the court/Tribunal or from such members of the company having requisite number of shares as specified in section 213 of the Companies Act 2013.The order of investigation should be given after considering all relevant factors otherwise the share price of the company will fall sharply in reaction merely on this news, which will result into huge loss to investors of that company.

The Central Government has established the Serious Frauds Investigation Office (SFIO), a specialized, multi-disciplinary organization to deal with cases of corporate fraud. The SFIO is headed by a director not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with the matters relating to corporate affairs and also consist of experts from various disciplines [section 211]. The SFIO should be strengthened further and its multi-disciplinary character retained essential to unravel the complex corporate processes that may hide fraudulent behavior. In addition to investigation, there is also a need to take up prosecution of the concerned corporate and officers to default in the appropriate forum. For this purpose, procedures would need to be simplified to enable SFIO to move swiftly and purposefully for successful prosecution of the guilty. To enable this, there are certain ambiguities in the law which would have to be removed to enable SFIO to take up prosecution under the IPC in addition to violation of the Companies Act. It is also necessary that a separate statute may be framed to regulate and guide the functioning of the (SFIO) and to address such issues to enable successful investigation and prosecution of cases of corporate fraud. Officers of the SFIO may also be authorised by Central Government to file complaints for offences under Criminal Procedure Code in addition to offences under the Companies Act. This will enable to

take speedy measures to prevent corporate frauds which are generally the result of very complex and intricate series of actions and to protect the interest of investors.

RESEARCH QUESTION 3: WHETHER AUDIT OF BOOKS OF ACCOUNT AND VOUCHERS OF THE COMPANY WILL SERVE TO CHECK FRAUDULENT OR UNLAWFUL CONDUCT OF THE COMPANY IN ORDER TO PROTECT THE RIGHTS AND INTERESTS OF INVESTORS?

Audit is an official examination and verification of any company's financial accounts and records. It is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report. The purpose is then to give an opinion on the adequacy of controls (financial and otherwise) within an environment they audit, to evaluate and improve the effectiveness of risk management, control, and governance processes. An audit must adhere to generally accepted standards established by governing bodies. These standards assure third parties or external users that they can rely upon the auditor's opinion on the fairness of financial statements, or other subjects on which the auditor expresses an opinion. It has revealed many corporate frauds and it is an important means to protect the interests of investors. They play a major role in ensuring transparency and accountability in the corporate world, thus they are often referred to as gatekeepers. Auditing is the central to the public confidence in financial disclosures especially as an auditor is considered to be an intermediary between firms and investors in respect of corporate financial statements. In India, an auditor is a chartered accountant under the Chartered Accountants Act, 1949 who is appointed to examine the books of account and the accounts of a company registered under the Companies Act, and to report upon them to the company's shareholders.

Sections 138 to 148 of the Companies Act, 2013 deal with audit and auditors. Internal audit by qualified auditors as decided by the board in the manner prescribed by the Central Government has been made mandatory by section 138 of the Act. Every company will appoint an individual or firm as an auditor in the AGM who shall hold office for five years and he shall also be present in every AGM. Section 144 of Companies Act 2013, now, provides for the services which the auditor cannot perform directly or indirectly to the company or its holding company, subsidiary company or associate company. Now there are civil and criminal liabilities, through section 147, have been imposed on auditor and on the partner(s) of an auditor firm who has audited in contravention of provisions of Companies Act, 2013. It is required to impose severe criminal liabilities on such auditor(s) in cases of serious frauds occurring with their active participation in corporate arena. Any deviation from standard rules of audit, as prescribed, should be viewed seriously and in such cases auditor(s) shall be held personally liable for both civil wrong as well as criminal offence, in case of fraud committed by any company with their co-operation. There is also need to implement right of information Act in public as well as private company as it is there in Government sector, for better transparency and accountabilities in the corporate system.

RESEARCH QUESTION 4: WHETHER THE SECURITY AND EXCHANGE BOARD OF INDIA (SEBI) IS ABLE TO CHECK FRAUDULENT OR UNLAWFUL CONDUCT OF THE COMPANY IN ORDER TO PROTECT THE RIGHTS AND INTERESTS OF INVESTORS?

The Securities and Exchange Board of India (SEBI) was implemented in 1992 with the prime objective to regulate the capital market of the country. The primary function of Security and Exchange Board of India under SEBI Act is the protection of the investor’s interests and healthy development of stock market of the India. It is very difficult and herculean task for the regulators to prevent the scams in the capital

market considering the great difficulty in regulating and monitoring each and every segment of the financial markets. This is the responsibility of regulators to set the system right once the scam has taken place, especially the responsibility of redressing the grievances of the investors so that their confidence is restored. The redressal of investor's grievances after the scam is the most challenging task before the regulators all over the world and Indian regulator is not an exception. One of the weapons in the hand of the regulators is the collection and distribution of disgorged money to the aggrieved investors. SEBI had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and investor protection) Guidelines, 2000. These guidelines have been issued by the SEBI under section 11 of the SEBI Act, 1992.

SEBI has been emphasizing on the importance of disclosure standards for corporate in disseminating relevant and correct information to the investors. With this view SEBI has appointed a committee under the chairmanship of **Shri C B Bhave** to suggest measures for improving the continuing disclosure standards by corporate and timely dissemination of price sensitive information to the public. The committee submitted its report to the SEBI. Previously Issue of Securities has been dealt with by SEBI (DIP) Guidelines 2000. Presently Issue of Securities is regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. SEBI (DIP) Guidelines have been replaced by these Regulations of 2009. These regulations are called the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. These regulations apply to the following:

(a) a public issue;

(b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;

(c) a preferential issue;

(d) an issue of bonus shares by a listed issuer;

(e) a qualified institutions placement by a listed issuer;

(f) an issue of Indian Depository Receipts.

A company cannot raise capital from more than 50 people without issuing a proper prospectus and its balance sheet and accounts must be audited periodically. Chapter V of SEBI Act, 1992 provides guidelines for pre issue obligations to raise the capital through the public issues and chapter VII for post issue obligations. SEBI is also empowered to call for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds etc. The Board can inspect any book, or register, or other documents or records of any listed public company. Where the Board has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any of the provisions of the SEBI Act or the rules or the regulations made or directions issued by the board there under, it may at any time by order in writing, direct investigating authority to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the board [section 11C of the SEBI Act].In this way SEBI is empowered to check and control the occurrence of fraud in the capital market.

At the same time, it is pointed that SEBI watchdog is a dog without teeth. It only wears dentures to fight against manipulators and finally those people get away with murder. In Essar Steel delisting case, 2007, SEBI watched silently when the promoters came to the market, didn't share profits and left the investors high and dry and took the cool delisting option. SEBI just said –"its as per GOI laws". Do investors need the SEBI to tell that? Aggrieved investors comment that investor protection is a big joke and money making exercise. SEBI came with finger printing and collected close to 100 crores. The scheme was scrapped, then why money was not returned by SEBI? Had it been by other market players SEBI would have demanded them to pay? There

should not be one yard stick for the ruler and the other for the ruled. SEBI may also be held liable in case of failure to check the corporate fraud, which resulted into loss to investors in the capital market.

1.6 AIMS AND OBJECTIVE

The objective of this research work is to find out whether the provisions related to inspection, investigation and audit, made in the Companies Act, 2013 and SEBI Act, 1992 are sufficient to safeguard the interest of the investors and to redress their grievances, in case it may arise. What approaches have been adopted by the courts through its pronouncement in various decided cases in providing remedy to them? It is necessary to regain the confidence of investors in Indian market. Therefore it is important to protect the interest of the investors. There are various provisions embodied in the Companies Act as well in SEBI Act to protect the rights and interests of the investors but still serious frauds and scams like insider trading, sudden stake selling, falsification of books of account, cartelization etc. are taking place which have shaken the confidence of investors. They feel insecure to invest money in the capital market. Due to that a kind of fear is created in the mind of foreign investors to invest in Indian market. It indicates that there are loopholes either in law or procedures which facilitate such scams. Therefore the aim of this research is to carry out an in depth critical analysis of the protections of investors available in the Companies Act 2013 and SEBI Act 1992, in the form of inspection, investigation and audit. The further scope of improvement for better protection of investors and to prevent the corporate scams will also be looked in.

1.7 SCOPE

There are several types of companies, which are governed by the Companies Act, 2013. The public limited companies are, mostly, incorporated by raising capital from the general public by means of public issue. It is compulsory for all those companies

to be listed in a recognized stock exchange and governed by the SEBI Act, 1992. Therefore, the scope of this research is to carry out an in depth critical analysis of the protections of investors of public listed companies, available in the Companies Act 2013 and SEBI Act 1992, in the form of inspection, investigation and audit and to suggest suitable measures to be taken to prevent corporate frauds.

1.8 HYPOTHESIS

The provisions related with inspection of various documents/records, investigation into the affairs of the company and audit of various registers, books and records of the company as embodied in the Indian Company Act, 2013 and SEBI Act, 1992 are not adequate to protect the rights and interests of investors.

1.9 PLANS OF CHAPTERS

In the present research work, in depth study of the protections of investors available in the Companies Act 2013 and SEBI Act 1992, in the form of inspection, investigation and audit, has been done with the help of important judicial pronouncements. How far these statutory and judicial pronouncements are able to protect the interests of various major or minor investors, are the main focus of this research work. The entire work has been divided into following six chapters including the present chapter, which is on introduction.

CHAPTER I: INTRODUCTION

This chapter contains introduction about the subject matter, aim and objective of the study along with the methodology adopted in the research are also spelt out. The meaning, definition and objectives of an investment and various legislations which protect the interests of investors are also dealt briefly in this chapter.

CHAPTER II: VARIOUS PROTECTIONS AVAILABLE TO INVESTORS UNDER THE COMPANIES ACT, 2013 AND THE SECURITY & EXCHANGE BOARD OF INDIA ACT, 1992

This chapter deals with the definition of investor, various kinds of investors such as shareholder, members, debenture holder, depositories etc, how to become the member of the company and various protections available to them under Companies Act, 2013 & the Security and Exchange Board of India Act 1992. Under the Companies Act, the protections available during incorporation and post incorporation of a company, protections through inspection, inquiry, investigation and audit of the documents and records, prevention of oppression and mismanagement and criminal and civil liabilities in case of contravention of the provisions of the Companies laws are discussed.

SEBI Act was implemented in 1992 with the prime objective to regulate the capital market of the country. The Preamble of this Act describes the basic functions of the Securities and Exchange Board of India as

> "*...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.*"

SEBI is responsible to the needs of three groups, which constitute the market: the issuers of securities, the investors, the market intermediaries. SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. SEBI is empowered to check and control the occurrence of fraud in the capital market. Where the Board has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any

of the provisions of the SEBI Act or the rules or the regulations made or directions issued by the Board there under, it may at any time by order in writing, direct Investigating Authority to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board. These roles of SEBI in protection of the investor's interest are also dealt in this chapter.

CHAPTER III: INSPECTION AS A MEANS OF PROTECTION OF INVESTORS

Inspection of documents of company related with investors, shareholders, creditors etc by company registrar, Reserve bank of India, officers appointed by the Central Government, board of director, committee of inspection are discussed in this chapter. Periodic inspection of important document of a company is necessary to know the fairness and transparent functioning of the company which is important for the protection of various investors. SEBI is also empowered to inspect any book, or register, or other documents or records of any listed public company to examine the fairness, will also be dealt in this chapter.

CHAPTER IV: INVESTIGATION AS A MEANS OF PROTECTION OF INVESTORS

The Central Government is empowered to investigate the affairs of a company when circumstances so require. Such an investigation can be initiated by the administrative agency or its own initiative or upon the receipt of complaint from group of oppressive shareholders or any an order of court or at the company embodied in the special resolution. The inspectors are also appointed to investigate the affairs of a company on report by the Company Registrar. They submit the investigation reports to the Central Government, for further follow up action. This is again an important means to protect the interests of the investors, dealt in this chapter.

The Central Government has established the Serious Frauds Investigation Office (SFIO), a specialized, multi-disciplinary organization to deal with cases of corporate frauds in the Act of 2013. In this chapter, appointment, functions, powers of the inspector, role of the SFIO in serious fraud cases, follow up actions and various other provisions related with investigation are also dealt and how investigation serves as an important means to protect the investors is discussed in this chapter.

CHAPTER V: AUDIT AS A MEANS OF PROTECTION OF INVESTORS

This chapter deals with the meanings of audit, qualification for the appointment of auditors the minimum numbers of auditors for a company for audit work, their remunerations, power, functions, statutory duties, duty to exercise standard of care and skill, various criminal and civil liabilities and tenure etc. Audit has revealed many corporate frauds and may serve as important means of protection of investors.

CHAPTER VI: CONCLUSION AND SUGGESTIONS

In this chapter, the research work is concluded and evaluated the provisions related with inspection of the documents, audit of books and papers and investigation of the affairs of the company, as embodied in the Companies Act, 2013 and SEBI Act, 1992. On the basis of critical analysis, improvement in this area are also suggested

1.10 RESEARCH METHODOLOGY

This research is based on doctrinal and analytical methodology of legal research which mainly consist various primary sources like Statutes, Rules and Reports of Commissions, and secondary sources like books, articles, commentaries, opinions etc. *Ratio decidendi* of important judicial and quasi-judicial pronouncements are given due place in this research, in order to appreciate their approach towards the investor protections. The websites sources have also been used to get the latest information on

the topic. Internet has provided a major contribution, most relevant and latest information on the topic, which has helped the researcher to explore the subject through various dimensions.

Blue book of citation (19th edition) has been used in foot noting and citations in the research work.

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CHAPTER II

VARIOUS PROTECTIONS AVAILABLE TO INVESTORS UNDER COMPANIES ACT, 2013 AND THE SECURITY & EXCHANGE BOARD OF INDIA ACT, 1992

2.1 INTRODUCTION

An investor may be a member, shareholder, debenture holder or depository of a company and he does investment of money with the hope of financial return. The assets which he may buy range broadly, but include stocks, mutual funds, bonds, real estate etc. The portfolio of investors generally includes a variety of assets that balance the rewards and risks of each investment. Generally, an investor has no role to play in the routine management of the business of the company or its control except as permitted by the law. He is a blind person and he does not know any activities made by the company. In these circumstances he requires protection of his interest of investment made in a particular company. The Companies Act, 2013 provides several protections to investors which have been dealt in this chapter. Judiciary and Company Law Board (Now, Tribunal) has also pronounced several landmark judgments to protect the investors and same has also been mentioned at due places. Similarly an investor also requires protection in the capital market against numbers of frauds. As a powerful regulator, Securities and Exchange Board of India under the SEBI Act, 1992 was constituted for the protection of the investors' interest and to promote the healthy development of Indian financial markets. This has also been dealt here.

In this chapter, the meaning of investors, types of investor and a brief study on various protections available to them, civil and criminal liabilities of company and

directors, establishment and role of investor's education and protection fund under Companies Act, 2013 has been dealt. Role of SEBI as regulator of capital market, the investor's protection measures under the Security and Exchange Board of India (SEBI) Act, 1992 and through various regulations and power to investigate the transactions of securities in the capital market has also been dealt.

2.2 MEANING OF INVESTOR

The term 'investor' is not defined in the Companies Act, 2013, SEBI Act as well as in other legislations. According to Oxford dictionary, investor is the person who put money into a bank, business, property etc. in the hope that he will make a profit and an act of putting money is called investment. Therefore, an individual who commits money to investment products with the hope of financial return is called an investor. He is a person or entity that purchases assets with the objective of receiving a financial return. The assets which he may buy range broadly, but include stocks, mutual funds, bonds, real estate etc. The portfolio of investors generally includes a variety of assets that balance the rewards and risks of each investment.[1] Investors are also called the backbone of the security market. The Companies Act, 2013 describes various categories of investors. They may be members or shareholders or creditors or debenture-holders or other depositories of the company.

An investor is a person who is an individual or a corporate legal entity investing his capital in another venture or business but does not do the business himself or itself. The investor has no role to play in the routine management of the business or its control except as permitted by the law. Investor carries on business when they purchase and sell assets, arranges for other to purchase and sell assets, manages assets belonging to others, or operates collective investment schemes. An investor engages these activities, but they are not having any control over the day-to-day activities of any corporate. Normally, an investor is a blind person and he does not

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1. Tripathy, R.A., " *Investors Education and Education Fund*," retrieved from SSRN, *Id*.-2308987

know any activities made by the company. Investor cannot guide the fortune or destiny of the company in which he has invested money. An investor to that extent is quite fragile and is exposed to certain risks because the utiliser of his money can commit mistakes. Normally they are contributing the funds for fruitful purpose of the company, and they are exposing him to the business decisions that the company has taken or will be taking.[2]

If the investor does capital investment in a company and owns stocks, he is called as shareholder of the company. The main objectives of an investment are-

(a) To secure his capital (i.e. principal money)

(b) To get profit or enhancement or dividend.

An angel investor or angel (also known as an informal investor) is a person with significant financial resources who provides capital for a business to begin. Usually such investor provides capital in exchange of a percentage of return on his investment or for partial ownership in the company and a say in management decisions. Angels usually invest their own funds, unlike venture capitalists who manage the pooled money of others in a professionally-managed fund.[3]

The Companies Act, 2013 provides for a variety of companies that may be promoted and registered under the Act. The two common types of companies which may be registered under the Act are-

(a) Private Company

(b) Public Company

Private companies can raise the capital through private relations from its relations or from friends but public companies can raise its capital by inviting offers from the members of the public to subscribe for the shares or debentures through prospectus.

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2. Jain Sankalp, "*Investors' Protection in India: Regulatory Framework and Investors' Rights, Obligations & Grievances*," retrieved from SSRN, Id-2462944
3. Pradhan K, "*Protection of Investors : An Analysis*," retrieved from SSRN, Id-2377855

The Companies Act, 2013 has, for the first time, allowed formation of one person company (OPC), a limited liability company on the recommendation of **J.J Irani Expert Committee**. Such a company is described under section 3(1) (c) as a private company. 'One Person Company' is a one shareholder corporate entity.[4]

In these way shareholders, members and debenture holders do investment of money in the company are called investors according to Companies Act. In addition to these, depositories of the company are also called investors.

2.3 TYPES OF INVESTORS

Here, it is necessary to know the various types of investors. Under the Companies Act, 2013, following persons are called investors-

(i) Members
(ii) Shareholders
(iii) Debenture holders
(iv) Depositories

2.4 MEMBERS

Generally members of the company are its shareholders. The term shareholder is not defined in the Companies Act, 2013. However section 2(55) of the Act of 2013 [corresponding to section 41 of the Companies Act, 1956] has defined the term 'member' which is as follow-

(a) The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.

(b) Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall be a member of the company.

4. S. 2(62) of the Companies Act, 2013 (hereafter, referred as the Act)

(c) Every person holding equity share capital of company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

In case of a company limited by guarantee having no share capital or an unlimited company having no share capital, there will be only 'members' but no 'shareholders'.

In ***Vijay Kumar Narang*** **v.** ***Prakash Coach Builders (P) Ltd.***[5] it was held that section 41 of the Companies Act, 1956 [Now section 2(55) of the Act of 2013] statutory obligation for a member that his name shall be entered as member in the register of members, when he subscribed and in reference to other there should be an application in writing and the name should be there in the register of members.

In ***Herdilia Unimers Ltd.*** **v.** ***Renu Jain***,[6] it was held that when the name of the shares allottee is entered in the Registered of members, he becomes member of the company. It is immaterial whether he has received the shares certificates or not.

In ***Balaji textiles Mills (P) Ltd*** **v.** ***Ashok Kavle***,[7] it was held by the Kerala High Court that a person may be regarded as a member if he has acquired the right of membership through his name is not in the register and a person whose name is in the register may not be regarded as a member if he did not agree to be a member in writing or is not accepting his position as such.

In ***Jayalakshmi Acharya*** **v.** ***Kal Electronics and Consultants (P) Ltd.,***[8] it was justified that where one joint holder died and the shares were registered in the name of surviving joint holder though the legal heirs were claiming registration in their name as shares can be held jointly and principles relating to rights and liabilities under joint promises would apply.

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5. [(2005) 128 Comp. Cas.976, CLB]
6. [(1995) 4 Comp. L. J. 45 (Raj.)]
7. [(1989) 66 Comp. Cas. 654 (Ker.)]
8. [(1999) 90 Comp. Cas 200]

A person who holds equity shares in a demat form and his name does not appear in the company's register of members still he will be regarded as member of the company.[9]

In view of above, there are following two prerequisites for a person to become member of a company-

(a) the agreement in writing to take shares of the company and

(b) the registration of his name in its register of members.

2.5 MODES OF ACQUIRING MEMBERSHIP OF THE COMPANY

It will be worth to know the various modes to become member of a company. A person may become a member in a company in any of the following ways:

2.5.1 BY SUBSCRIBING TO THE MEMORANDUM OF ASSOCIATION

A Memorandum of Association (MOA) is an important legal document of a company and it is prepared in the formation and registration process of a limited liability company to define its relationship with members (shareholders). The MOA is accessible to the public and describes the name of the company, physical address of its registered office, names of shareholders and the distribution of shares. The MOA along with Articles of Association serve as the constitution of the company.

According to Section 2(55) of the Act the subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration shall be entered as members in its register of members.

It means that the subscribers of the memorandum of a company become *ipso facto* members on its incorporation and their name will be entered in the Register of

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9. S. 8 of the Depository Act, 1996

Members. Therefore, the signatories to the memorandum become members of the company, simply by reason of their having signed the memorandum.

It is also to be noted that section 3 of the Act requires that any seven or more persons for the lawful purpose of forming a public company and two or more person for the purpose of forming a public company and one person for the purpose of forming OPC may subscribe their names to the memorandum.

In ***Official Liquidator* v. *Suleman Bhai***,[10] it was held that neither application form nor allotment of shares is necessary for becoming a member of the company if subscribed the memorandum of the company. Even an absence of entry in the register of members can not deprive him of his status. He acquires, as soon as the company is registered, the full status of a member with all rights and liabilities.

2.5.2 BY AGREEMENT

A person may also become the member of the company if he agreed in writing to purchase the shares of the company and the company has duly accepted the request of the person. It means when the company has allotted the requisite number of shares on the basis of application then it shall be presumed that the company has accepted the request. Thereafter the name of the person is entered in the register of the members.[11]

It means except in the case of subscribers of memorandum, to become a member of the company, two conditions must be satisfied namely-

(a) that there is an agreement in writing to become a member and

(b) his name is entered in the Register of the member of the company.

In ***Balkrishna Gupta* v. *Swadeshi Polytex Ltd.,***[12] the Supreme Court has held that both the conditions of section 41(2) of the Act of 1956[corresponding section 2(55) (ii) of the Act of 2013] are cumulative and both the conditions have to satisfied to enable him to exercise the rights of a member.

10. AIR 1955 M.P. 166
11. S. 2(55) (ii)
12. [(1985) 58 Comp. Cas. 563

In ***Kumaranpotty* v. *Vinod Pharmaceuticals Chemical Lt.,***[13] the Kerala High Court has held that it is necessary that agreement should be in writing to become a member of the company and merely oral agreement will not suffice the purpose.

2.5.3 BY ALLOTMENT OF SHARES

The second part of section 2 (55) of the Act is related to those persons who become members of the company by a method other than by subscribing to the memorandum. Shares may be issued directly from the company and such a transaction is referred to as "allotment" as compared with the term "transfer" which applies when shares are purchased from another shareholder of the company. Section 2 (55) lays down two conditions which must be fulfilled before membership may be obtained by this method-

(a) There must be an agreement in writing by the applicant to become a Member and
(b) the name of the applicant must be entered in the register of members.

Offers for shares are made on application forms supplied by the company. When an application is accepted, it is an allotment. Generally a person becomes a member of the company by applying for the shares in writing and securing the allotment thereof directly from the company. A valid allotment has to comply with the requirements of the Companies Act and principles of the law of contract relating to acceptance of offer.

2.5.4 BY BENEFICIAL OWNER OF THE COMPANY

Clause (iii) of section 2(55) states that every person holding equity share capital of company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

According to section 8 of the Depository Act, 1996, a person can hold shares of the company to the depositories in place of having share certificates. A person who holds equity shares in a demat form and his name does not appear in the

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13. [(1989) 65 Comp. Cas. 246

company's register of members still he will be regarded as member of the company.

2.5.5 BY TRANSFER

A person may also become a member of the company by purchasing shares in the open market and then getting them registered in his name. A person may also become a shareholder by obtaining a transfer of shares from another shareholder either for a consideration or as a gift but the conditions of agreement and entry on the register of members are necessary. Until the name of the transferee is put on the register of members, he only holds an equitable title; the legal title rests with the transferor whose name is entered on the register of members. In such situation, the expressions "holder of shares" and "shareholders" become relevant because the transferor will remain "shareholder" and the transferee will be the "holder of shares" till the name of the transferor is struck down from the register of members and the name of the transferee is entered in the register. As soon as this formality is completed, "the holder of share" and "shareholder" would be the same person.

2.5.6 BY TRANSMISSION OR SUCCESSION

A person may become a shareholder by succession or operation of law, for instance in the case of death, insolvency or lunacy of a member, or insolvency of a member. Transmission is different from transfer. It is an involuntary transfer. It takes place by operation of law, to a person who is entitled under the law to succeed to the estate of the deceased or lunatic automatically and does not require an instrument of transfer like transfer deed, execution, attestation and stamp duty etc.

Section 56(6) which provides the formalities of transfer specially provides that nothing in the section shall prejudice the power of the company to register as shareholder any person to whom the right to any shares has been transmitted by operation of law. Provisions relating to transmission are generally found in the

company’s articles which are similar to provision of transfer. Clauses 23 to 27 of schedule I contain such provisions.

2.5.7 BY PRINCIPLE OF ESTOPPEL

This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he was actually parted with his shares. In the case of winding up, he will be liable like other genuine members as a contributory.[14]

Under the principle of estoppel if a person holds himself out being in a position of membership which is not true, he will then be estopped from denying that he is a member.

It is important to note that such a person whose name has been wrongly entered in the Register of Members, does not become liable as a member unless either he agrees in writing to become a member of the company or he has in fact accepted the position and acted as a member. A person cannot be deemed to have become a member by means of ‘estoppel’ simply because his name is entered wrongly in the 'Register'.

It is very difficult to become a member by estoppel although the possibilities of such a situation cannot be entirely overruled. If a person finds himself on a company's register of members and in some manner deals with the shares as if he were really a member, the court may consider him to have held himself out as d member. The remedy of being removed from the register may be denied to such a person and he might be held liable for debts in a winding up as one of the contributories. It was brought to the notice of the Sastri Committee (1957) in India that in some cases, on the verge of liquidation, entries were made in the register of members of the names of persons who never applied for shares, in order to fasten liability on those persons as contributories. To avoid this contingency, in 1960, the

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14. Majumdar A.K. and G.K.Kapoor, *Company Law and Practice*, 15th edition, p. 390, Taxmann.

words "in writing" after the word "agrees" were added. This amendment has prevented a person from becoming a shareholder by estoppel in India.

2.6 WHO CAN BE A MEMBER OF THE COMPANY?

Here, it is also necessary to know who can become a member of the company. Any person *sui juris* can become the member of the company subject to the memorandum, articles of the company and other provisions of the law of the land. The legal position of minor, a company, a partnership firm, a registered society, a receiver or official liquidator and a foreigner to become member of the company are discussed below.

2.6.1 MINOR

A minor cannot become a member of company. This is so because under the Indian Contract Act, 1872, a minor is declared to be, incompetent to contract[15] and, therefore, he cannot contract to take shares. Such a contract would be void under contract law and would be equally unenforceable at the instance of the minor as well as of the company. As soon as the memorandum and articles of association are registered, these documents have contractual effect and section 10 of the Companies Act, 2013 supports this view when it provides that

"... the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company *and by each member and contained covenants on its and his part ..."*

Under these circumstances, a minor can neither give his consent in writing as has been contemplated in section 2(55) nor according to section 10 of the Act, he can become a party to the memorandum or articles of association.

However, under U.K Companies Act, an infant can become a *bona fide* member of the company either by virtue of his subscription to the memorandum or by accepting the allotment of shares and he remains as such until he repudiates his contract, which he must do before reaching 21 or within a reasonable time

15. Ss. 10 and 11 of the Contract Act, 1872

thereafter[16]. In the latter case he must act with speed or he will be deemed to be bound by acquiescence. If he avoids he cannot recover the money paid for the shares unless there has been a total failure of the consideration for which the money was paid[17].

In ***Palaniappa* v. *Official Liquidator, Pashupati Bank Ltd.,***[18] it was held that if an application for shares is made by a father as guardian of his infant and the company registers the shares in the name of the infant describing him as minor, neither the guardian nor infant can be placed on the list of contributories at the time of winding up of the company.

In ***Fazulbhoy Zafar* v. *Credit bank of India Ltd***,[19] it was held that if somehow the name of a minor appears on the registered of members and in the meantime he attains majority, and if he does not want to continue to be a member, then he must repudiate his liability on the shares on the ground of minority.

In ***Devan Singh* v. *Minerva Films Ltd***,[20] it was held that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer of transmission provided the shares are fully paid up and no further obligation or liability is attached to them.

2.6.2 A COMPANY

A company, being a juristic person and a separate legal entity may become a member of another company, if it is so authorized by MOA to purchase or invest in shares. Here it is important to note that a subsidiary company cannot be a member of its holding company. Similarly, according to section 67 of the Act, a company cannot purchase its own shares and therefore, cannot become member of itself. However section 68 of the Act states that company can purchase its own shares in

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16. Re Laxon & Co. N 29 (1892) 3 Ch. 555
17. Charlesworth's *Company law*, 18th Edn., p. 292, Sweat & Maxwell (South Asian Edn.)
18. [(1942) 12 Com. Cas. 89 (Mad.)
19. AIR 1914 Bom. 128
20. AIR 1956 Punj. 106

the form of buy back if authorised by its articles and a special resolution has been passed by AGM of the company in this regard.

2.6.3 A PARTNERSHIP FIRM

A partnership firm being an unincorporated association and therefore, not having a separate legal entity from the partner, cannot be registered as a member of a company. However, a partnership firm may become a member of a company registered under section 8 of the Act (i.e., association for charitable purpose and not for profit). Partners either individually or in their joint names (as joint members) may hold shares in a company as a part of the partnership property.

2.6.4 A REGISTERED SOCIETY

A society registered under the Societies Registration Act, 1860 is not a body corporate so it cannot be a member of a company. However, the member of the society, as individual capacity, can become member of the company under section 2(55) (ii) of the Act.

2.6.5 RECEIVER OR OFFICIAL LIQUIDATOR

Receiver or official liquidator are, generally, cannot be a member of a company because shares do not vest in them. Merely appointment as a receiver or official liquidator of the company does not entitle them to become member. The privilege of a member can be exercised by only that person whose name is entered in the Register of members of the company.

2.6.6 A FOREIGNER

Subject to the provisions of the Foreign Exchange Management Act (FEMA), 1999 and Indian Contract Act 1872, a foreigner can enter into the contract and therefore, can purchase shares in a company and become member.

2.7 SHAREHOLDERS

The term shareholder is not defined in the Companies Act, 2013. A company registered under the Companies Act, 2013 may be registered with or without share

capital. In case the company has a share capital, the persons who invest money to the capital of the company by subscribing to the shares are known as shareholders. Where the company does not have share capital, the persons who invest money to the capital of the company are known as members. However, generally the term 'member', 'shareholder' and 'holder of a share' are used interchangeably. However section 2(55) of the Act of 2013 [corresponding to section 41 of the Companies Act, 1956] has defined the term 'member' instead of the term shareholder which has dealt in Para 2.5 *(supra)*.

Shareholders are categorized on the basis of capital of a company which is divided into shares of a fixed amount. All the shares may be of only one class or may be divided into two different classes of securities. For this purpose securities means securities defined in Section 2(h) Securities Contracts (Regulation) Act, 1956 [S. 2(81)] and includes 'Hybrid.' Hybrid means any security which has the characteristics of more than one type of security including their derivatives. The Act permitted only two kinds of shares to be issued, namely-

(a) Equity share capital, that is, ordinary shares, and

(b) Preference shares, which constitute the preference share capital.

Equity share holders of a company are called equity shareholders and holders of preference shares as preference shareholders.

Ordinary share capital or "equity share capital" is defined section 43 of the Act as all share capital which is not preference share capital. The equity share capitals of companies limited by shares are also of two kinds only, namely:-

(i) with voting rights or

(ii) with differential rights as to dividend, voting as otherwise in accordance with such rules and subject to such conditions as may be prescribed.

Preference share capital is also defined in section 43 of the Act. Preference share capital means that part of the share capital of a company which fulfils both the following requirements:

(a) during the continuance of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount (for example, Rs. 80, 000 in a year) payable to preference shareholders before anything is paid to the ordinary shareholders.

(b) on the winding up of the company it must carry a preferential right to be paid, that is, the amount paid up on preference shares must be paid back before anything is paid to the ordinary shareholders. This preference, unless there is an agreement to the contrary, exists only up to the amount paid up or deemed to have been paid up on the shares.

Preference shares have the features of both equity shares and debentures. Like equity shares, dividend on preference shares is payable only when there are profits and at the discretion of the Board of Directors.

Preference shares are also similar to debentures in the sense that the rate of dividend is fixed and preference shareholders do not normally enjoy voting rights. Therefore, preference shares are a hybrid form of financing.

2.8 DIFFERENCES BETWEEN PREFERENCE SHAREHOLDERS AND EQUITY SHAREHOLDERS

There are following differences between preference shareholders and equity shareholders on the basis of shares they hold-

(a) Preference shareholders are entitled to a fixed rate of dividend whereas the rate of dividend on equity shareholders are not fixed and depends upon the availability of net profit.

(b) Dividend on preference shares is paid in priority to the equity shares and equity shares are paid only after the preference dividend has been paid.

(c) Preference shareholders have preference as regards to refund of capital over equity shareholders whereas equity share capital cannot be paid before preference capital.

(d) Redeemable preference share are redeemed by the company on expiry of the stipulated period but equity shares cannot be redeemed.

(e) A company cannot issue bonus shares and rights shares to preference shareholders whereas the bonus shares and rights shares can be issued to existing equity shareholders.

(f) Voting right of preference shares is restricted to resolutions which are directly affect the rights attached to his preference shares except when dividends has remained unpaid in which case he may vote on any resolution in respect of preference share capital but any equity shareholder can vote on all matters.

(g) Arrears of dividend may accumulate in certain cases in preference shares but there is no provision to pay arrears of dividend in equity shares.

(h) Preference shareholders have no right to participate in management of the company whereas equity shareholders have right to participate in management.

(i) Preference share offer a profitable and safe source of investment. While the fixed rate of income is guaranteed, the risk involved is much less as compared to the risk undertaken by the an equity shareholders.

2.9 DIFFERENCES BETWEEN MEMBER AND SHAREHOLDERS

In case of a company limited by shares, a company limited by guarantee and having a share capital and an unlimited company whose capital is definite shares, the term ‘member’ and ‘shareholder’ are synonymous and there can be no membership except through the medium of shareholding. In case of a company limited by shares, the persons whose names are put on the register of members are the members of the company. They may also be called shareholders of the company as they have been allotted shares and are holding them in their own right. When a person is a member of a company limited by shares, his name is placed on the Register of members and he is holding shares in his own right and, therefore, whether we call him a member or a shareholder, it is immaterial. A shareholder is a

person who buys and holds shares in a company having share capital. Such person becomes member of the company once their name is entered in the Register of members. In case of company limited by the equity shares, the following differences can be made between members and shareholders-

(i) ON SUCCESSION

A legal representative of a deceased is not a member until he applies for registration of his name in the Register of members. However, he can rightly be called a shareholder even though his name does not appear in such register. When the name of legal representative gets his own name entered in the Register, then the name of deceased will cease to be member of the company.

(ii) ON BASIS OF REGISTRATION

A deceased shareholder remains member of the company until his name is not struck off from the Register of members. But he cannot be called shareholder in true sense as the rights to holds shares get transfer to his successor, who may be called shareholder *in stricto* sense. A registered shareholder is a member but a registered member may not be a shareholder because company may not have a share capital.

(iii) ON SALE OF SHARES

When a member sells his shares to another person, for consideration, he ceases to be a shareholder of the company. But he continues to be member till the transfer of shares is registered by the company in favour of buyer.

(iv) ON BECOMING INSOLVENT

When a shareholder becomes insolvent, then his property including shares vest in the Official Receiver. The Official Receiver holds the shares in his own right. In such circumstances, insolvent is no longer the shareholder, though he continues to be the member of the company.

(v) ON BEARER OF SHARE WARRANT

A person who owns a share warrant is a shareholder but he is not a member as his name is struck off from the register of members. This means that a person can be holder of shares without being a member.

(vi) ON SUBSCRIBING MEMORANDUM

The subscribers of the memorandum of a company become *ipso facto* members on its incorporation and their name will be entered in the Register of Members. Therefore, the signatories to the memorandum become members of the company, simply by reason of their having signed the memorandum even though no shares are allotted to them. The subscriber is a member until shares are allotted to him but not the shareholder of the company.

2.10 DEBENTURE HOLDERS

Companies have to frequently borrow large sum of money. The loan requirement of a company may not, therefore, be met by a single lender. The loan amount may have to be split into several units. One very convenient method of doing so is to borrow by issuing debentures. Suppose, for example, the sum to be borrowed is rupees ten lakh. It may be divided into ten thousand units each of the value of hundred rupees. A lender may purchase as many units as he pleases. The company will certify the number of units he holds. This is the concept of a debenture. A debenture is, therefore, a certificate of loan issued by a company. It is a type of security.[21] A person, who purchases the debentures, is called debenture holder. He is also an investor of the company since he lends money to the company.

Section 2(30) of the Act, defines the term as ‘Debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt whether constituting a charge on the company’s assets or not.”

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21. Singh, Avtar, *Company Law*, 16th edition, p.462,EBC

This definition does not explain the term and its nature, so we have to look into the definition given by imminent persons. According to **Justice Chitty**[22]

> "*Debenture means a document which either creates a debt or acknowledges it and any document which fulfills either of those conditions is a debenture.*"

According to **Gower,**

> *"Debenture is a name applied to certain types of documents evidencing an indebtedness which is normally but not necessarily secured by a charge over property."*

A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption, which shall be approved by a special resolution passed at AGM. No company shall issue any debentures carrying any voting rights.[23]

Debenture holders are also called the creditors of the company due to carrying a fixed rate of interest and payable on a debenture is a charge against profit and hence it is also tax deductible expenditure.

2.11 DIFFERENCES BETWEEN SHAREHOLDER AND DEBENTURE HOLDER

There are several similarities between a shareholder and a debenture holder. Both are making investment in the company and getting returns, although one gets it by way of dividend and the other by way of interest. In many respects a debenture is similar to a share. It can be purchased or sold in the stock-market. Like shares, the market value of a debenture can also be used by the holders as collateral security to secure temporary loans. However, there are following points of difference between a shareholder and a debenture holder.

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22. *Levy* v. *Abercorris Co*.,[1888] 37 Ch.D. 260-264
23. S. 71 (2) of the Act

(a) A shareholder is a member of the company and enjoys all rights of membership including voting right while a debenture holder is simply a creditor of the company and does not have voting right in AGM.

(b) A debenture holder is entitled to get return in the form of interest on fixed rate regardless of the amount of profit or loss of the company at the stipulated time but the shareholder does not receive any dividend unless the company makes a profit. Even when the company has made a profit, the payment of dividend normally depends upon the discretion of the directors. Sometimes he may get dividends which may be much higher than the rate of interest.

(c) A debenture holder is entitled to repayment of principal amount at the expiry of a specified period but a shareholder cannot be paid back (except in case of redeemable preference shares) until its winding up. The share capital cannot be repaid without legal formalities.

(d) In the case of winding up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debenture holders, normally, being the secured lenders, have prior claim for repayment.

(e) Dividend on shares is not a charge against the profit. Interest on debentures on the other hand is a charge against profits and is deducted from revenues for the purpose of calculating tax liability.

2.12 DEPOSITORS IN THE COMPANY

It has become an important means to receive deposits from public by the companies to make its financial position sound. It is easier to the companies to receive money by way of deposit or loan from public (small depositors) than financial institutions. This is due to less hassles and also free from guarantees, so without making shareholders of the company, such companies receives large deposit in the form of small deposits from the public. Such persons are also called depositors and hence they are investors of the company. Deposits under the 1956

Act were always treated as “unsecured” and there was no provision for deposit insurance.[24]

According to Section 2 (31) of the Act of 2013 (corresponding to Explanation of Section 58 A of the companies Act, 1956), deposit includes any receipt of money by way of deposit or loan or in any other form by a company but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

The Company (Acceptance of Deposit) Rules 2014 has further elaborated this term and stated that "deposit" includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include-

(i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature ;

(ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 (42 of 1999) and rules and regulations made there under;

(iii) any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a banking

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24. Ramaiya, *Guide to the Companies Act* (18th edn.), 2015, p. 1421, Lexis Nexis

institution notified by the Central Government under section 51 of the Banking Regulation Act, 1949 (10 of 1949), or a corresponding new bank as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or in clause (b) of section (2) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980) , or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934 (2 of 1934) ;

(iv) any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government in this behalf in consultation with the Reserve Bank of India or any regional financial institutions or Insurance Companies or Scheduled Banks as defined in the Reserve Bank of India Act, 1934 (2 of 1934);

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) any amount received by a company from any other company;

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

Experience has shown that in many cases deposits from the public so taken by the companies have not been refunded on the due dates. In many such cases either the companies have gone into liquidation or the funds are depleted to such an extent that the companies are not in a position to refund the deposits.[25]

Recently, the **Sahara Groups of Companies** is in big trouble with raising public fund of more than Rs. 24 thousand crores from 29.6 million investors through

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25. Ramaiya, *Guide to the Companies Act* (16th edn.) p. 718, Lexis Nexis

optionally fully convertible debentures (OFCDs) and also received deposits from small depositors from public . The chief of Sahara Mr. Subrata Roy along with two directors of the company have been arrested on the order of the Hon’ble Supreme Court in a dispute related with market regulator Security Exchange Board of India (SEBI). This company has collected money from millions small investors without bringing any IPOs and listing in the stock Exchange of India. Now after repeated order of the Supreme Court, they have started to refund the money to their investors. They have not even provided the correct list of investors to SEBI or to the Court. Subrata Roy has not yet been granted bail and kept in the judicial custody.

It is, accordingly considered necessary to control the companies inviting deposits from the small depositors. The issue of an advertisement in such form and in such form and in such manner as may be prescribed including therein a statement showing the financial position of the company seeking deposits from the public being made obligatory.

The Companies Act, 2013, has now, prohibited the acceptance of deposits from public.

Section 73 of the Act provides that on and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under Chapter V of the Act.

The proviso of section 73 (1) further states that nothing in this sub-section shall apply to a banking company and nonbanking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest,

as may be agreed upon between the company and its members[26], subject to the fulfillment of the following conditions, namely:—

(*a*) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;

(*b*) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

(*c*) depositing such sum which shall not be less than fifteen per cent. of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;

(*d*) providing such deposit insurance in such manner and to such extent as may be prescribed;

(*e*) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and

(*f*) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

The proviso of section 73 (2) further states that in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as ‘‘unsecured deposits’’ and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

Every deposit accepted by a company under section 73 (2) shall be repaid with interest in accordance with the terms and conditions of the agreement referred to in

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26. S. 73(2) of the Act

that sub-section[27]. If a company fails to repay the deposit or part thereof or any interest, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.[28]

The deposit repayment reserve account referred to in clause (*c*) of sub-section (*2*) of section 73, shall not be used by the company for any purpose other than repayment of deposits.[29]

It will be worth to mention here that the section 74 of the Act has made a provision of repayment of deposits accepted before commencement of the Act of 2013. Subsection (1) states that where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

(*a*) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(*b*) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

Further, the Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part

27. S. 73(3)
28. subsection (4) of section 73
29. subsection (5)

thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.[30]

If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in section 73 (1) or such further time as may be allowed by the Tribunal under section 73 (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.[31]

Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified or such further time as may be allowed by the Tribunal, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in section 74(3) and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

Subsection (*2*) of further states that any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

2.13 PROTECTIONS AVAILBLE TO INVESTORS UNDER THE COMPANIES ACT, 2013

Companies Act, 2013 provides several protections to investors. Since the main objective of this research work is to discuss in detail the provisions related to

30. subsection (2) of section 73
31. subsection (3)

inspection, investigation and audit as embodied in the Companies Act 2013 and in SEBI Act 1992, and how these are useful in protection of investor's interests are dealt in chapter III to chapter V respectively. In this chapter, various provisions of the Act related with the protection of investors have been dealt.

2.13.1 PROTECTIONS DURING INCORPORATION OF THE COMPANY

Generally the promoters are the first persons who plays important role during incorporation of a company. Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company. The persons who assume the task of promotion are called promoters[32]. A promoter may be an individual, syndicate, association, partner of company, who acts as per the provisions of the companies Act, 2013. A number of sections impose civil as well as criminal liabilities on promoters for misrepresentations in a prospectus or a statement in lieu of prospectus, for misappropriation or misapplication of the money collected. The status of a promoter is generally terminated when the Board of directors has been formed and they start governing the company.

Therefore, promoters are the first person who controls or influence the company's affairs. It is they who conceive the idea of forming the company, and it is they who take the necessary steps to incorporate it, to provide it with share and loan capital and acquire the business or property which it is to manage. When these things have been done, they hand over the control of the company to its directors, who are often themselves under a different name.[33]

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32. S. 2(69) of the Act defines the term promoter as-"promoter" means a person-(*a*) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or (*b*) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or (*c*) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:
    Provided that nothing in sub-clause (*c*) shall apply to a person who is acting merely in a professional capacity;
33. Majumdar, A.K. and G.K.Kapoor, *Company Law and Practice*, 15th edition, p. 119, Taxmann.

The legal position of a promoter is that he stands in a fiduciary position towards the company about to be formed. He is neither agent nor trustee of the proposed company. He is not the agent because there is no company yet in existence and he is not trustee because there is no trust in existence. Lord Cairns has rightly stated the position of promoter in ***Erlanger* v. *New Sombrero Phosphate Co***.,[34]

"the promoters of a company stands undoubtedly in a fiduciary position. They have in their hands the creation and molding of the company."

They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begins to act as a trading corporation. They occupy an important position and have wide unfettered power relating to the formation of a company. There are also chances to misuse this power. The Act contains no provisions regarding the duties of promoters. It merely imposes with criminal and civil liability through section 34 and 35 of the Act, on promoters for untrue statements in the prospectus they are parties to and for fraudulent trading.

The courts, however, have been conscious of the possibility of abuse inherent in the promoters' position and therefore laid down that anyone who can properly be regarded as promoter stands in a fiduciary position towards the company with all the duties of disclosure and accounting. In particular, the two fiduciary duties imposed on a promoter are-

(i) not to make any secret profit out of the promotion of the company,

(ii) to disclose to the company any interest which he has in a transaction entered into by it.

2.13.1.1 CRIMINAL LIABILITY OF THE COMPANY

The following corporate activities during incorporation of a company, have been regarded as fraud and kept under the category of cognizable as well as non-bailable offences and punishable under section 447 of the Companies Act, 2013.

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34. 39 LT 269 & [1878] 3 App. Cas.1218

(a) Furnishing False or incorrect information during registration of company-If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company.[35]

(b) Incorporation of company by fraudulent means- Any company incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action[36].

(c) Untrue or Misleading Prospectus- When a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead[37].

(d) Inducing a person to enter into financial matter- Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into.

(i) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting securities; or

(ii) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(iii) any agreement for, or with a view to obtaining credit facilities from any ank or financial institution[38].

35. S. 7(5) of the Act
36. S. 7(6)
37. S. 34
38. S. 36

(e) Any person who **makes or abets** making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name[39].

Any person including promoter, who is found to be **guilty of fraud**, will be punished with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.[40]

2.13.1.2 CIVIL LIABILITY AGAINST MIS-STATEMENTS IN PROSPECTUS

There is also provision for making the person with civil liability against mis-statements in prospectus. Section 35 of the Act (corresponding to section 62 of the Act of 1956) imposes civil liability on the directors, promoters or any authorized person for mis-statements in prospectus to pay the compensations to those who suffered losses.

Subsection (1) states that where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who-

(*a*) is a director of the company at the time of the issue of the prospectus;

(*b*) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

39. S. 38(1)
40. S. 447

(*c*) is a promoter of the company;

(*d*) has authorised the issue of the prospectus; and

(*e*) is an expert referred to in sub-section (*5*) of section 26,

shall, besides punishment under section 36(discussed *supra*), be liable to pay compensation to every person who has sustained such loss or damage.

Subsection (2) provides defences to abovementioned person to avoid civil liability. It provides that no person shall be liable under sub-section (*1*), if he proves-

(*a*) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(*b*) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

However, if it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.[41]

In ***Probir Kumar Mishra* v. *Ramaniamaswamy***,[42] it was held that promoters are liable to the company as well as third parties in respect of their conduct and contracts entered into by them during pre-incorporation stage (including statement in prospectus), either treating them as agents or trustees of company to be incorporated and company is entitled to make a claim against a promoter on basis of principles of breach of trust in case it is found that conduct of promoter is detrimental to interest of company.

41. S. 35 (3) of the Act
42. [2010] 104 SCL 174(Mad.)

2.13.2 PROTECTIONS THROUGH MEMORANDUM OF ASSOCIATION AND ARTICLE OF ASSOCIATION

The two important documents of company i.e., Memorandum of Association (MOA) and Articles of Association (AOA) provide various important protections to its shareholders/members.

The memorandum of association (MOA) of a company is an important document which contains the fundamental conditions upon which alone the company has been incorporated. According to section 2 (56) of the Act, memorandum means memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. It contains the objects for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers that will be *ultra vires* the company and so void. MOA can be altered only under certain circumstances and in the manner prescribed in the section 13 of the Act. In most of the cases permission of the Central Government is required when special resolutions of the companies are passed.

The articles of association (AOA) of a company are its bye laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. According to section 2 (5) of the Act, articles means articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. The AOA regulates the internal management of the company. It defines the powers of its officers and determines how the object of the company shall be achieved. AOA can only be altered by the members by passing a special resolution only.

MOA and AOA constitute a contract between the company and its member. The contract contained in MOA and AOA is one of the original incidents of shares. In other words, it can be said that the memorandum and articles constitutes a contract of some sort between the company and its shareholders, and it is these documents

which directly or indirectly define and affect the rights and interests of shareholders conferred by the shares.

The provision mentioned in the MOA is mandatory for the company to abide with its members. Such rights includes, right to have his name on the Register of members, to vote at the meeting of members, to receive dividends when declared, to exercise the right of pre-emption, return of capital on winding-up or on reduction of share capital of the company etc. Since MOA provides the Object Clause of the Company, the member has a right to bring action to restrain the company from doing an *ultra-vires* act.

The rule of *ultra vires* was for the first time laid down by the House of Lords in ***Ashbury Rly. Carriage & Iron Company* v. *Riche,***[43] In this case, the object of the doctrine was explained by Lord Justice Cairns as follows:

(i) to protect investors of the company so that they may know the objects in which their money is to be employed and

(ii) to protect the creditors by ensuring that the company funds, to which they must look for payment are not dissipated in unauthorised activities.

If a company is not working according to the 'Object clause', the act will be held *ultra vires* and will have *null and void ab initio* effect.

In ***Lashmanaswamy Mudaliar* v. *L.I.C.***,[44] the directors of the company were authorised to make payments towards any charitable or any benevolent object or for any general public or useful object. As per the shareholder's resolution, the directors paid Rs. 2 lakhs to a trust for the purpose of promoting technical and business knowledge. The company's business having been taken by the Life Insurance Corporation of India (LIC), it had no business left of its own. The Apex Court held that the payment was *ultra vires* the company. They could spend for the

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43. [1875] LR 7 HL 653 as mentioned by Majumdar, A.K. & Kapoor, *Company Law and Practice*, 15th edition, p. 143, Taxmann.

44. AIR 1963 SC 1185

promotion only on such charitable objects as would be useful for the attainment of the company's own object.

In ***Smt. Claude Lila Parulekar* v. *Sakal Papers (P) Ltd.,***[45]., it was held that the articles will have a contractual force between the company and its members as also between members *inter se* in relation to their rights as such members. Therefore the articles binds the member *inter se,* i.e., one to another as far s rights and duties arising out of the articles are concerned.

In ***V.B Rangaraj* v. *V.B. Gopalkrishnan,***[46]it was decided that the AOA are the regulations of the company binding on the company and its shareholders. Shareholders, therefore, cannot among themselves, enter into an agreement which is contrary to or inconsistence with articles of the company.

In ***Wood* v. *Odissa Waterworks***,[47] it was held that the directors proposed to pay dividend in kind by issuing debentures. The AOA provided for payment of dividends. The court decided that payment means payment in cash and therefore the company could be compelled to pay dividends in terms of the articles.

In ***World India (P) Ltd* v. *WPI Group Inc., U.S.A.***, [48]where respondent shareholder asserted affirmative vote in board meeting in terms of JVA entered into between parties but AOA had not been amended to incorporate affirmative vote provided to respondent, it was held that JVA was not binding on company and respondent could not insist on exercise of affirmative vote.

2.13.3 PROTECTION THROUGH ADVERTISEMENT OF PROSPECTUS AND OTHER ESSENTIAL DOCUMENTS:

Disclosure is the basic principle of corporate governance. Companies are required to make relevant and correct disclosure on its status, object, financial position, joint ventures etc. in the general meeting to its shareholders. Every member of the

45. [(2005) 59 SCL 414 (SC)]
46. [(1992) 73 Comp. Cas. 201 (SC)]
47. [(1889) 42 Ch. D. 636]
48. [2013] taxmann.com 238

company would like to know its financial soundness. These disclosures are available through following four ways in the companies Act-

(a) Notification in Official Gazette

(b) Registration of the company at Registrar of the Company

(c) Compulsory keeping of various registers/documents of the company

(d) Compulsory disclosure of the financial status of the company

Investors get valuable information of a company through various notifications published in official gazette. Official gazette is an authorised legal document of Government of India, which is authentic in content, accurate and strictly in accordance with the Government policies and decisions. Prospectus is the first document of a company which provides many important information to prospective investors.

According to section 2 (70), a **prospectus** means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate. A document shall be called a prospectus if it satisfies two things-

(i) when it invites subscription to or purchase of, shares or debenture or any other securities of a body corporate

(ii) the aforesaid invitation is made to the public.

According to section 26 of the Act and Rule 3 of the Companies (Prospectus and Allotment of Securities) Rules 2014, a prospectus requires to state the **following information of the company-**

(a) the names, addresses and contact details of the registered office of the company, company secretary, CFO, auditors, legal advisor, trustee if any, compliance officer of the issuer company, merchant bankers and co-managers to the issue, registrar to the issue, bankers to the issue, stock brokers to the

issue, credit rating agency for the issue, arrangers, if any, of the instrument, names and addresses of such other persons as may be specified by the Securities and Exchange Board in its regulations;

(b) the dates relating to opening and closing of the issue;

(c) a declaration which shall be made by the Board or the Committee authorised by the Board in the prospectus that the allotment letters shall be issued or application money shall be refunded within fifteen days from the closure of the issue or such lesser time as may be specified by Securities and Exchange Board or else the application money shall be refunded to the applicants forthwith, failing which interest shall be due to be paid to the applicants at the rate of fifteen per cent per annum for the delayed period.

(d) a statement given by the Board that all monies received out of the issue shall be transferred to a separate bank account maintained with a Scheduled Bank;

(e) the details of all utilized and unutilized monies out of the monies collected in the previous issue made by way of public offer shall be disclosed and continued to be disclosed in the balance sheet till the time any part of the proceeds of such previous issue remains unutilized indicating the purpose for which such monies have been utilized, and the securities or other forms of financial assets in which such unutilized monies have been invested;

(f) the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them;

(g) the consent of trustees, solicitors or advocates, merchant bankers to the issue, registrar to the issue, lenders and experts;

The capital structure of the company shall be presented in the manner as prescribed in Rule 3 (2) and should contain the following details -

(i) (a) the authorised, issued, subscribed and paid up capital (number of securities, description and aggregate nominal value);

(b) the size of the present issue;

(c) the paid up capital- (A) after the issue and (B) after conversion of convertible instruments (if applicable);

(d) the share premium account (before and after the issue)

(ii) the details of the existing share capital of the issuer company in a tabular form, indicating therein with regard to each allotment, the date of allotment, the number of shares allotted, the face value of the shares allotted, the price and the form of consideration:

Provided that in the case of an initial public offer of an existing company, the details regarding individual allotment shall be given from the date of incorporation of the issuer and in the case of a listed issuer company, the details shall be given for five years immediately preceding the date of filing of the prospectus.

Provided that the issuer company shall also disclose the number and price at which each of the allotments were made in the last two years preceding the date of the prospectus separately indicating the allotments made for considerations other than cash and the details of the consideration in each case.

According to Rule 3(3), the prospectus to be issued shall contain the following particulars, namely: -

(a) the objects of the issue;

(b) the purpose for which there is a requirement of funds ;

(c) the funding plan (means of finance);

(d) the summary of the project appraisal report (if any);

(e) the schedule of implementation of the project;

(f) the interim use of funds, if any

In this way prospectus contains important information of a company which serve important role in protection of the investors.

Section 128 of the Companies Act, 2013 provides that every company should prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which gives a true and fair view of the state of the affairs of the company. The definition of **'book of account'** is given in section 2(13) of the Act which states that the 'books of account" includes records maintained in respect of-

(i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;

(ii) all sales and purchases of goods and services by the company;

(iii) the assets and liabilities of the company; and

(iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

To satisfy the above requirements, companies usually maintain the following **books and records:**

(a) Cash book to record cash and bank receipt and payment, cash discount received and allowed,

(b) Purchase Day Book, Purchase Book, Invoice Book or Bought Book for recording credit purchase,

(c) Sale Day Book, Sales Book or Sold Book for recording credit sales,

(d) Purchase Return Book or Returns Outward Book for recording goods returned by the company,

(e) Sales Return Book or Returns Inward Book to record goods returned to the company,

(f) Bills Receivable Book to keep a record of bills of exchange receivable,

(g) Bills payable Books to keep e record of bills of exchange payable,

(h) Journal to record opening entries, transfers from one account to another,

(i) Customers' Ledger or Debtors' ledger showing the position of account with company's customers enjoying credit facilities,

(j) Suppliers ledger or Creditors' Ledger showing the company's indebtedness to parties which supplied goods to the company on credit,

(k) General Ledger showing accounts other than those of customers and suppliers mentioned in (i) and (j),

(l) Cost Accounting Records as prescribed.

Apart from the above Books of Account, companies also maintain Vouchers, Bills, Invoices and other documents supporting each entry in the Books of Account as well as other records such as Stock records, Stock-taking statements, Bank reconciliation statement etc. These are only an illustrative list and many companies maintain other books of account also. Many companies combine some of the above books and records.[49]

Section 128 of the Companies Act, 2013 provides that every company should prepare books of account, other relevant books and financial statement for every financial year and to be kept at its **registered office**. The following persons of the company are responsible for keeping proper books of account and records of the company as per the section 128(6)-

(a) the managing director of the company,

(b) the whole time director in charge of finance,

(c) the Chief Financial Officer or

(d) any other person of the company charged by the Board

In case of contravention, the company itself is not punishable but abovementioned persons are held liable and they may be punished with imprisonment or with heavy

49. Dutta, C.R., *Company Law*, 6th Edn., p.3148, Lexis Nexis

fine or with both as prescribed in the Act. The following **punishments** are prescribed for non-compliance with this section-

(a) imprisonment which may extend up to one year, or,

(b) with fine of not less than rupees fifty thousand but may be extended to rupees five lakh, or,

(c) with both.

Section 128(2) of the Companies Act, 2013 further prescribes that where a company has a **branch office**, whether in India or outside India, the company shall be deemed to have complied with the provisions of section 128(1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns, made up to date, at the intervals of not more than three months, are sent by the branch office to the registered office of the company or at such other address where the books of account are kept by fulfilling the requirements mentioned earlier. This requirement is specific that a foreign branch has also to maintain proper books of account as required by section 128(1) of the Act, irrespective of the requirement, if any, in the country where the branch is located.

Every company is required to **preserve the books of accounts**, related vouchers and other relevant records in good condition for **a period of not less than eight years** immediately preceding the current year. Where the company had not been inexistence for a period less than eight years, the books of account and related vouchers should be preserved in good order right from the first accounting year of the company. A new provision has been added in the Act of 2013, that where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.[50]

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50. S. 128(5) of the Act of 2013

Section 135 of the Act of 2013 made it mandatory for every company having specified net worth or turnover or net profit during any financial year, to spend in every financial year, at least two percent of the average net profits made during the three immediate preceding financial years, in pursuance of its **corporate social responsibility policy**. It requires such companies to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The companies specified for this purpose are those having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year. The composition of the committee formed under Section 135 needs to be disclosed in the Board's report. Clause (o) of the Section 134(3) requires disclosure of company's policy and initiatives taken during the year. The Companies (Social Responsibility Policy) Rules 2014 states that the Board's report shall include an annual report on CSR containing particulars specified in the Annexure to the rules and also be disclosed on the company's website.

The Companies Act, 2013 also permits the company to maintain the books of account and other relevant paper **in an electronic mode**. If a company decides to maintain the books of account in the electronic mode, the Rule 3 of the Companies (Accounts) Rules, 2014 requires that such books of account and records to remain accessible in India for being usable subsequently. Such books and records must be maintained in the format in which they were originally generated, sent or received. Such books of account kept in electronic mode are also subject matter of inspection.

Section 137 of the Act has prescribed that a copy of **financial statement of a company** is required to be filed with Company Registrar. It states that a copy of the financial statements**,** including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the Registrar within thirty days of the date of annual

general meeting in such manner, with such fees or additional fees as may be prescribed within the time specified under section 403. The proviso states that where the financial statements are not adopted at annual general meeting or adjourned annual general meeting, such un adopted financial statements along with the required documents shall be filed with the Registrar within thirty days of the date of annual general meeting and the Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose.

The proviso of section 137 further provides that financial statements adopted in the adjourned annual general meeting shall be filed with the Registrar within thirty days of the date of such adjourned annual general meeting with such fees or such additional fees as may be prescribed within the time specified under section 403.

In case of a One Person Company shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within one hundred eighty days from the closure of the financial year.

Section 137(2) of the Act also states that where the annual general meeting of a company for any year has not been held, the financial statements along with the documents required to be attached duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held and in such manner, with such fees or additional fees as may be prescribed within the time specified, under section 403.

There is provision of **punishment** under section 137(3) of the Act. It prescribes that if a company fails to file the copy of the financial statements before the expiry of the period specified in section 403, the company shall be punishable with fine of one thousand rupees for every day during which the failure continues but which shall not be more than ten lakh rupees, and the managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing

director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

In this way prospectus provides important information of a company to its intending investors who decides whether or not they should subscribe to the shares or debentures. The company law requires fair disclosure of various matters through prospectus and forbids variations of any terms and conditions of a contract contained therein except with the approval and authority of the company in AGM. In case of any mis-statement in the prospectus criminal liabilities as well as civil liability are imposed to the promoter, director and all those persons, responsible for fraud. Stock Exchange Board of India (SEBI) has also issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2009, which has been discussed in Para 2.15.4 in detail *(infra)*.

2.13.4 PROTECTIONS THROUGH INSPECTION, INQUIRY, INVESTIGATION AND AUDIT OF THE DOCUMENTS AND RECORDS

Every company maintains the register of their members indicating separately for each class of equity and preference shares holders, debenture holders and other security holders at the registered office of the company or at any such places as prescribed by the Companies Act, 2013. It is also necessary by every company to prepare annual return every year as prescribed by the Act, duly signed by a director and the company secretary and to be kept at the registered office of the company. These all registers, copies of annual returns and other records are kept open for inspection by any member, debenture-holder, other security holder or beneficial

owner during business hours without payment of any fees. They can also take extracts from any register or records without payment of any fees.[51]

Periodic inspection of these important documents of a company is necessary to know the fairness and transparent functioning of the company, which is also important to protect the interests of investors of the company. The Company Registrar is empowered by section 206 of the Companies Act, 2013, to call for further information, inspection of books and conduct inquiries in case he is not satisfied after scrutiny of documents filed by the company before him or any information received by him.

Investigation of a company is the process to examine the management of the company's affairs to find out whether any irregularities have been committed or not. Under section 210 an inspector is appointed only to investigate the affairs of a company and to make a report thereon. The Act also empowers the Central Government with the right to investigate the affairs of the company, especially in cases of an alleged fraud or even in the oppression of the minority shareholders. There are following three types of investigation mentioned in the Companies Act 2013:-

(i) Investigation into the affairs of the Companies
(ii) Investigation into company's affairs in other cases
(iii) Investigation into the ownership of the Companies

The provisions related to inspection, inquiry and investigation are available from Sections 139 to 148 of the Act and detail studies have been made in chapter III and IV respectively

Audit has become an essential requirement for good corporate governance and it plays a major role in ensuring transparency and accountability in the corporate financial administration. A company carries on business with capital provided by persons who are not in control of the use of the money supplied by them. They would, therefore, like to see their investments are safe, being used for intended

51. s.94(3) of the Companies Act, 2013

purposes and the annual accounts of the company present a true and fair view of the state of affairs of the company. For this purpose, the accounts of the company must be checked and audited by a duly qualified and independent person who is neither employed in the company nor is in any way indebted or otherwise obliged to the company. Sections 206 to 229 of the Act deal with the audit and detail study has been made in chapter V.

2.13.5 PROTECTION AVAILABLE THROUGH VARIOUS MEETINGS OF THE COMPANY

It is important to call meeting to pass resolutions to protect the interest of the investors. Protection of investors is one of the primary objects of the Act of 2013. Section 96 of the Act provides the shareholders/members with a forum of self protection. This forum is the general meeting of the shareholders. One meeting that is compulsory to be held every year is the annual general meeting (AGM). Other meetings are left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. A number of important managerial decisions are approved by the shareholders in AGM. For this purpose, they must have adequate information supplied to them well in advance of the date of meeting. When members are fully equipped with information only then will they be able to fulfill the underlying purpose of requiring companies to hold meetings, which is that the members shall be able to attend in person so as to debate and vote on matters affecting the company[52]. The members should be adequately represented at the meeting in the form of quorum. They should have a free and fair opportunity of considering matters that come before the meeting. The members can use the forum for exercising their rights as members in appointing and removing directors, i.e.to constitute management, appoint auditors and participate in other decisions which requires approval of the members and therefore, there can be no disproportionate voting rights for shareholders holding shares of the same class.

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52. Ramaiya, *Guide to the Companies Act* (18th edn.), p. 1623, Lexis Nexis

The Act of 2013 provides following three types of meeting with which shareholders are directly concerned.

1. Annual General Meeting (AGM)
2. Extra-ordinary general meeting and
3. Class meeting

Here, it is worth to be mentioned that the provisions related to Statutory meeting of the company under the Act of 1956 is now omitted in the Act of 2013.

2.13.5.1 ANNUAL GENERAL MEETING

The most important meeting of the shareholders, at which the 'ordinary business' of the company is transacted is the AGM. This meeting provides a forum to members for expressing their views and discussing important matters related to the company's affairs. This is the forum at which policy making decisions are taken and in the meeting shareholders exercise their corporate powers and control over Board of directors. In the interest of general public and the shareholders who are less conversant with the complexities of the company law, it becomes essential that the company statute should regulate the holding and conduct of this meeting and ensures that interests of all shareholders are properly safeguarded.

According to section 96 of the Act, every company other than a One Person Company shall in each year hold in addition to any other meetings every year, a general meeting as its annual general meeting and shall specify the meeting as such in the notices calling it. The Act provides two conditions as regards the holding of an AGM:

(a) it should be held every year and

(b) not more than fifteen months should elapse between the date of one AGM of a company and that of the next.

But in case of the first AGM, it shall be held within a period of nine months from the date of closing of the first financial year of the company and in any other case,

within a period of six months, from the date of closing of the financial year and then no meeting will be necessary for the year of incorporation.

In ***T.V.Mathew v. Nadukara Agro Processing Co. Ltd***,[53]the Kerala High Court held that the first AGM cannot be deferred as there is no provision in the company Act.

The Registrar is empowered to extend the time within which any AGM, other than the first AGM, shall be held, by a period not exceeding three months, for any special reason.[54]

Section 97 of the Act provides that if any **default** is made in holding the AGM of a company under section 96, **the Tribunal** may, notwithstanding anything contained in this Act or the articles of the company, **on the application of any member of the company**, call, or direct the calling of, an AGM of the company and give such ancillary or consequential directions as the Tribunal thinks expedient.

Directions given by the Tribunal may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. A general meeting held in pursuance of section 97 shall, subject to any directions of the Tribunal, be deemed to be an AGM of the company under this Act.

If any **default** is made in holding a meeting of the company in accordance with section 96 or section 97 or section 98 or in complying with any directions of the Tribunal, the company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continues.[55]

IMPORTANCE OF AGM

AGM is an important institution for the protection of members/shareholders of a company. The ultimate control and destiny of a company should be in hands of its

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53. (2002) 108 Comp Cas 130 (Ker.)
54. Proviso of S.96 of the Act
55. S. 99 of the Act

shareholders. It is, therefore, desirable that the shareholders should come together in a year to review the working of the company. This meeting affords that opportunity to them. It is not practical to list all business which can be transacted at the AGM. Any business can be transacted at the AGM and as to what business can be conducted at AGM generally depends upon the articles of association. The companies Act, however, requires certain business to be transacted at the AGM. They are:

(i) consideration of accounts, balance sheet, report of directors and auditors- Chairman delivers a speech listing the advances of the company during the year. Directors have to present annual accounts for consideration of the shareholders. A failure to present the account is punishable offence.[56] The shareholders can ask any questions relating to accounts or affairs of the company.

(ii) the election or re-election of a director- it is at this meeting that some of the directors will retire and come up for re-election and the shareholders will be able to exercise real control by refusing to re-elect a director whose action and policy they disapprove.

(iii) auditors retire at this meeting enabling the shareholders to considered whether they should be re-appointed or replaced.[57]

(iv) fixing of remuneration of directors and auditors

(v) generally dividends are declared at AGM.

2.13.5.2 EXTRAORDINARY GENERAL MEETING

As discussed above, AGM is held once in a year but, in practical, it observed that some time, situation may arise in between two AGM that an urgent decision is required to be taken by the shareholders. According to Clause 42 of the Table F (Schedule 1), all general meetings other than AGMs are known as extraordinary general meetings (EOM). According to section 100, the Board may, whenever it

56. s. 136 and 137
57. s. 139

deems fit, call an extraordinary general meeting of the company at the requisition made by,—

(i) in the case of a company having a share capital, such number of members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

(ii) in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote, call an EOM of the company within the period specified.

Therefore, this provision the Act empowers specific number of shareholders the right to convene an EOM of the company. In such a situation it is obligatory on the part of directors to call EOM provided such requisition is made by holders of not less than one tenth of the equity capital carrying voting rights.

If the Board does not, within twenty-one days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than forty-five days from the date of receipt of such requisition, the meeting may be called and held by the requisitonists themselves within a period of three months from the date of the requisition.[58]

The requisition must set out the matters for the consideration of which the meeting is to be called. No other business can be done. For example, where certain shareholders requisitioned a meeting for the appointment of three new directors, and subsequently the chairman wanted to add to the agenda the removal of a director also, the meeting was restrained from considering the matter.[59] Only such matters can be taken up at the meeting in respect of which the requisitionists possess the same voting strength as is required to requisition a meeting.

58. S. 100 (4)
59. *Ball v. Metal Industries Ltd,* 1957 SLT 124 (Scotland)

The class meetings of shareholders may also be called EOMs but they are not so in the strict sense. As they are the meetings of a particular group of shareholders and not all shareholders, it is better to group them separately.

In ***Life Insurance Company v. Escorts***,[60] it was held that shareholders have the right to requisition an EOM of a company for removal and appointment of directors and if the company does not issue a notice within 21 days convening the meeting within 45 days, the requsitionists have the right to convene the meeting. Therefore, when the requsitionists convened the EOM in accordance with law, the said meeting cannot be impugned nor the decisions taken threat for removal and appointment of directors.[61]

In ***BG Somayaji v. Karnataka Bank Ltd***.,[62] it was also held that a requisition for an EOM drafted by one shareholder who has *locus standi* and signed by the prescribed number of shareholders is valid.

2.13.5.3 CLASS MEETINGS

As discussed earlier, the share capital of a company may be divided into different classes. The holders of these shares carry different rights from the holders of equity shares. The holders of shares of each type constitute one class, e.g. preference shareholders, creditors' etc. class meetings are called when it is proposed to modify or vary any rights or privileges of a particular class of shareholders. These meetings are held to pass resolution which will bind the members of class concerned, and only that class can attend and vote.

Section 48 of the Act, provides that where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class,-

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60. AIR 1986 SC 1370
61. [2011] 3 Comp LJ 547 (CLB)
62. AIR 1995 Kant 344

(*a*) if provision with respect to such variation is contained in the memorandum or articles of the company; or

(*b*) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class:

In case variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained.

Unless the articles of the company or a contract binding on the person or class concerned otherwise provides, all provision pertaining to calling of a general meeting and its conduct, apply to such meetings.

2.13.6 PROTECTION AGAINST OPPRESSION AND MISMANAGEMENT:

Democratic decisions are made in accordance with the majority decision and are deemed to be fair and justified while overshadowing the minority concerns. The corporate world has adopted this majority rule in decision making process and management of the companies. Statutory provisions in this regard have been provided under the Companies Act, 2013. "Despite the fact provisions have been in place under the Companies Act, 1956 to protect the interest of the minority shareholders, the minority has been incapable or unwilling due to lack of time, recourse or capability, financial or otherwise. This has resulted in the minority to either let the majority dominate and suppress them or squeeze them out of the decision making process of the company and eventually the company. The Act of 2013 has sought to invariably provide for protection of minority shareholders rights and can be regarded as a game changer in the tussle between the majority and minority shareholders. Various provisions have been introduced in the Act of

2013 to essentially bridge the gap towards protection and welfare of the minority shareholders”.[63]

The fundamental principle relating to the administration of the internal affairs of a company is that “the court will not, in general, intervene at the instance of shareholders in matters of internal administration; and will not interfere with the management of a company by its directors so long as they are acting within the powers conferred on them under the articles of the company”[64] in other words, the court will not interfere so long it as they are performing on the basis of “Principle of majority.” This principle is evolved in the famous case, ***Foss v. Harbottle***.[65] Once a resolution is passed by requisite majority then it is binding on all the members of the company.

The protection of the minority shareholders within the domain of corporate activity constitutes one of the most difficult problems facing modern corporate laws. The aim must be to strike a balance between the effective control of the company and interests of small individual shareholders. According to Palmer- “A proper balance of the rights of majority and minority shareholder’s is essential for the smooth functioning of the company.”[66] The Act of 2013, therefore, contains a large number of provisions for the protection of the interests of investors in companies. The aim of these provisions is to require those who control the affairs of a company to exercise their powers according to certain principles of natural justice. The Act provides special provisions for prevention of oppression and mismanagement and to safeguard the interest of investors including minority shareholders, in chapter XVI, from section 241 to 246.

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63. Sulalit Akshat, “*Rise of Minotity Shareholders*” available at http://www.indialawjournal.com/volume6 /issue-2/article5.html, visited on 10/04/2015.
64. *Rajahmundry Electric Supply Corpn Ltd* v. *A Nageshwara Rao,* AIR 1956 SC 213
65. [1843] 2 Hare 461: 67 ER 189
66. Palmer’s Company Law (20th Edn. 1959) p. 492.

2.13.6.1 RIGHT TO APPLY TO TRIBUNAL FOR RELIEF AGAINST OPPRESSION AND MIS-MANAGEMENT

The first remedy in the hands of oppressed minority is to move the Tribunal. Whenever the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to any other member or members, an application can be made to the Tribunal under section 241(1) (a) of the Act. Alternatively, an application can be made to the Tribunal under sub-clause (b) of this section on the grounds that the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members.

Section 241 (2) provides that an application may be made to the Tribunal for an order by the Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest. In ***N.R Murthy v. Industrial Development Corporation of Orissa Ltd.***[67], it was held that in the case of a company indented to operate in modern welfare State, the concept of 'public interest' takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community, at any rate, not in manner detrimental to the public goods.

67. [1977] 47 Comp. Cas. 389 (Ori)

2.13.6.2 WHO CAN APPLY

The requisite number of members, who must sign the application, is given in section 241. The requirement varies with the fact as to whether the company has a share capital or not. It states that-

(i) in the case of a company having a share capital, the application must be signed by not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(ii) in the case of a company not having a share capital, the application must be signed by not less than one-fifth of the total number of its members:

Here, it is also significant to note that the Tribunal has right to waive all or any of the requirement as aforesaid to enable the members to make the application under section 241, in case of joint holding of the shares, the joint holders will be counted one.[68] Further, a member after taking consent of the requisite number of the members may make the application on behalf of all of them.[69]

2.13.6.3 POWERS OF TRIBUNAL TO GRANT RELEIF

Section 242 provides that the Tribunal is empowered to make order to bring an end to the matter complained of and may provide for the following-

(*a*) the regulation of conduct of affairs of the company in future;

(*b*) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(*c*) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(*d*) restrictions on the transfer or allotment of the shares of the company;

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68. Proviso of s. 244 (1).
69. subsection (2) of S. 244

(*e*) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(*f*) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (*e*):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(*g*) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(*h*) removal of the managing director, manager or any of the directors of the company;

(*i*) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(*j*) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (*h*);

(*k*) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(*l*) imposition of costs as may be deemed fit by the Tribunal;

(*m*) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

2.13.6.4 CLASS ACTION BY MEMBERS OR DEPOSITORIES AGAINST MIS-MANAGEMENT

Section 245 is a new provision of the Act of 2013 which provides provision for class action by members or depositories against the mis-management or conduct of the affairs of the company which is conducted in a manner prejudicial to the interests of the company or its members or depositors. The requisite number of members in case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less can apply to Tribunal for seeking all or any of the following remedial action –

(*a*) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;

(*b*) to restrain the company from committing breach of any provision of the company's memorandum or articles;

(*c*) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

(*d*) to restrain the company and its directors from acting on such resolution;

(*e*) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(*f*) to restrain the company from taking action contrary to any resolution passed by the members;

(*g*) to claim damages or compensation or demand any other suitable action from or against—

(*i*) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

(*ii*) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

(*iii*) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

(*h*) to seek any other remedy as the Tribunal may deem fit.

In ***Bajirao G. Ghatke v. Bombay Docking Co. (P.) Ltd.***,[70] it was held that non maintenance of statutory records and not conducting affairs of the company in accordance with the Companies Act is an act of oppression.

In re Hindustan Co-operative Insurance Society Ltd.,[71] it was held oppression if the shareholders are kept in dark and not calling a general meeting of the company.

In ***Mohan Lal Chandu Mal v. Punjab Company Ltd***.,[72]it was held that act of the company depriving a member of the right of getting dividend, oppressive.

In ***Radhe Shyam Tulsian v. Panchmukhi Inv. Ltd.,***[73]it was held that irregular appointment of director on the strength of irregular allotment of shares is an act of oppressive.

In ***Birla Education Trust v. Birla Corporation Ltd.***,[74]it was held that illegal and ultra virus action by the Board controlling by Chief managing director and his group constituting majority is an act of as a consequences of mismanagement.

In ***Rajiv Kant Laxman v. Bobby Electronics (P) Ltd.,***[75] the share capital of a company was increased to meet out urgent requirement of funds. The holding of EOGM and allotment of shares was not strictly in accordance with the requirement

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70. [1984] 56 Comp.Cas. 428 (Bom.)
71. [1961] 31 Comp. Cas. 193 (Cal.)
72. [1962] 32 Comp. Cas. 937 (Punj.)
73. [2002] 35 SCL 849 (CLB)
74. [2012] 114 SCL 31 (CLB)
75. [2014] 43 taxmann. Com 54 (Mumbai)

of the Companies Act. It was held that as share capital was increased to meet out urgent requirement of funds, holding of EOGM and allotment of impugned shares, even if not be strictly in accordance with provisions of the Act, did not amount to an act of oppression.

In ***P.N.Nahar v. Nahar Textile (P) Ltd.,***[76]it was held that an attempt by the persons managing company to sell immovable property of company at under price for their personal gain was held to be oppressive and prejudicial conduct detrimental to interest of all stakeholders.

2.13.7 PROTECTION DURING WINDING UP OF THE COMPANY

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a liquidator, is appointed and he takes control of the company, collects its assets, pays it debts and finally distributes any surplus among the members in accordance with their rights.[77]

According to Pennington, "Winding up or liquidation is the process by which the management of a company's affairs is taken out of its director's hand, its assets are realized by a liquidator and its debts and liabilities are discharged out of the proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end".[78]

There are two modes of winding up of a company, prescribed in the Act-

(i) by the Tribunal making a winding up order. This is also known as compulsory winding up.

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76. [2014] 46 taxmann. Com 86 (Mumbai)
77. Gower, *The Principles of Modern Company Law* (3rd Edition), 1969, p.647
78. Pennington's *Company Law*, 5th Edn., p.839

(ii) by passing of an appropriate resolution for voluntary winding up at a general meeting of members. This is also known as voluntary winding up.

2.13.7.1 COMPULSORY WINDING UP

Compulsory winding up of a company takes place by the Tribunal on the petition filed under the Act (section 272). Section 271 of the Act provides the following circumstances under which a company will be wound up-

(a) if the company is unable to pay its debts;

(b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(d) if the Tribunal has ordered the winding up of the company under Chapter XIX (i.e. if revival and rehabilitation of sick company is found unlikely by the Tribunal);

(e) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

(g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

2.13.7.2 VOLUNTARY WINDING UP

When a company is wound up by the members or creditors without intervention of Tribunal, it is known as Voluntary winding up. In this type of winding up, the company and its creditors are left free to settle their affairs without going to the Tribunal although they may apply to Tribunal for directions or order if and when necessary. Section 304 of the Act prescribes circumstances in which a company may be wound up voluntarily in the following two ways-

(*a*) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily

(i) where the period fixed by the Articles for the duration of the company has expired, or

(ii) the event has occurred on which under the Articles the company is be dissolved;

(*b*) if the company passes a *special resolution* that the company be wound up voluntarily.

2.13.7.3 PUBLICATION OF RESOLUTION TO WIND UP VOLUNTARILY

Section 307 of the Act provides that where a company has passed a resolution for voluntary winding up and a resolution is passed, it must within fourteen days of the passing of the resolution give notice of the resolution by advertisement in the Official Gazette and also in a newspaper which is in circulation in the district where the registered Office or the principal office of the company is situated. In case of contravention, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which such default continues.

2.13.7.4 PROTECTION OF INVESTORS DURING WINDING UP OF A COMPANY

(a) According to section 313 of the Act, on the appointment of a Company Liquidator, all the powers of the Board of Directors and of the managing or whole-time directors and manager, if any, shall cease, except for the purpose of giving notice of such appointment of the Company Liquidator to the Registrar.

(b) Where the Company Liquidator has made a report to the Tribunal stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal under section 300, may direct that such person or officer shall attend before the Tribunal and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof.

(c) Section 283 has prescribed that where a winding up order has been made or where a provisional liquidator has been appointed, the Company Liquidator or the provisional liquidator, as the case may be, shall, on the order of the Tribunal, forthwith take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company.

(d) According to section 279 of the Act, when a winding up order has been passed or a provisional liquidator has been appointed, all actions and suits against the company except cases on appeal pending before the Supreme Court or the High Court are stayed, unless the Tribunal gives leave to continue or commence proceedings.

(e) Section 328 provides the provision to prevent fraudulent preference transfer of movables or immovable to creditors. Tribunal may declare such fraudulent preference of transaction invalid which serves as protection to bonafide investors.

(f) Any floating charge created within 12 months immediately preceding the commencement of winding up is void unless it is proved that the company after creation of the charge was solvent. However, any cash advanced at the time of or subsequent to the creation of, and in consideration for, the charge together with or to any interest on that amount @ 5% p.a. or such other rate notified by the Central Government in Official Gazette shall not be invalid. This provision under section 332 of the Act also serves protection to investors.

(g) Section 335 (1) (a) provides that any attachment, distress or execution put in force, without leave of the Tribunal against the estate or effects of the company after the commencement of the winding up shall be void. However this provision will not apply to any proceeding for the recovery of any tax or impost or any dues payable to Government.

(h) Section 335 (1) (b) provides that any sale held without leave of the Tribunal, of any properties of effects of the company after commencement of winding up shall be void.

(i) As soon as the affairs of a company are fully wound up, the Company Liquidator shall

(i) prepare a report of the winding up showing that the property and assets of the company have been disposed of and its debt fully discharged or discharged to the satisfaction of the creditors; and

(ii) call a general meeting of the company for the purpose of laying the final winding up accounts before it and giving any explanation thereon.

(iii) If the majority of the members of the company after considering the report of the Company Liquidator is satisfied that the company shall be wound up, they may pass a resolution for its dissolution.

(j) The Company liquidator may, with the leave of the Tribunal, disclaims the onerous properties belonging to company as mentioned in section 333 of the Act. Such property may consists-

(i) land of any tenure, burdened with onerous covenants;

(ii) shares or stocks in companies;

(iii) any other property which is not saleable or is not readily saleable by reason of the possessor thereof being bound either to the performance of any onerous act or to the payment of any sum of money; or

(iv) unprofitable contracts.

In ***ONGC Ltd.*** **v.** ***Official Liquidator***,[79] the Supreme Court of India held that claim for preferential payment as secured creditor merely on the basis of an undertaking given by company-in-liquidation would not amount to creation of charge. The application was denied preferential payment in priority to secured creditors and workmen and the claims would be payable as per provisions of sections 529 and 529A [corresponding to section 325/326 of the Act of 2013].

In ***Kitti Steels Ltd.*** **v.** ***Sanghi Industries Ltd.***,[80]it was held that when a suit has been decreed and the same decree is under appeal, a petition for winding up based on the decree is not tenable.

In ***Atlanta Pums (P.) Ltd.*** **v.** ***Mrs Kunda J Majli***,[81] Karnataka High Court held that order of admission of winding up petition has to be speaking and reasoned order. As the admission order of the court was non-speaking and unreasoned, appeal against that order is admissible as the interest of the company concerned can be affected.

2.14. INVESTOR EDUCATION AND PROTECTION FUND

Section 125 of the Act corresponds to section 205 C of the Act of 1956. This provision was not the part of the original 1956 Act and was inserted by the Companies (Amendment) Act, 1999 to provide for establishment of investor education and protection fund for the protection and education of investors (IEPF). **J.J Irani Committee report, 2005** has also recommended for promotion of

79. [2014] 44 taxmann.com 350 (SC)
80. [2010] 102 SCL 308 (AP)
81. [2012] 114 SCL 516 (Kar.)

investors awareness and education program and establishment of investor's protection fund. Section 125 of Companies Act, 2013 has incorporated this recommendation to equip the investors with better knowledge of protection against frauds. IEPF is meant for promotion of investors' awareness and protection of their interests. The IEPF accounts for unclaimed funds from dividends, matured deposits, matured debentures or share application money, which is transferred to the Government by companies if they are not claimed for seven years. The fund is utilized for the purpose of protection of investors and promotion of investor education and awareness. This fund is managed by a Committee that consists of the Secretary, Company Affairs, as well as members from RBI, SEBI and experts on investor protection. The committee considers investor education and protection activities keeping in view the purpose of utilization of fund. Meeting of the committee is convened at least once in 3 months by the convener and in his absence, by any member nominated by the convener, on his behalf. The SEBI ensures maintenance of proper and separate accounts and other relevant records in relation to the fund. Accordingly, SEBI has made regulations for investors' protection and education fund, 2009, with a view to strengthen its activities for protection of investors, which has been discussed in Para 2.15.8 (*infra*).

In ***Nivedita Sharma* v. *ICICI Bank Ltd.***[82], the constitutional validity of section 205 C of the Act of 1956 was challenged and it was observed that it was enacted with the object to ensure that a company does not unjustified and unduly enrich itself of the money which has not been claimed by the depositors for seven years. Therefore, section 205 C cannot be held to be unconstitutional or violative of Article 14 of the Constitution. The word 'unclaimed' used in the proviso to subsection (2) of the section 205 C clarifies that in case a claim is made within a period of 7 years from the date the amount become due and payable, the amount shall not be transferred to the Investor Education and Protection Fund and as such the provisions of the section shall not apply.

82. [2012] 106 CLA 23 (Del)

According to Section 125 of the Act, the following monies shall be credited to this fund-

(a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the unpaid dividend account of companies transferred to the Fund under sub-section (5) of section 124;

(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;

(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) the interest or other income received out of investments made from the Fund;

(g) the amount received under sub-section (4) of section 38;

(h) the application money received by companies for allotment of any securities and due for refund;

(i) matured deposits with companies other than banking companies;

(j) matured debentures with companies;

(k) interest accrued on the amounts referred to in clauses (h) to (j);

(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) such other amount as may be prescribed:

This fund is **utilised** for following purposes-

(i) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(ii) promotion of investors’ education, awareness and protection;

(iii) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;

(iv) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(v) any other purpose incidental thereto, in accordance with such rules as may be prescribed.

2.15 PROTECTIONS TO INVESTORS UNDER STOCK EXCHANGE BOARD OF INDIA (SEBI) ACT, 1992

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the securities market of India. It promotes orderly and healthy development in the stock market but initially it was not able to exercise complete control over the stock market transactions. Its status was as a watch dog of the securities market, to observe the activities. Consequently, it was found ineffective in regulating and controlling them. Therefore, in May 1992, it was granted legal status by the Parliament by the Securities Exchange Board of India (SEBI) Act, 1992. It is, now, a body corporate having a separate legal existence and perpetual succession. It’s

Headquarter in Mumbai and having nine regional offices across the country, at present.

The primary function of Security and Exchange Board under SEBI Act, 1992 is the protection of the investors' interest and the healthy development of Indian financial markets. No doubt, it is very difficult and herculean task for the regulators to prevent the scams in the markets considering the great difficulty in regulating and monitoring each and every segment of the financial markets and the same is true for the Indian regulator also. But what are the responsibilities of the regulators to set the system right once the scam has taken place, especially the responsibility of redressing the grievances of the investors so that their confidence is restored. The redressal of investors' grievances, after the scam, is the most challenging task before the regulators all over the world and the Indian regulator is not an exception. One of the weapons in the hand of the regulators is the collection and distribution of disgorged money to the aggrieved investors. SEBI had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000. These Guidelines were issued by the Securities and Exchange Board of India under Section 11 of the SEBI Act. Further, stringent guidelines were suggested by the C.V Bhave committee and accordingly SEBI (Disclosure and Investor Protection) Guidelines, 2000 was replaced by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, which has been discussed in Para 2.15.3(*infra*).

Since the empowerment of the Securities and Exchange Board of India (SEBI) through an Act of Parliament in 1992, SEBI has come up with a number of initiatives aimed at regulating and developing the Indian securities market and improving its safety and efficiency. These initiatives have made an impact on nearly every aspect of the market[83]. Some of those initiatives have transformed the market fundamentally. Particularly noteworthy is the growth in the following:

- Market capitalization

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83. Sabarinathan, G, '*SEBI's Regulation of the Indian Security Market : A Critical Review of the Major Development,*' Vikalpa, Vol. 35, No. 4 (2010)

• Number of listed firms

• Trading volumes and turnover both in the spot and futures markets.

2.15.1 INVESTOR PROTECTION MEASURES BY SEBI

Section 11(2) of the SEBI Act contains measures available with SEBI to implement the legislators' desire of investor protection. The measures available with SEBI include the following:-

1. Regulating the business in Stock Exchanges (SEs) and any other securities markets.

2. Registering and regulating the working of intermediaries like stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers etc. associated with securities markets.

3. Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and other intermediaries.

4. Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.

5. Promoting and regulating self-regulatory organizations.

6. Prohibiting fraudulent and unfair trade practices relating to securities markets.

7. Prohibiting insider trading in securities.

8. Regulating substantial acquisition of shares and takeover of companies.

9. Promoting investors' education and training of intermediaries of securities markets.

10. Carry out inspection/ audits of the SEs / intermediaries etc.

11. Call for information from any bank / any authority / corporation / agencies in respect of any transaction in securities which is under investigation or inquiry by SEBI.

12. Performing such functions and exercising such powers under the Securities contracts (Regulation) Act, 1956 (SCRA)

13. Levying fees or other charges

14. Conducting research

15. Performing such other functions as may be prescribed.

2.15.2 POWER OF SEBI TO INVESTIGATE THE TRANSACTIONS OF SECURITIES

Section 11C of the SEBI Act empowers the Board to investigate when there is reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board there under, it may, at any time by order in writing, direct any person (Investigating Authority) specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.

2.15.3 POWER TO INSPECT THE STOCK EXCHANGES

SEBI is also empowered to inspect the Stock Exchanges to review of market operations, organizational structure and administrative control to ascertain as to whether -

(a) It provides a fair, equitable, transparent and growing market to the investors,

(b) Its organization system and practices are in accordance with the Securities Contracts (Regulation) Act, 1956 [SC(R) Act], 1956 and rules framed there under,

(c) It has implemented the directions, guidelines and instructions issued by SEBI/ Government of India from time to time and

(d) It has complied with the conditions, if any, imposed on it at the time of renewal / grant of its recognition under section 4 of the SC(R) Act, 1956.

2.15.4 SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIRMEMNTS) REGULATIONS, 2009

SEBI has got wide powers to regulate the securities market and to protect the interest of investors in primary market as well as secondary market. The Board has powers to regulate the functioning of stock broker, sub brokers or other intermediaries, so that investor's money cannot be lost by malpractices or in other way. The investment through primary market by investors deemed to the first step in this technical securities market. Therefore, it is primary duty of the SEBI to protect the rights and interest of the investors at the first stage. SEBI had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and investor protection) Guidelines, 2000. These guidelines have been issued by the SEBI under section 11 of the SEBI Act, 1992.

SEBI has been emphasizing on the importance of disclosure standards for corporate in disseminating relevant and correct information to the investors. With this view, SEBI has appointed a committee under the chairmanship of **Shri C. B. Bhave** to suggest measures for improving the continuing disclosure standards by corporate and timely dissemination of price sensitive information to the public. The committee submitted its report to the SEBI. Previously issue of securities was dealt by SEBI (DIP) Guidelines 2000 but now, issue of securities is regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. SEBI (DIP) Guidelines is replaced by the Regulations of 2009. These regulations are called the SEBI (Issue of Capital and Disclosure Requirements) Regulation, 2009 and apply to the following[84]:

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84. Regulation 3 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

(a) a public issue;

(b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;

(c) a preferential issue;

(d) an issue of bonus shares by a listed issuer;

(e) a qualified institutions placement by a listed issuer;

(f) an issue of Indian Depository Receipts.

Important features of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

1. On Disclosure norms, SEBI has directed stock exchanges to disclose all details of complaints lodged by investors against trading members and companies listed on the exchange, on their website. These disclosures would also include details pertaining to arbitration and penal action against trading members. This is a welcome change and an important move to bring in more transparency in the grievance redress mechanism.[85]

2. An investor has the option to apply for and receive the shares in physical form as well as in allotment in demat form as the shares issued through an IPO/FPO are tradable only in the demat form. In any case, for all IPO/FPOs of any security of issue size of Rs. 10 crore or more, issues have to be compulsorily be only in dematerialized form, while Qualified Institutional buyers and large investors (applying for more than Rs. 2,00,000), can apply only in demat form. There are two depositories in the country-National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Ltd.(CDSL). Both have an extensive network of authorized Depository Participants (DPs). Investor can open demat account with any of these DPs.

85. http://taxguru.in/sebi/comparison-between-sebi-issue-of-capital-and-disclosure-requirements-regulations- 2009, accessed on 27April, 2015.

3. On Allotment, refund and payment of interest, the issuer and merchant bankers shall ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue. Where specified securities are not allotted and/or application moneys are not refunded within the period stipulated, the issuer shall undertake to pay interest at such rate and within such time as disclosed in the offer document.

4. On Conditions for initial public offer, an issuer may make an initial public offer, if it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent are held in monetary assets.

5. On manner of disclosures in the offer document, the offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision.

2.15.5 SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES REGULATING SECURITY MARKET) REGULATIONS, 2003

The object of Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 (hereinafter "FUTP Regulations") is to ensure markets are fair, efficient, and transparent which is closely linked to protecting investors from unfair, manipulative, or fraudulent practices, including synchronized trading, front-running, mis-selling etc.

Regulation 3 of the FUTP Regulations prohibits certain enumerated categories of activity. On the lines of Section 12A of SEBI Act, 1992, regulation 3 of the FUTP Regulations is couched in wide terms so as to cover myriad ways of perpetrators of fraudulent, unfair and manipulative practices, directly or indirectly. For instance, they include the employment of a device, scheme or artifice to defraud in connection with dealing with securities; they also include an act, practice, or

course of business which operates as fraud or deceit upon any person in connection with any dealing in securities in contravention of the provisions of the SEBI Act or the rules and regulations framed there under.

Regulation 4 of the FUTP Regulations prohibits fraudulent and unfair trade practices and specifically states that this is *"without prejudice to the generality of Regulation 3"*. Further, Regulation 4(2) states that dealing in securities shall be deemed to be a fraudulent or unfair trade practice if it involves fraud and may include certain categories of activity which are listed in sub-regulations (a) to (s).

Regulation 4 of the FUTP Regulations states the power of the Board to order investigation by 'Investigating Authority so appointed' when there is reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market in violation of these regulations or any intermediary or any person associated with the securities market has violated any of the provisions of the Act or the rules or the regulations. Investigating Authority shall have the power to call for information or records from any person specified in section 11 (2)(i) of the Act for inspection purpose, where he has reasonable grounds to believe that such company has been conducting in violation of these regulations. They can also keep in his custody any books, registers, other documents and record produced under this regulation for a maximum period of one month which may be extended up to a period of six months by the Board. Regulation 9 prescribes that the Investigating Authority shall, on completion of investigation, after taking into account all relevant facts, submit a report to the appointing authority. Further, the Investigating Authority may also submit an interim report pending completion of investigations if he considers necessary in the interest of investors and the securities market or as directed by the appointing authority.

2.15.6 PROHIBITION OF MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING AND SUBSTANTIAL ACQUISITION OF SECURITIES OR CONTROL

Section 12 A of Chapter VA of SEBI Act, which was inserted by Amendment Act, 2002, prohibits any person who directly or indirectly-

(a) uses or employs, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations,

(*b*) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognized stock exchange;

(*c*) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or the regulations,

(*d*) engage in insider trading,

(*e*) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations.

(*f*) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange in contravention of the regulations made under this Act.

2.15.7 SEBI (PROHIBITION OF INSIDER TRADING) REGULATION, 2015

SEBI has viewed insider trading a very serious offence and regarded it as against the investor's interests. "Insider trading" means[86]-

(*i*) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

(*ii*) an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person.

If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.

To tighten gaps in existing norms, SEBI will, soon, introduce the SEBI (Prohibition of Insider Trading) Regulations, 2015, that will replace the existing SEBI (Prohibition of Insider Trading) Regulations, 1992. The new regulations appear to be promising, more practical, and largely in line with the global approach to insider trading. They also seem to be equipped to ensure better compliance and enforcement. The Norms governing insider trading prohibit anyone who has access to inside information in a company from dealing in that firm's publicly traded shares. If found guilty of insider trading, a person could be sent to prison for up to 10 years or be required to pay a fine of up to Rs.25 crore or thrice the amount of profits made.

86. S. 195 of the Companies Act, 2013

2.15.8 SEBI'S POWER OF ADJUDICATION AND TO PUNISH IN CASE OF CONTRAVENTION

SEBI has been empowered to adjudicate and stipulate penalties in case of contravention of its provision, rule and regulation. Section15A to 15HB of chapter VIA of the SEBI Act prescribes penalties for the violation of the provisions of the Act, rules and regulation made there under. Section 15I to 15JB provides the power of SEBI for adjudication. For the purpose of adjudging under this chapter, the Board shall appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty. Some of the important powers are discussed below-

2.15.8.1 PENALTY FOR FAILURE TO FURNISH INFORMATION, RETURN, ETC.

Section 15A provides that if any person, who is required under this Act or any rules or regulations made there under-

(*a*) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

(*b*) to file any return or furnish any information, books or other documents within the time specified there for in the regulations, fails to file return or furnish the same within the time specified there for in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

(*c*) to maintain books of account or records, fails to maintain the same, he shall be liable to a penalty which shall not be less than one lakh rupees but which

may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

2.15.8.2 PENALTY FOR FAILURE BY ANY PERSON TO ENTER INTO AGREEMENT WITH CLIENTS

Section 15B of the Act provides that if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

2.15.8.3 PENALTY FOR FAILURE TO REDRESS INVESTORS' GRIEVANCES.

According to section 15C, If any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

2.15.8.4 PENALTY FOR DEFAULT IN CASE OF STOCK BROKERS

Section 15F provides that if any person, who is registered as a stock broker under this Act-

(*a*) fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to for which the contract note was required to be issued by that broker.

(*b*) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he

shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees.

(*c*) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

2.15.8.5 PENALTY FOR INSIDER TRADING

Section 15G prescribes a very stringent penalty for insider trading. It states that if any insider who,-

(*i*) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or

(*ii*) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(*iii*) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information,

He shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

2.15.8.6 PENALTY FOR NON-DISCLOSURE OF ACQUISITION OF SHARES AND TAKEOVERS

Section 15H provides that if any person, who is required under this Act or any rules or regulations made there under, fails to,-

(*i*) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or

(*ii*) make a public announcement to acquire shares at a minimum price; or

(*iii*) make a public offer by sending letter of offer to the shareholders of the concerned company; or

(*iv*) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer,

He shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.

2.15.8.7 PENALTY FOR FRAUDULENT AND UNFAIR TRADE PRACTICES

According to section 15HA, If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

2.15.8.8 PENALTY FOR CONTRAVENTION WHERE NO SEPARATE PENALTY HAS BEEN PROVIDED

Section 15HB is miscellaneous provision for awarding penalty. It states that whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board there under for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

2.15.9 SEBI (INVESTOR PROTECTION AND EDUCATION) REGULATIONS, 2009

It is worth to mention here that SEBI has also made regulations for investors' protection and education fund with a view to strengthening its activities for

protection of investors. The salient features of these regulations are as follow-

1. The Fund shall be used for the purpose of protection of investors and promotion of investors' education and awareness in ways like:

   (a) educational activities including seminars, training, research and publications, aimed at investors;

   (b) awareness programmes through media - print, electronic, aimed at investors.

   (c) funding investor education and awareness activities of investors' associations recognized by the Board.

   (d) aiding investors' associations recognized by the Board to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed.

2. The Board shall constitute a seven-member advisory committee for recommending investor education and protection activities as mentioned above, to the Board. This Committee would comprise of both SEBI officials and outside experts.

3. These regulations also provide for suitable amendment to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, to provide for one of the sources of income for the investors' protection and education fund.

Thus, SEBI is empowered by SEBI Act, 1992 to protect the investors' interest and promote healthy development of Indian financial markets.

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CHAPTER III

INSPECTION AS A MEANS OF PROTECTION OF INVESTORS

3.1 INTRODUCTION

It has been said that public companies have to work in glass house, which exposes their workings all sides. The belief is that declared affairs are likely to be more honest than those behind the curtain. Professor Gower has stated: "On the basis that forewarned is forearmed" the principle underlying the Companies Act has been that of disclosure. If the public and the members were enabled to find out all relevant information about the company, this, thought the founding fathers of our company law, would be a sure shield. Basically disclosure still remains the principal safeguard on which the Companies Acts pin their faith.[1]

Inspection is a useful instrument and the preliminary step for finding out the true and fair view of the state of company's affairs accordance with the provision of the Companies Act. The object of inspection is not only to keep a watch on the performance of companies but also to evaluate precisely the level of efficiency in the conduct of the affairs of the company concerned. Inspection facilitates to reveal the concealment of income by falsification of accounts, misuse of fiduciary responsibilities by management for personal aggrandizement, misapplication of funds while the industry itself is in a state of perpetual crisis. It helps the Government to ascertain the quantum of profits which have accrued but not adequately accounted for taxation purposes. Knowledge about the management of the business of the company with intent to defraud the creditors, shareholders and

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1. As quoted by Ramaiya, *Guide to the Companies Act* (16th edn.) p. 1973, Lexis Nexis

the avenue, otherwise the fraudulent or unlawful purposes would enable the Government to take effective emergent remedial measures, before company goes into liquidation and thus it protects the interests of the investors of the company.

Every company maintains the register of their members indicating separately for each class of equity and preference shares holders, debenture holders and other security holders at the registered office of the company or at any such places as prescribed by section 88 and 128 of the Companies Act, 2013. It is also necessary by every company to prepare annual return every year as prescribed by the section 92 of the Act, duly signed by a director and the company secretary and to be kept at the registered office of the company. These all registers, copies of annual returns and other records are kept open for inspection by any member, debenture-holder, other security holder or beneficial owner during business hours without payment of any fees. They can also take extracts from any register or records without payment of any fees.[2]

Since last few decades there have been umpteen corporate frauds around the world and India too could not escape from happenings of such frauds. These are taking place not only in corporations but almost in every walk of life. This is because of fall in moral and ethical values, which has led to less respect for other persons and their properties. People's values of life are changing fast.[3]

Periodic inspection of these important documents of a company is necessary to know the fairness and transparent functioning of the company, which is also important to protect the interests of investors of the company. The Company Registrar is empowered by section 206 of the Companies Act, 2013, to call for further information, inspection of books and conduct inquiries in case he is not satisfied after scrutiny of documents filed by the company before him or any information received by him. In this chapter, it is intended to discuss in detail about inspection of various records and document of the company, the persons who

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2. S.94(3) of the Companies Act, 2013
3. Pandey, T.N. "Corporate Frauds - Nature, Control And Regulation," [2014] 50 taxmann.com 18

can inspect, powers of inspector, submission of report, follow up action of this report and importance of inspection.

3.2 INSPECTION OF COMPANY'S DOCUMENTS / RECORDS BY MEMBERS/SHARE HOLDERS, DEBENTURE HOLDERS/ OTHER SECURITY HOLDERS OF THE COMPANY

Investor of a company is entitled to inspect the documents and records. A comparative study of the U.K. Companies Act, 2006 and Indian Companies Act, 2013, in this regard, has been made here.

3.2.1 UNDER UNITED KINGDOM COMPANIES ACT, 2006

In United Kingdom, the Companies Act requires that the accounting records must be kept at the registered office or such other place as the directors think fit and must, at all times, be open for inspection by the officers of the company[4]. There is, however, no express statutory provision authorizing the court to compel inspection[5]. It means no legal rights of inspection of book of accounts/ records of the company have been provided to shareholders, debenture holders, creditors etc. of the company. If accounting records are kept at a place outside the United Kingdom, accounts and returns with respect to the business dealt with in the accounting records so kept must be sent to, and kept at, a place in the United Kingdom, and must at all times be open to such inspection. Such accounts and returns must be such as to-

(a) disclose with reasonably accuracy the financial position of the business in question at intervals of not more than six months and

(b) enable the directors to ensure that the accounts required to be prepared comply with the requirements of the Act.[6]

4. S. 388(1) of the U.K. Companies Act, 2006
5. Charlesworth's *Company Law*, 18th edn.(London Sweat and Maxwell, 2011), p. 456
6. S. 388(3) of the U.K. Companies Act, 2006

Accounting records that a company is required by Section 386 to keep, must be preserved by it-

(a) for three years from the date on which they are made in case of a private company.
(b) for six month from the date on which they are made in case of a public company.[7]

However the United Kingdom's Taxes Management Act, 1970 effectively requires a six years retention period, and in order to cover against possible actions for negligence under the Limitation Act, 1980, the retention period would have been as long as 15 years. Failure to keep accounting records as required is an offence for which officers of the company are held liable, the penalty being imprisonment and/or a fine.[8]

This Act also provides for criminal liabilities on directors of the company in respect of the failure to file account and records.[9]The civil penalty may also follow.[10] There are also provision in the Act for revision of defective accounts and reports. Where a company's annual accounts, summary financial statement, director's report do not comply with the Act, the director may voluntarily revise them.[11] The Secretary of the State may also give notice to a company's directors indicating how he believes that the financial statements and/or reports laid before the company or delivered to the Registrar may not comply with the Act's requirements. The director must within a specified period of up to a month give satisfactory explanations or prepare revised financial statements and/or reports, failing which the Secretary of State may apply to the court.[12]

An application may be made to the court by the Secretary of the State, after having complied with s. 455 or by a person authorised by the Secretary of the State, for a declaration that the annual accounts of a company do not comply, or

7. S. 388(4) of the U.K. Companies Act, 2006
8. S. 389 of the U.K. Companies Act, 2006
9. S. 451 of the U.K. Companies Act, 2006
10. S.453 of the U.K. Companies Act, 2006
11. S.454 (1) of the U.K. Companies Act, 2006
12. S.455 of the U.K. Companies Act, 2006

a director report does not comply, with the requirement of this Act.[13] The court may pass the order to revise the said documents to directors of the company complying with the requirement of the Act.

3.2.2 UNDER INDIAN COMPANIES ACT, 2013

Section 94 of the Companies Act, 2013 prescribes the place of keeping and inspection of registers, return etc. It states that the registers required to be kept and maintained by a company under section 88, 128 and copies of the annual returns filed under section 92, are to be kept at the registered office of the company. These registers, copies of returns and documents may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company and the Registrar has been given a copy of the proposed special resolution in advance.[14]

The Act requires that every company should prepare the annual return in the prescribed form containing the particulars as they stood on the close of the financial year regarding[15]—

(i) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;

(ii) its shares, debentures and other securities and shareholding pattern;

(iii) its indebtedness;

(iv) its members and debenture-holders along with changes therein since the close of the previous financial year;

(v) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;

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13. S.456 of the U.K. Companies Act, 2006
14. S.92 of the Act, 2013 (hereafter referred as the Act)
15. sub section (2) *Ibid*

(vi) meetings of members or a class thereof, Board and its various committees along with attendance details;

(vii) remuneration of directors and key managerial personnel;

(viii) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;

(ix) matters relating to certification of compliances, disclosures as may be prescribed;

(x) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors(FII) indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and

(xi) such other matters as may be prescribed, and signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice.

In case of One Person Company (OPC) and small companies, the annual returns are required to be signed by the company secretary, or where there is no company secretary, by the director of the company. The Companies Act, 2013 has, for the first time, allowed formation of a limited liability company by just one person on the recommendation of J.J Irani Expert Committee. Such a company is described under section 3(1)(c) as a private company, 'One Person Company' is a one shareholder corporate entity.

The annual return, filed by a listed company or, by a company having such paid-up capital and turnover as may be prescribed, should be certified by a company secretary in practice in the prescribed form, stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of this Act.[16]

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16. sub section (2) *Ibid*

3.2.2.1 FILING OF ANNUAL RETURNS

Every company should file with the Registrar a copy of the annual return, within 60 days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within 60 days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed, within the time as specified, under section 403.[17]

3.2.2.2 PENALTY FOR NON-COMPLIANCE

If a company fails to file its annual return under section 94(4) of the Act, before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than rupees fifty thousand but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than rupees fifty thousand but which may extend to rupees five lakh, or with both.[18]

If a company secretary in practice certifies the annual return otherwise than inconformity with the requirements of this section or the rules made there under, he shall be punishable with fine which shall not be less than rupees fifty thousand but which may be extended to rupees five lakh.[19]

3.2.2.3 INSPECTION OF DOCUMENTS

The registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns are required to be kept open for inspection by any member, debenture-holder, other security holder or beneficial owner,

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17. sub section (4) *Ibid*
18. sub section (5) *Ibid*
19. sub section (6) *Ibid*

during business hours without payment of any fees and by any other person on payment of such fees as may be prescribed.[20]

Any such member, debenture-holder, other security holder or beneficial owner or any other person may—

(*a*) take extracts from any register, or index or return without payment of any fee; or

(*b*) require a copy of any such register or entries therein or return on payment of such fees as may be prescribed.

If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be held liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues.[21]

Chapter IX of the Companies Act, 2010 provides for the provision of preparation and keeping books of account and other relevant books of every company at the registered office of the company. Company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Section 128 corresponds to section 209 of the companies Act, 1956.This section provides for inspection of above documents, open for any director of the company, during business hours but not open for the members of the company.

In ***Amal Fakkirji* v. *E.A. Pearson***[22], it was held that members of a company do not have a right of access to its records. Article of Association may entitle the directors to authorize a member to inspect accounting records of the company if ordinary resolution of members is passed. Even in such a case the member would have to exercise this right personally and not through a proxy.

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20. S. 94(2) of the Act
21. sub section (4) *Ibid*
22. AIR 1926 Sind 295

In ***Lalita Rajya Laxmi* v. *Indian Motor Co. Ltd,***[23] it was held that a shareholder has no statutory right of inspection of the books of account of the company. He can, however, inspect the books only if such right is given specifically through the article, which is rare.

3.2.2.4 CLOSING OF THE REGISTER OF MEMBERS/DEBENTURE HOLDERS/OTHER SECURITY HOLDERS OF THE COMPANY

A public listed company can close the register of members or debenture holder or other security holders for any period or periods not exceeding in aggregate 45 days in each year, but not exceeding 30 days at any one time, to get their security listed or prior to the annual general meeting for the finalizing the list of shareholders to whom notice should be sent as also to determine the entitlement of dividend for shareholders if and when declared at the annual general meeting. For the purposes of rights or bonus issues, the register may again be closed, for the purpose of determining the entitlement of rights or bonus, as the case may be.

This is, however subjected to notice of at least seven days or such lesser period as may be specified by Security and Exchange Board of India.[24] Such previous notice may be served through advertisement in newspapers circulating in the country where the registered office of the company is located. There is provision of penalty if such notice has not given. Such company and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for every day subject to a minimum of one lakh rupees during which the register is kept closed.[25]

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23. (1962) 32 Company cases 207
24. S. 91 of the Act of 2013
25. sub section (2) *Ibid*

3.3 INSPECTION OF COMPANY'S DOCUMENTS / RECORDS BY AUTHORISED PERSONS OTHER THAN MEMBERS / SHARE-HOLDERS/DEBENTURE HOLDERS / OTHER SECURITY HOLDERS OF THE COMPANY

Inspection of books of account and papers of the company can be inspected by persons other than members, shareholders, debenture holders or other security holders, if authorised. Central Government may pass order of inspection either by the Registrar or an Inspector or any statutory authority, appointed for this purpose under Section 206 of the Companies Act, 2013. A check on the performance of companies is generally exercised by scrutiny of balance-sheet and profit and loss account filled by them with the Registrar of the Company (ROC) who is empowered under section 206 of the Companies Act, 2013 to call for information and explanation with respect to any matter to which such documents purport to relate.

The inspection of books of account also enable the Government to ascertain the quantum of profits which have accrued but not adequately accounted for taxation purposes, concealment of income by falsification of accounts, misuse of fiduciary responsibilities by management for personal aggrandizement, misapplication of funds while the industry itself is in a state of perpetual crisis. Such knowledge about the management of the business of the company with intent to defraud the creditors, shareholders and the avenue, otherwise the fraudulent or unlawful purposes would enable the Government to take effective emergent remedial measures, before company goes into liquidation and thus only save the industry or trade, as such, but also prevent distress to the employees and the workers.

The another significant object of inspection is ensuring that the transactions have been validly entered into in accordance with the rules and procedures of the company and also ascertaining how far the statutory auditors have

discharged their functions and duties in certifying the true and fair view of the company's account and their proper maintenance.[26]

Section 206, 207, 208, 220, 223 and 224 of the Companies Act, 2013 deals with inspection of books of account, other books and papers also by the Company Registrar or Inspector appointed for this purpose and making of reports but they are not empowered for investigation of affairs of the company, *suo moto,* in case of finding of irregularity. If the company has acted fraudulently or unlawful manner then there are chances to destroy, mutilated, alter, falsified or secreted of such documents. They are merely report making authority.

The Registrar or inspector shall, after the inspection of the books of account or an inquiry submits a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a necessary giving reason in support. Now it is on the discretion of the Central Government to order for further investigation into the affairs of the company (section 210). Therefore, such default company will get time to destroy, mutilated, alter, falsified or secreted of such documents so to prevent such occurrences it is necessary that inspectors should be empowered to start investigation along with the submission of report to Central Government. This will help in better protection of the rights and interests of investors.

3.4 PERSONS/INSTITUTIONS AUTHORISED FOR INSPECTION

Inspection of the books of account can be conducted by the Registrar of Companies or any other officer of the Government who is authorised in this behalf. A new provision through section 206(6) has been introduced in the Companies Act, 2013 which empowered the Central Government to authorize any statutory authority to carry out the inspection of books of account of a

26. Object and reason of S. 209A of the Companies (Amendment) Act, 1960 (now, S. 206 of the Act of 2013).

company or class of companies, by general or special order. There was no such provision in the Companies Act, 1956.

Now, the provision authorizing Stock Exchange Board of India (SEBI) has been removed from the Act of 2013. The Companies Amendment Act, 2000 had added clause (a)(iii) in section 209, under which SEBI was also given the power of inspection for listed companies or companies intending to get listed in respect of specified matters, through such officer as may be authorised by it. The SEBI power was confined to sections specified in section 55A of the Act of 1956, in so far as they relate to issue and transfer of securities or nonpayment of dividend, has now removed in the Companies Act. 2013.

Thus, inspection of the books of account can be conducted by the following persons or institutions-

(a) Registrar of Companies

(b) Person authorised by Central Government

(c) Statutory Authority appointed by the Central Government

(d) Director of the Company

(e) Advisory Committee during liquidation of a company

(f) Reserve bank of India

3.4.1 INSPECTION BY REGISTRAR OF COMPANIES

Registrar of Companies (ROC) is the important authority for a company from its incorporation to till its winding up procedure. They are full time field officers, appointed by the Central Government, who deal directly with the companies registered or intended to be registered within their territorial jurisdiction. Section 396 of the Act empowers the Central Government to establish registration offices for the purpose of registration of companies and exercising powers and functions through ROC, under the Act. These offices function as registry of records, relating to the companies registered with them,

which are available for inspection by members of public on payment of the prescribed fee. The Central Government exercises administrative control over these offices through the respective Regional Directors.

It has been made compulsory to every company to send all relevant documents and papers related to incorporation and all activities to Registrar of Companies. Under Rule 10 of the Companies (Registration Office and Fees) Rules 2014, after a document is filled with ROC, he is required to examine or cause to be examined the document received in his office which is required under the Act to be registered, recorded or filled by or with the ROC. The ROC needs to take a decision within 30 days from the date of filling of the document.

3.4.1.1 POWER OF REGISTRAR OF COMPANY (ROC) TO CALL FOR INFORMATION

If the Registrar, on scrutiny of any document, filed by a company or on any information received by him, is of the opinion that any further information or explanation or any further documents relating to the company is necessary, he may require the company to furnish in writing such information or explanation or produce such documents. The Registrar will give written notice to the company to provide the desired information within reasonable time.[27]

It is the duty of the company and of its officers concerned to furnish such information or explanation to the best of their knowledge and power and to produce the documents to the Registrar within the time specified in the notice. The Registrar may by another written notice stating the reasons, call on the company to produce for his inspection such further books of account, books, papers and explanations-

(a) if the company fails to furnish the information or explanation to the Registrar within the time specified, or

27. S. 206(1) of the Act

(b) if the Registrar on an examination of the documents furnished is of the opinion that the information or explanation furnished is inadequate, or

(c) if the Registrar is satisfied on a scrutiny of the documents furnished that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required.[28]

3.4.1.2 POWER OF REGISTRAR OF COMPANY TO CONDUCT INQUIRY

An additional power to ROC, to conduct inquiry, has been added in the Companies Act, 2013. If the Registrar is satisfied on the basis of information available with or furnished to him or on a representation made to him by any person that

(a) the business of a company is being carried on for a fraudulent or unlawful purpose, or

(b) not in compliance with the provisions of this Act, or

(c) if the grievances of investors are not being addressed,

the Registrar may, after informing the company of the allegations made against it by a written order, call on the company to furnish in writing any information or explanation on matters specified in the order within such time as he may specify therein and carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard.[29]

Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar for the purpose to carry out the inquiry of such company. Where a Registrar calls for the books of account and other books and papers under section 206, it shall be the duty of every director, officer or other employee of the company to produce all such documents to the Registrar and furnish him with such statements, information or explanations in such form as the Registrar may require and shall render all assistance to the Registrar in connection with such inspection.[30]

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28. S. 206(2) and (3) of the Act
29. S. 206 (4) of the Act
30. S.207 of the Act

In ***Indra Prakash Karnani* v. *Registrar of Companies***,[31] it was held that the Registrar of the Companies has right to inspect the books of account and if he is prevented from rendering inspection of accounts, the directors of the company may be prosecuted. A prior prosecution of company is not a pre-condition for prosecution of director of the company.

In ***Bajoria B.M.* v. *Union of India,***[32] the court held that the power of inspection is different from an investigation under the Act and that is not necessary for the Registrar before filling a complaint on the basis of inspection of accounts to give to a company a copy of the inspection report.

3.4.1.2 PENALTY IN CASE OF CONTRAVENTION

Section 206(7) of the Act of 2013 provides that if a company fails to furnish any information or explanation or produce any document required under this section, the company and every officer of the company, who is in default shall be punishable with a fine which may extend to one lakh rupees and in the case of a continuing failure, with an additional fine which may extend to five hundred rupees for everyday after the first during which the failure continues. Where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud in the manner as provided in section 447.

3.4.1.3 POWER OF REGISTRAR OF COMPANY TO RETAIN THE SEIZED BOOKS

Section 209 of the Companies Act, 2013 provides that when the Registrar has reasonable ground to believe on information or otherwise, that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or

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31. (1985) 57 Comp.Cas.662 (Cal)
32. (1972) 42 Comp. Cases 338 (Del)

secreted, he may, after obtaining an order from the Special Court for the seizure of such books and papers,—

(i) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and

(ii) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

These books and papers seized should be returned, as soon as may be, and in any case not later than one hundred and eightieth days after such seizure, to the company from whose custody or power such books or papers were seized. Earlier in the Act of 1956, Registrar was allowed to keep such seized books and papers only for 30 days. In case of further requirement after 180 days, the books and papers may be called for by the Registrar by an order in writing. This power of Registrar was also not available in the Act of 1956. He may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

3.4.2 INSPECTION BY THE PERSON AUTHORISED BY CENTRAL GOVERNMENT

The Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it for the purpose.[33] Since the company comes under the subject matter of the Central Government, so Central Government has passed numbers of rules for the effective control over companies. The Central Government can appoint any person as inspector to check the functioning of any company accordance with the Act. The subject matter of inspection is book and papers, which includes books of account,

33. S. 206 (5) of the Act

deeds, vouchers, writings, documents, minutes and registers maintained on paper or electronic form.[34]

Where an inspector calls for the books of account and other books and papers under section 206, it shall be the duty of every director, officer or other employee of the company to produce all such documents to inspector and furnish him with such statements, information or explanations in such form as inspector may require and shall render all assistance to inspector in connection with such inspection.[35]

The inspector shall, after the inspection of the books of account or an inquiry submits a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a necessary giving reason in support. Now it is on the discretion of the Central Government to order for further investigation into the affairs of the company in case of irregularities.[36]The powers of the Inspector have been dealt in detail in separate heading.

3.4.3 INSPECTION BY STATUTORY AUTHORITY APPOINTED BY THE CENTRAL GOVERNMENT

The Central Government may, having regard to the circumstances by general or special order, authorize any statutory authority to carry out the inspection of books of account of a company or class of companies. This is a new provision in the Companies Act, 2013. This provision was necessary to protect the interest of investors. Such statutory authority submits the report, after inspection of books of account of a company or class of companies, to the Central Government.

It is noticed from the Annual Reports of the Department of Corporate Affairs that the books of account and other records of the companies are inspected selectively by officers of the Directorate of Inspection authorised for this purpose under this section. Inspection *inter alia*, covers the companies with paid up capital exceeding certain level, companies incurring losses and companies in respect of which

34. S. 2(12) of the Act
35. S. 207 of the Act
36. S. 210 of the Act

complaints are received. The material brought out in the inspection reports is made use of for taking actions under important provisions of the Act including inter alia, appointment of Government directors, ordering investigations into the affairs of the companies under section 210, and consideration of application seeking approval for the appointment of managerial personnel in companies. In certain cases, prosecutions are also launched on the basis of the finding contained in the inspection report. Besides, cases involving non-compliance of certain provisions of the Act, including inadequate maintenance of statutory records noticed during such inspections, are also taken up with the companies for necessary remedial action. Information of interest to other Government Departments/agencies as brought out in the inspection reports is also communicated to them for suitable and appropriate action.[37]

3.4.4 INSPECTION BY DIRECTOR OF THE COMPANY

A director of the company is empowered to inspect the books of account and other books and paper maintained by the company within India, at the registered office of the company or at such other place in India during business hours. In the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as may be prescribed.[38]

A director cannot be prevented or refused inspection of the books of accounts as it is a statutory right given to him under section 128(3) of the Companies Act, 2013. In case of prevention or refusal, he can enforce his right through the court. But, the right of inspection by a director is not an absolute right.

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37. Kapoor, G.K and S.Dhamija, *Company Law and Practices*, Taxmann,19th edn. 2014, pp.676-677
38. S. 128(3) of the Act

3.4.4.1 WHETHER DIRECTOR'S RIGHT OF INSPECTION OF BOOKS OF ACCOUNT IS ENFORCEABLE THROUGH THE COURT OF LAW?

The question whether the director's right of inspection of books of account is enforceable or not through a Court of Law, was considered by the Rajasthan High Court in ***Maharaj Kumar Mahendra Singh* v. *Lake Palace Hotels (P.) Ltd.***[39] It was urged because the company contended that section 209[now section 128(3)] does not contain any provision conferring on the Court the power to make any order directing the company to allow any inspection to any director, and, therefore, in the absence of any such provision the right of inspection is not enforceable. In support of this plausible argument, an express provision contained in some of the sections was also pointed out, *e.g.,* in sections 144, 163, 196, 304, 307 of the Act of 1956, etc. This argument, however, could not carry conviction with the Court. The High Court held that a petition was maintainable under section 209(4) for enforcement of the right conferred by the said section[40]. The learned Judge observed as follows:

> "…. In my opinion, it cannot be conceived that where a statute confers a right, then the right would remain unenforceable. It is one thing that penal proceedings may be taken. It is entirely different that without initiating penal proceedings, the right is sought to be enforced. It is the look out of the director only to launch the prosecution or to seek enforcement of his right by initiating the proceedings before the Court which has jurisdiction to entertain such petition. The general maxim is "*ubi jus ibi remedium*" (where there is a right, there is a remedy). Here sub-section (4) of section 209 of the Act confers a statutory right of inspection and the Court which has jurisdiction under the Act, in my opinion, possesses powers to enforce that statutory right. It has been urged that the Companies (Court) Rules, 1959 do not envisage any such

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39. [1985] 58 Comp. Cas. 805
40. Chandratre K.R.,*"Directors' Right to Inspection of Books of Account of a Company," [2014] 49 taxmann.com 554*

> petition and what petitions lie, are specified. Petitions provided under the Rules are exhaustive. I am unable to agree with this submission as well. As already stated, when sub-section (4) of section 209 of the Act envisages conferment of right of inspection on the director then the director can seek a remedy by moving a petition to this Court. Thus, I hold that the petition is maintainable under section 209(4) of the Act and the company is under an obligation to allow inspection to the petitioner of all the books of account and other books and papers." [p. 807]

Where on the facts and circumstances it is clear in any case that there is reason to believe that the inspection is sought for supplying information to a rival in business of the company or for any purpose which is prejudicial or injurious to the interest of the company, the inspection may be justifiably be refused.

The right of inspection can be exercised either by director himself or through his agent. In ***Vakharia* v. *Supreme General Film Exchange Co. Ltd*.**[41] it was held that a director is entitled to make inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertaken not to utilize the information obtained by him for any purpose other than the purpose of his principal. In aforesaid case inspection through an agent was allowed because of the physical inability of the director to inspect books of account personally.

In ***M.L. Thukral* v. *Krone Communications Ltd***[42] the petitioners (directors) wanted to exercise their right of inspection by a chartered accountant. The Company Law Board (CLB) allowed it subject to the undertaking being given by the charted accountant that he would disclose the information obtained through inspection only to petitioners and not to others.

In ***D. Ross Porter* v. *Pioneer Steel Co. Ltd,***[43]the Delhi High Court has said that it would be proper to allow the director concerned inspection of the books of

41. (1948) 18 Com. Cases 34
42. (1996) 86 Com. Cases 643
43. (1990) 68 Com Cases 145

account, accounts with banks, financial institutions and private parties from whom loans had been taken by the company and register of movable assets only.

3.4.5 INSPECTION BY ADVISORY COMMITTEE DURING LIQUIDATION OF A COMPANY

Section 287 of the Companies Act, 2013 provides that the Tribunal may, while passing an order of winding up of a company, direct that there should be, an Advisory Committee to advice the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct. Earlier, this Advisory Committee was known as Committee of Inspection in the Act of 1956. Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a liquidator is appointed and he takes control of the company, collects its assets, pays it debts and finally distributes any surplus among the members in accordance with their rights.[44]

According to Pennington, Winding up or liquidation is the process by which the management of a company's affairs is taken out of its director's hand, its assets are realized by a liquidator and its debts and liabilities are discharged out of the proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.[45]

There are two modes of winding up of a company, prescribed in the Act-

(i) by the Tribunal making a winding up order. This is also known as compulsory winding up.

(ii) by passing of an appropriate resolution for voluntary winding up at a general meeting of members. This is also known as voluntary winding up.

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44. Gower, *The Principles of Modern Company Law* (3rd Edition), 1969, p.647
45. Pennington's *Company Law*, 5th Edn., p.839

3.4.5.1 COMPOSITION OF ADVISORY COMMITTEE

Advisory Committee is constituted on the direction of Company Tribunal under section 287 of the Act of 2013 and earlier this power of appointment was vested in the court. However the appointment of this committee is not obligatory as the operating word of section 287 says- "the Tribunal may." The Tribunal passes order for the constitution of this committee while passing an order of winding up of a company. The Tribunal may also direct that the Committee should advice the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may seek.

The advisory committee appointed by the Tribunal should consist of maximum twelve members of creditors and contributories of the company or such other persons in such proportion as the Tribunal may, keeping in view the circumstances of the company under liquidation, direct. Company Liquidator is the chairman of this committee. The Company Liquidator should convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee. This time limit for convening meeting of creditors and contributories was two month in the Act of 1956 which is, now, reduced to thirty days in the Act of 2013.

3.4.5.2 RIGHT OF INSPECTION OF BOOKS OF ACCOUNT OF THE COMPANY DURING LIQUIDATION

The Advisory Committee, so appointed under section 287 of the Act, has the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time. Section 293 provides the provision regarding the books to be kept by Company Liquidator. According to this provision, the Company Liquidator should keep proper books in such manner, as may be prescribed, in which he should cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed.

Any creditor or contributory may, subject to the control of the Tribunal, inspect any such books, personally or through his agent.

Section 294 of the Act, confers a special duty to the Company Liquidator to maintain the proper and regular books of account so that the interests of all beneficiaries could be protected. According to this provision, the Company Liquidator should maintain proper and regular books of account including accounts of receipts and payments made by him in such form and manner as maybe prescribed. He should, at such times as may be prescribed but not less than twice in each year during his tenure of office, present to the Tribunal an account of the receipts and payments as such liquidator in the prescribed form in duplicate, which should be verified by a declaration in such form and manner as may be prescribed.

The Tribunal is required to cause the accounts to be audited in such manner as it thinks fit and for the purpose of the audit, the Company Liquidator should furnish to the Tribunal with such vouchers and information as the Tribunal may require, and the Tribunal may, at anytime, require the production of, and inspect, any books of account kept by the Company Liquidator. When the accounts of the company have been audited, one copy thereof is to be filed by the Company Liquidator with the Tribunal, and the other copy is to be delivered to the Registrar which should be open to inspection by any creditor, contributory or person interested.[46] Further The Company Liquidator should cause the accounts when audited, or a summary thereof, to be printed, and should send a printed copy of the accounts or summary thereof by post to every creditor and every contributory.

3.4.6 INSPECTION BY RESERVE BANK OF INDIA

The Reserve Bank of India is empowered to inspect the books and paper of all the non-banking companies by sub-section (1) of Section 45N of the Reserve Bank of India Act, 1934. This section states that the banks may, at any time, cause an inspection to be made by one or more of its officers or employees or other persons(hereafter in this section referred to as the inspecting authority-

46. S.294(4) of the Act

(i) of any non-banking institution, including a financial institution, for the purpose of verifying the correctness or completeness of any statement, information or particulars furnished to the bank or for the purpose of obtaining any information or particulars which the non-banking institution has failed to furnish on being called upon to do so; or

(ii) of any non-banking institution being a financial institution if the bank considers it necessary or expedient to inspect that institution.

3.5 PERSONS RESPONSIBLE FOR KEEPING PROPER BOOKS OF ACCOUNT/RECORDS OF THE COMPANY

Section 128 of the Companies Act, 2013 provides that every company should prepare books of account, other relevant books and financial statement for every financial year and to be kept at its registered office. The following persons of the company are responsible for keeping proper books of account and records of the company as per the section 128(6)-

(a) the managing director of the company,

(b) the whole time director in charge of finance,

(c) the Chief Financial Officer or

(d) any other person of the company charged by the Board

In case of contravention, the company itself is not punishable but abovementioned persons are held liable and they may be punished with imprisonment or with heavy fine or with both as prescribed in the Act. The following punishments are prescribed for non-compliance with this section-

(a) imprisonment which may extend up to one year, or,

(b) with fine of not less than rupees fifty thousand but may be extended to rupees five lakh, or,

(c) with both.

3.6 PROPER BOOKS OF ACCOUNT IN RELATION TO THE BRANCH OF A COMPANY

Section 128(2) of the Companies Act, 2013 prescribes that where a company has a branch office, whether in India or outside India, the company shall be deemed to have complied with the provisions of section 128(1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns, made up to date, at the intervals of not more than three months, are sent by the branch office to the registered office of the company or at such other address where the books of account are kept by fulfilling the requirements mentioned earlier. This requirement is specific that a foreign branch has also to maintain proper books of account as required by section 128(1) of the Act, irrespective of the requirement, if any, in the country where the branch is located.

3.7 PERIOD FOR WHICH BOOKS OF ACCOUNT TO BE PRESERVED

Every company is required to preserve the books of accounts, related vouchers and other relevant records in good condition for a period of not less than eight years immediately preceding the current year. Where the company had not been inexistence for a period less than eight years, the books of account and related vouchers should be preserved in good order right from the first accounting year of the company. A new provision has been added in the Act of 2013, that where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.[47]

47. S. 128(5) of the Act

3.8 BOOKS OF ACCOUNT/RECORDS OF THE COMPANY WHICH CAN BE INSPECTED

Section 128 of the Companies Act, 2013 provides that every company should prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which gives a true and fair view of the state of the affairs of the company. The definition of 'book of account' is given in section 2(13) of the Act which states that the 'books of account" includes records maintained in respect of-

(i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
(ii) all sales and purchases of goods and services by the company;
(iii) the assets and liabilities of the company; and
(iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

To satisfy the above requirements, companies usually maintain the following books and records:

(a) Cash book to record cash and bank receipt and payment, cash discount received and allowed,

(b) Purchase Day Book, Purchase Book, Invoice Book or Bought Book for recording credit purchase,

(c) Sale Day Book, Sales Book or Sold Book for recording credit sales,

(d) Purchase Return Book or Returns Outward Book for recording goods returned by the company,

(e) Sales Return Book or Returns Inward Book to record goods returned to the Company,

(f) Bills Receivable Book to keep a record of bills of exchange receivable,

(g) Bills payable Books to keep e record of bills of exchange payable,

(h) Journal to record opening entries, transfers from one account to another,

(i) Customers' Ledger or Debtors' ledger showing the position of account with company's customers enjoying credit facilities,

(j) Suppliers ledger or Creditors' Ledger showing the company's indebtedness to parties which supplied goods to the company on credit,

(k) General Ledger showing accounts other than those of customers and suppliers mentioned in (i) and (j),

(l) Cost Accounting Records as prescribed.

Apart from the above Books of Account, companies also maintain Vouchers, Bills, Invoices and other documents supporting each entry in the Books of Account as well as other records such as Stock records, Stock-taking statements, Bank reconciliation statement etc. These are only an illustrative list and many companies maintain other books of account also. Many companies combine some of the above books and records.[48]

3.8.1 ANNUAL REPORT ON CORPORATE SOCIAL RESPONSIBILITY

Section 135 of the Act of 2013 made it mandatory for every company having specified net worth or turnover or net profit during any financial year, to spend in every financial year, at least two percent of the average net profits made during the three immediate preceding financial years, in pursuance of its corporate social responsibility policy. It requires such companies to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The companies specified for this purpose are those having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees

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48. Dutta C.R, *Company Law*, 6th Edn., p.3148, Lexis Nexis

five crore or more during any financial year. The composition of the committee formed under Section 135 needs to be disclosed in the Board's report. Clause (o) of the Section 134(3) requires disclosure of company's policy and initiatives taken during the year. The Companies (Social Responsibility Policy) Rules 2014 states that the Board's report shall include an annual report on CSR containing particulars specified in the Annexure to the rules and also be disclosed on the company's website.

3.9 MAINTENANCE OF ELECTRONIC RECORDS

The Companies Act, 2013 also permits the company to maintain the books of account and other relevant paper in an electronic mode. If a company decides to maintain the books of account in the electronic mode, the rule 3 of the Companies (Accounts) Rules, 2014 requires that such books of account and records to remain accessible in India for being usable subsequently. Such books and records must be maintained in the format in which they were originally generated, sent or received. Such books of account kept in electronic mode are also subject matter of inspection.

The Information Technology Act, 2000 provides that where any law requires that any information or matter should be in typewritten or printed form, then such requirement shall be deemed to be satisfied if it is in an electronic form. However, it will have to be ensured that the information contained in the electronic records remains accessible and unaltered and its origin, destination, date, etc. can be identified. The Act further provides that where any law requires that information or document or other matter should be authenticated by means of digital signatures affixed in such manner as may be prescribed under the rules framed by the Central Government.[49]

In present time several companies carry business globally, so importance of maintaining the various records in the electronic form has became necessary in order to access by management as well as by investors of the company. "As

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49. *Ibid*

business is carried out internationally, the need for a continuous, 24X7 accesses to corporate records becomes extremely important. While as companies have now been given the option to keep records in electronic format under the Companies Act, 2013, several companies may want to adopt electronic record keeping for statutory records. Companies are increasingly realizing that electronic records are not merely statutory formalities but they are very important reference points for the senior management as well. They are an integral part of the MIS"[50].

3.9.1 FILING OF APPLICATIONS, DOCUMENTS, INSPECTION, ETC., IN ELECTRONIC FORM

Section 398 of the Act of 2013 provides the provision for filling of applications documents, inspection, etc., of the companies in electronic form. The Central Government is empowered to make rules in this regard in accordance with the provisions contained in section 6 of the Information Technology Act, 2000. The Central Government may, by notification in the Official gazette, make rules regarding:

(*a*) such applications, balance sheet, prospectus, return, declaration, memorandum, articles, particulars of charges, or any other particulars or document as may be required to be filed or delivered under this Act or the rules made there under, shall be filed in the electronic form and authenticated in such manner as may be prescribed;

(*b*) such document, notice, any communication or intimation, as may be required to be served or delivered under this Act, in the electronic form and authenticated in such manner as may be prescribed;

(*c*) such applications, balance sheet, prospectus, return, register, memorandum, articles, particulars of charges, or any other particulars or document and return filed under this Act or rules made there under shall be

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50. Kothari Vinod and N. Shankar, *"Companies Act, 2013: Requisites with respect to electronic records"*, [2015] 53 taxmann.com 341

maintained by the Registrar in the electronic form and registered or authenticated, as the case may be, in such manner as may be prescribed;

(*d*) such inspection of the memorandum, articles, register, index, balance sheet, return or any other particulars or document maintained in the electronic form, as is otherwise available for inspection under this Act or the rules made there under, may be made by any person through the electronic form in such manner as may be prescribed;

(*e*) such fees, charges or other sums payable under this Act or the rules made there under shall be paid through the electronic form and in such manner as may be prescribed; and

(*f*) the Registrar shall register change of registered office, alteration of memorandum or articles, prospectus, issue certificate of incorporation, register such document, issue such certificate, record the notice, receive such communication as may be required to be registered or issued or recorded or received, as the case may be, under this Act or the rules made there under or perform duties or discharge functions or exercise powers under this Act or the rules made there under or do any act which is by this Act directed to be performed or discharged or exercised or done by the Registrar in the electronic form in such manner as may be prescribed.

3.9.2 ELECTRONIC FORM TO BE EXCLUSIVE, ALTERNATIVE OR IN ADDITION TO PHYSICAL FORM

Section 400 clarifies that the electronic form shall be exclusive, or in the alternative or in addition to the physical form. The Central Government is empowered to make rule in this respect. The Central Government may also provide such value added services through the electronic form and levy such fees as may be prescribed. This is a new provision in the Act of 2013.

3.10 INSPECTION OF OTHER BOOKS AND PAPERS OF THE COMPANY

Not only the books of account but also other books and papers of every company are open for inspection by the Registrar or any other officer authorised by the Central Government. Section 128(3) clearly states that the other books and papers are also the subject matter of inspection. Section 2(12) of the Act of 2013 has defined the terms "book and paper" in an inclusive manner. It provides that "book and paper" and "book or paper" shall include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or electronic form. It may be noted that the definition equates "book and paper" and "book or paper" and provides for a wide coverage which may not necessarily be related to the books of account but also includes such records maintained in the electronic form.

3.11 TIME AND PLACE OF INSPECTION

Inspection may be made at any time during business hours and for this purpose no previous notice to the company is necessary. The place at which inspection may be carried out need not be the registered office of the company. The books of account have to be kept either at the registered office of the company or at some other place, after an intimation to the Registrar of the company.

In ***Indra Prakash Karnani* v. *Registrar of Company***,[51] the Calcutta High Court has held that authorised Inspecting Officer or Registrar of Company is entitled to demand inspection of the books of accounts even in his office under clause (iii) of subsection (5) of section 209-A of the Act of 1956 (Now, 206(3)(c) of the Act of 2013). However, it can be made at any time during business hours.

3.12 DUTIES OF DIRECTORS, OFFICERS, EMPLOYEES OF THE COMPANY TO ASSIST IN INSPECTION AND INQUIRY

Although the Inspecting Officer is empowered by the Act to inspect the books of account and records of the company but he can execute this successfully only

51. (1985) 57 Comp. Cas. 62 (Cal)

when the employees of the company co-operate with him during inspection. Section 207(1) casts a duty of every director, officer or other employee of the company to produce all such documents to the Registrar or inspector and furnish him with such statements, information or explanations relating to the affairs of company in such form as the said person may require within such time and at such place as he may specify. Further it shall also be the duty of every director, officer or other employee of the company to the person making inspection under this section all assistance in connection with the inspection which the company may reasonably be expected to give.

3.12.1 PUNISHMENTS FOR DEFAULT

Subsection (4) of section 207 prescribes that if any director or officer of the company disobeys the direction issued by the Registrar or the inspector, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees. Further, if a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.

3.13 POWERS OF THE INPECTOR DURING INSPECTION

We have seen that under section 206 (5) of the Act of 2013, the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it to check the functioning of any company accordance with the Act. The following powers have been provided to an inspector during inspection, under the Act.

(a) Power to call for books of account and other books and papers

(b) Power to make or cause to be made copies

(c) Power to place identification of marks

(d) Powers of Civil Court

(e) Powers to search and seizure

3.13.1 POWER TO CALL FOR BOOKS OF ACCOUNT AND OTHER BOOKS AND PAPERS

Section 207 (1) of the Act empowers a person making the inspection or inquiry under section 206 to call for the books of account and other books and papers for inspection. It shall be the duty of every director, officer or other employee of the company to produce all such documents to the Inspector and furnish him with information or explanations in such form as the Inspector may require and shall render all assistance to him in connection with such inspection.

3.13.2 POWER TO MAKE OR CAUSE TO BE MADE COPIES

Section 207 (2) of the Act empowers a person making the inspection or inquiry under section 206 may make or cause to be made copies of books of account and other books and papers during the course of such inspection or inquiry, as the case may be. It shall be the duty of every director, officer or other employee of the company to render assistance to the person making inspection.

3.13.3 POWER TO PLACE IDENTIFICATION OF MARKS

The Inspector has the power to place or cause to be placed any marks of identification in such books in token of the inspection having been made, during the course of inspection. Clause (b) of subsection (2) of section 207 empowers the inspector with this power. It is so done to mark the documents already inspected and also to identify easily the documents not inspected so far. This saves the time as well as money.

3.13.4 INSPECTOR'S POWERS OF CIVIL COURT

The person, who is appointed as inspector enjoys the power of as are vested in a civil court under the Code of Civil Procedure, 1908, during the process of

inspection. Section 207(3) of the Act of 2013 provides that notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, any person making an inspection or inquiry shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely:-

(i) the discovery and production of books of account and other documents, at such place and time as may be specified by such person making the inspection or inquiry,

(ii) summoning and enforcing the attendance of persons and examining them on oath and

(iii) inspection of any books, registers and other documents of the company at any place

3.13.5 POWERS TO SEARCH AND SEIZURE

Section 209(3) of the Companies Act, 2013 provides that, when the Inspector has reasonable ground to believe on information or otherwise, that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be

(i) destroyed or
(ii) mutilated or
(iii) altered or
(iv) falsified or
(v) secreted,

he may, after obtaining an order from the **Special Court** for the seizure of such books and papers,-

(i) enter into the place or places where such books or papers are kept, with such assistance as may be required,

(ii) search, the place or places where such books or papers are kept; and

(iii) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

Here, it is to be noted that under the Act of 2013, now the inspector can exercise the power of search and seizure, after obtaining order from the Special Court where as in the Act of 1956, section 234-A was required that the inspector to apply to the Magistrate of the First Class/the Presidency Magistrate having jurisdiction for an order for the seizure of such books and papers.

These books and papers seized should be returned, as soon as may be, and in any case not later than one hundred and eightieth days after such seizure, to the company from whose custody or power such books or papers were seized. Earlier in the Act of 1956, Inspector was allowed to keep such seized books and papers only for 30 days. In case of further requirement after 180 days, the books and papers may be called for by the Inspector by an order in writing. This power of Inspector was also not available in the Act of 1956. He may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

3.14 REPORT OF REGISTRAR/INSPECTOR

Where an inspection of the books of account and inquiry has been made, a report is prepared by the person inspected and submitted to the Central Government. Section 208 requires that the Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

According to the provision of section 208, it is the duty of the Inspecting Officer to submit the report to the Central Government. The Central Government shall decide

the further course of action and the same time the Central Government is not bound to forward a copy of the inspection report to the company.

3.15 CONCLUSION

Inspection of books of account and other books and paper of a company is necessary to know the fairness and transparent functioning of the company accordance with the Act. It is a useful instrument and the preliminary step for finding out the true and fair view of the state of company's affairs. Every company is required to maintain the books of account, registers, annual returns and other records at the registered office of the company. Therefore a company should prepare its annual report as per the section 92 of the Act and it should be duly signed by the company secretary or director if there is no company secretary. This annual reports are also required to be filed at ROC within 60 days from the completion of AGM. In case of non-compliance, section 94(5) of the Act has prescribed punishment with fine which shall not be less than rupees fifty thousand but which may be extended up to rupees five lakh. The Act has also prescribed to maintain the books of account and other relevant paper in electronic form. Section 400 also clarifies that the electronic form shall be exclusive, or in the alternative or in addition to the physical form.

Inspection of books of account and other books and paper of a company can be done by the ROC or inspector duly appointed by the Central Government under section 206 or any other person/authority as mentioned in the Act. They enjoy with certain powers as mentioned in the section 206 (5) of the Act, during inspection. They also have the power to summon and enforce the attendance of persons and examine them on oath as are vested in a civil court, during inspection. They can also seize the doubtful documents during inspection. Investor of a company can also inspect such documents and records during office hours without paying any fee and they can also take the extracts or copies of it. Inspection of such documents of a company enables the investors to check the true affairs of the company. They would like to see that their investments are safe and also being used for the

intended purpose. If the investor is not satisfied with affairs of the company, he may sell out the shares of that company. Therefore, companies are bound to maintain the proper books of account and records according to the provision of the Act in order to sustain and prosper further. This will help in prevention of fraud which ultimately provides better protection of the rights and interests of investors.

Here, it is also to be noted that the inspection under section 206 and 207 is not an investigation, though it may lead to one, in case, anything wrong or objectionable or fraudulent. The right to inspection is limited to books of account and other books and paper only. The inspector cannot under the guise of this right, undertake a roving inquiry into all the affairs of the company. Person Inspecting are merely report making authority. They are required to submit an inspection report to the Central Government after completion of inspection.

Now, it is on the discretion of the Central Government to order for further investigation into the affairs of the company (section 210), in case the affairs of the company are not in consonance with the Act. Meantime, such default company will get time to destroy, mutilated, alter, falsified or secreted of such documents. Therefore, to prevent such occurrences, it is necessary that inspectors should be empowered to start investigation *suo moto* along with the submission of report to Central Government and recommendation for further investigation into the affairs of the company by giving his reasons in support..

The Calcutta High Court has held in *Indra Prakash Karnani v. Registrar of Company* [(1985) 57 Comp. Cas. 62 (Cal)] that inspector or ROC is entitled to demand inspection of the books of accounts even in his office under clause (iii) of subsection (5) of section 209-A of the Act of 1956 [Now, 206(3) (c) of the Act of 2013]. However, it can be made at any time during business hours. Further, it was also held that the ROC has right to inspect the books of account and if he is prevented from rendering inspection of accounts, the directors of the company may be prosecuted. A prior prosecution of company is not a pre-condition for prosecution of director of the company.

In *Bajoria B.M. v. Union of India* [(1972) 42 Comp. Cases 338 (Del)], the Delhi High Court held that the power of inspection is different from an investigation under the Act and that is not necessary for the Registrar before filling a complaint on the basis of inspection of accounts to give to a company a copy of the inspection report. In this way the courts of India are also vigilant in implementation of the powers of inspector or ROC for the inspection of documents and other records of the company so that the investors can be protected against any intended corporate frauds.

Annual Report on the working and administration of the Companies Act, 1956, in pursuance of Section 638 of the Companies Act, 1956 (now, section 461 of the Act of 2013) which lays down that the Central Government shall cause a general annual report on the working and administration of this Act to prepared and laid down before each House of the Parliament within one year of the close of the year to which the report relates.

57th Annual Report for the year ended March 2013, disclosed that inspection of the books of account and other books and paper of the companies under section 209A(now, Section 206) were carried out by the inspectors, authorised by the Central Government, on various complaints received, during the financial year 2012-2013.Total 101 inspection reports were received by the Ministry of Corporate Affairs during the financial year 2012-2013 whereas this number was 80 during the financial year 2011-2012.[52]

The report also states that total 46 cases were referred to Serious Fraud Investigation Office (SFIO) under section 235/237 of the Companies Act, 1956 (now, section 210/213 of the Act of 2013), by the Ministry of Corporate Affairs, where the size of the alleged fraud was estimated to be at least Rs. 50 crores or more in each cases, for further investigation. The Ministry has received 22 investigation reports from SFIO during the period the financial year 2012-13 and prosecutions have been launched in various courts. Therefore, this report

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52. 57th Annual Report on the working and administration of the Companies Act, 1956, 31 March 2013, p. 52-54.

also shows that inspection of the documents and other records is an importance means to protect the interest of investors.

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CHAPTER IV

INVESTIGATION AS A MEANS OF PROTECTION OF INVESTORS

4.1 INTRODUCTION

Investors are the real owners of a company but the power of management of the company is vested in the Board of directors. This may, sometimes, lead to abuse of power by few directors. Hence, the Central Government reserves its right to investigate the affairs of the companies, especially in the cases of alleged frauds or the oppression of the minority shareholders. In previous chapter we have seen that the Central Government is empowered to appoint inspectors to investigate the affairs of such companies, which are not complying the provision of the Companies Act, 2013, either, on its own if it is of the opinion that such investigation is required on the report of the Registrar or Inspector under section 208(i.e. report on inspection made) or in public interest.[1] The Central Government may also appoint inspectors to investigate the affairs of a company either on the request of the concerned company on the basis of a special resolution or on the direction of the Court/Tribunal or from such members of the company having requisite numbers of shares as specified in section 213 of the Companies Act, 2013.[2] The Central Government has established the Serious Frauds Investigation Office (SFIO), a specialized, multi-disciplinary organization to deal with cases of corporate frauds in the Act of 2013. In this chapter, appointment, functions, powers of the inspector, role of the serious fraud investigation office in serious fraud cases, follow up actions and various other provisions related with investigation are to be

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1. S.210 of the Companies Act, 2013
2. subsection (2) *ibid*

dealt and how investigation serves as an important means to protect the investors has been discussed.

4.2 MEANING OF INVESTIGATION OF COMPANY

Investigation of a company is the process to examine the management of the company's affairs to find out whether any irregularities have been committed or not. Under section 210 an inspector is appointed only to investigate the affairs of a company and to make a report thereon. The investigation is no more than the work of fact finding commission.[3]

The Companies Act, 2013 empowers the Central Government with the right to investigate the affairs of the company, especially in cases of an alleged fraud or even in the oppression of the minority shareholders. There are following three types of investigation mentioned in the Companies Act 2013:-

(i) Investigation into the affairs of the Companies[4]

(ii) Investigation into company's affairs in other cases[5]

(iii) Investigation into the ownership of the Companies[6]

4.3 PURPOSE OF INVESTIGATION

There was, generally, a policy of non-interference in the functions of the company and also minimum interferences by the court in the management of the affairs of a company, before independence in India. In the Companies Act, 1956 many provisions incorporated to empower the Government to interfere in the affairs of the company's function and management in order to protect the interest of the shareholders. Section 210 of the Act of 2013 gives right to members of a company to make an application for conducting investigation into the affairs of a company. While the powers to appoint inspectors and to conduct investigation and to act on the report of investigation would remain with the Central Government.

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3. Ramaiya, *Guide to the Companies Act* (16th edn.) p. 2523, Lexis Nexis
4. S. 210 of the Companies Act, 2013
5. S. 213
6. S. 216

Since last few decades there have been umpteen corporate frauds around the world and India too could not escape from happenings of such frauds. These are taking place not only in corporations but almost in every walk of life. This is because of fall in moral and ethical values, which has led to less respect for other persons and their properties. People's values of life are changing fast.[7]

The purpose of investigation is to discover something which is apparently not visible to the naked eye or on the face of it. An order of investigation can, *inter alia*, be made when the Tribunal is of opinion that the persons in management are guilty of fraud, siphoning off of funds, misfeasance, mismanagement or other misconduct in carrying on the day to day affairs of the company. Section 210 to 228 of the Companies Act, 2013 empowers the Central Government to carry out the investigation of affairs of a company. The Central Government appoints inspectors for this purpose. Thus the main objective of investigation is to redress the issue of mismanagement of a company and to protect the interest of members/shareholders, debenture holders, creditors and other investors of the company.

In ***Aditya Sharda* v. *Rangoli Texdye Pvt. Ltd*.**[8] it was held that materials *prima facie* should be available for the order of the investigation. The application disclosed that the available materials *prima facie,* conduct of the business was oppressive to the members and that the management of the company was guilty of grave irregularities causing prejudice to members and creditors of the company. The company became *de-funct*. In the premises, the appointment of an inspector did not affect the reputation and prospects of the company. The CLB (Now, Tribunal) ordered the investigation into the affairs of the company. The Central Government was directed to appoint one or more inspectors to investigate the affairs of the company and to take appropriate action on receipt of the investigation report.

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7. T.N. Pandey, "*Corporate Frauds - Nature, Control And Regulation*," [2014] 50 taxmann.com 18
8. (2005) 123 Comp. Cas. 309 (CLB)

In ***Dr. Kamal K. Dutta* v. *Ruby General Hospital Ltd*.**[9], an application was made for investigation into the state of affairs of the company. The respondent directors fully explained that their conduct was not *mala fide*. The explanations were accepted by the Court as satisfactory. The Court dismissed the allegations and the application.

In ***Gopalakrishna Kamath* v. *Mangalore Trading Association Pvt. Ltd.***,[10]it was held that a mere statement of facts based on the reports of auditor without any corroborative evidence will not assist the Company Law Board (now, Tribunal) in framing the requisite opinion for directing investigation into the affairs of the company under section 235 of the Companies Act, 1956 (now, Section 210 of the Act of 2013). The material placed before it should be such as to satisfy the Tribunal that a deeper probe is necessary.

In ***A. Ravishanker Prasad* v. *Prasad Production Pvt. Ltd.***[11], it was held that the order of investigation should not be ordered on mere suspicion or surmises. In the present case the alleged act of mismanagement were either past or concluded transactions or deliberated and appropriately dealt by the Board of directors. The order of investigation could not be made on mere suspicion or surmises without proper materials to enable the C.L.B. (now, Tribunal) to form an opinion that the affairs of the company required to be investigated.[12]

4.4 TYPES OF INVESTIGATION

There are following three types of investigation mentioned in the Companies Act, 2013:-

(i) investigation into the affairs of the company
(ii) investigation into company's affairs in other cases
(iii) investigation into the ownership of the company

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9. (2005) 124 Comp. Cas. 441 (CLB)
10. (2004) 121 Comp. Cas. 191 (CLB)
11. (2007) 135 Comp. Cas. 416 (A.P.)
12. Dutta C.R., *The Company Law*, 6th Edn. 2008, p.4249, Lexis Nexis

In United Kingdom, there are two different forms of investigations, mentioned in their Companies Act, 1985-

(i) a confidential investigation

(ii) an investigation by inspectors

A confidential investigation is an informal, unpublished inquiry, usually conducted by Companies Investigation Branch (CIB) officials and similar to a police inquiry. An investigation by inspectors is a much more serious affair, often lasting several years.[13]

4.4.1 INVESTIGATION OF THE AFFAIRS OF THE COMPANY

Investigation of the affairs of a company means investigation of all its business affairs i.e. profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too. Sub-clause (a) of section 210(1) empowers the Central Government to order investigation into the affairs of a company in the following occasions-

(a) on the receipt of report of the Registrar or inspector under Section 208, or

(b) on intimation of a special resolution passed by a company that its affairs are required to be investigated, or

(c) in the public interest

When an inquiry or inspection of books of account or other papers is made under Section 206 or section 207, the person making the inspection or inquiry may recommend further investigation into the affairs of the company. Based on the reasons for the recommendation for investigation on such report, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as it may direct.

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13. Mayson, French and Ryan, *Company Law,* 26th edition, p. 587, Oxford University Press

The Central Government shall also appoint one or more inspectors to investigate the affairs of a company where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of the company ought to be investigated. The Central Government may also direct to submit report thereon in such manner as prescribed.[14]

Under sub-clause (c) of Section 210(1) the Central Government has discretion to order an investigation into the affairs of company in public interest. In the case of a company intended to operate in modern welfare State, the concept of public interest takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community. [15]

The Central Government has also set up the Serious Fraud Investigation Office (SFIO) in the ministry of corporate affairs, a specialized, multi-disciplinary organization to deal with serious cases of corporate frauds. It has come up into statutory form by section 211 of the Act of 2013. Investigation into affairs of a company by SFIO has been dealt under separate heading.

4.4.2 INVESTIGATION INTO COMPANY'S AFFAIRS IN OTHER CASES

Section 213 of the Act, 2013, deals with the investigation into company's affairs in other cases. According to this provision, the Tribunal may pass an order that the affairs of a company ought to be investigated by an inspector appointed by the Central Government. If such an order is passed by the Tribunal, the Central Government shall appoint inspector(s) to investigate the affairs of the company in respect of such matter. Earlier in the Act of 1956, this power of Tribunal was vested in Company Law Board (CLB). The Tribunal may pass an order to investigate in the following conditions-

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14. subsection (2) and (3) of section 210
15. *N.R. Murthy* v. *Industrial Development Corporation of Orissa Ltd* (1977) 47 Comp. Cas. 389 (Ori)

(a) on an application made by not less than 100 members or members holding not less than one-tenth of the total voting power, in the case of a company having share capital or not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital. Such application is required to be supported by evidence to show that there are good reasons for seeking an order. Earlier in the Act of 1956, the corresponding section 235 (2) required that, in case of a company having a share capital, an application to CLB for an order of investigation should be made by not less than 200 members or from members holding not less than 10% of the total voting power therein.

(b) on an application made to it by any other person or otherwise, if it is satisfied that there are circumstances suggesting that-

(i) the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose.

(ii) persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or

(iii) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, or the manager of the company.

It is necessary that before passing an order under section 213, the parties concerned shall be given a reasonable opportunity of being heard.

Now, under the Act of 2013, if Tribunal finds that any of the circumstances specified exist, it can order an investigation and Central Government **shall** appoint inspector(s) but under the Act of 1956, if CLB found that any of the specified circumstances existed, it was only **discretionary** on part of Central Government to order an investigation and appoint inspector(s).

If the report of investigation proves that the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, every officer of the company who is in default and the person or persons concerned shall be punishable for fraud in the manner as provided in section 447 of the Act of 2013.[16]

The power of the Central Government under section 237 (now, section 213) is independent and operates without prejudice to its powers under section 235 (now, section 210). In other words, there can be simultaneous investigations under both sections, or an investigation can be ordered under section 237 if the investigation ordered by Central Government under section 235 cannot be proceeded with for some reason or the other.[17]

In ***Barium Chemical Ltd* v. *Company Law Board***,[18] it was held that where the order for investigation was made without proper materials and facts and formation of the opinion by the Central Government did not at all disclose any basis thereof and the denial of such allegations in the petition was evasive, it was held that the order for investigation was improper and not maintainable.[19]

In ***re, Delhi Flour Mills Co. Ltd***.[20]it was held that the allegation of uneconomic working of a company is not sufficient to invoke investigation. There must be sufficient supporting material evidence of mismanagement of affairs of the company.

In ***Safia Usman* v. *Union of India***,[21]it was held that in a petition under section 237 (corresponding to section 213 of the Act of 2013), the company and its managing

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16. Proviso of section 213 of the Act
17. Ramaiya, *Guide to the Companies Act* (16th edn.) p. 2529, Lexis Nexis
18. (1966) 36 Comp. Cas. 639 (SC)
19. Dutta C.R., *The Company Law*, 6th Edn. 2008, p.4267, Lexis Nexis
20. (1975) 45 Comp. Cas. 33 (Delhi)
21. (2002) 110 Comp. Cas. 710 (Ker.)

director or other directors are necessary parties and in the absence of in pleading such parties in petition, relief cannot be granted.

In ***Union of India* v. *Mukta Arts Ltd*.**,[22] it was held that investigation into the affairs of a company can be ordered when the inspection report has pointed out the huge financial irregularities.

In ***Jagannath Gupta & Co. Pvt. Ltd.* v. *Mulchand Gupta,***[23] it was held that where the remedy of investigation has been chosen, winding up proceeding should not be allowed to be pursued. Where facts disclosed were grounds for investigating into affairs of the company, petition on such grounds for winding up of the company will only be treated as for collateral purpose. The winding up petition will not be maintainable.

The Supreme Court of India has observed that the Writ jurisdiction is not appropriate Forum to invoke the investigation of affairs of a company. The power to appoint an inspector to investigate the affairs of the company has to be exercised by the Central Government after preliminary scrutiny by the Registrar of Companies or the CLB (now, Tribunal) under section 234, 235 and 237 of the Companies Act, 1956 (now, section 206, 210 and 213 of the Act of 2013). The investigation cannot be executed on the basis of allegations made by one shareholder.[24]

In ***M. Subbbiah* v. *Madras Cricket Club***,[25]the CLB (now Tribunal) has held that grievances of petitioners regarding induction of friends and associates of members of executive committee in the club, who have no sports background, does not fall within the ambit of section 237(b) [corresponding to section 213(b) of the Act of 2013][26].

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22. (2007) 137 Comp. Cas. 648 (CLB)
23. AIR 1969 Cal. 363 (DB)
24. *Sri Ramdas Motor Transport Ltd.* v. *Tadi Adhinarayana Reddy* AIR 1997 SC 2189
25. (2007) 80 SCL 155
26. See *supra*

The Bombay High Court in ***Panther Fincap & Management Services Ltd.* v. *Union of India*,**[27] has held that when a company is found to be engaged in any business authorised by its memorandum, even though its dominant business might remain stalled by various orders of the Government, nevertheless, the company has to be treated as running its business and the requirement if section 237(b) (i) of the Act,1956[corresponding to section 213(b) (i) of the Act of 2013] will be satisfied.

To order investigation, requirements of section 213(b) must be complied with. On a single instance of alleged oppression, extraordinary powers could not be invoked. In ***N.M. Pimpalkar* v. *Shree Narkeshari Prakashan Ltd*.**,[28] investigation was sought for an allegation that one R, who was appointed as managing director for one year in AGM, was relieved of his post within two months on obtaining resignation under pressure exerted by the chairman, but the petitioner had not been able, even prima facie, to prove how a fraud or oppression by members had been committed based on the instances cited by him which is a requirement under section 237(b) of the Act of 1956[corresponding to section 213(b) of the Act of 2013] and on the other hand, the company proved that the resignation was voluntary and further R, though a shareholder, did not join petitioners, investigation could not be ordered.[29]

In ***Bank of Rajasthan Ltd.* v. *Rajasthan Breweries Ltd*.**,[30] it was held that the scope of section 237(b) of the Act of 1956 [corresponding section 213(b) of the Act of 2013] is very wide as compared to inspection under section 209A [corresponding section 207 of the Act of 207 of the Act of 2013]. Violation of the provisions of the Act noticed on inspection strengthens the ground for ordering investigation under Section 237(b) [corresponding to section 213(b) of the Act of 2013].

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27. (2007) 74 SCL 202
28. (1998) 17 SCL 259
29. As quoted by Kapoor G.K and S. Dhamija, *Company Law and Practices*, Taxmann, 19th edn. 2014, p.686
30. (2007) 79 SCL 395 CLB, New Delhi

4.4.3 INVESTIGATION OF OWNERSHIP OF A COMPANY

Section 216 of the Act empowers the Central Government to investigate the ownership of a company when satisfied that there is good reason to do so. It may sometimes become necessary in public interest for the Central Government to know the persons who are financially interested in a company and who control the policy or materially influence it.[31] It provides that where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons-

(*a*) who are or have been financially interested in the success or failure, whether real or apparent, of the company; or

(*b*) who are or have been able to control or to materially influence the policy of the company.

The Central Government is also empowered to appoint one or more inspectors by sub-section (2) of the section 216, if the Tribunal, in the course of any proceeding before it, directs by an order that the affairs of the company ought to be investigated as regards the membership of the company and other matters relating to the company, for the purposes of determining the true person who are or have been financially interested in the success of failure, whether real or apparent, of the company who are or have been able to control or materially influence the policy of the company.

Similar provisions are also found in the section 442(1) of UK Companies Act, 1985 where the appointment of inspector(s) is done by the Secretary of State, if satisfied that there is good reason to do so with respect to the company, for the purpose of determining the true person who are or have been financially interested

31. Kapoor G.K and S. Dhamija, *Company Law and Practices*, Taxmann, 19th edn., 2014, p.687

in the success or failure (real or apparent) of the company or able to control or materially to influence its policy.

4.5 SCOPE OF INVESTIGATION

The Central Government may also define the scope of the investigation by inspector with respects to the matters or the period to which it is to extend or otherwise, and in particular, may limit the investigation to matters connected with particular shares or debentures. The inspector may also investigate whether there are any secret arrangements or understandings observed in practice, even though they may not be legally binding.[32] The inspector may also, with the prior approval of the Central Government, investigate the ownership of other connected companies such as subsidiary, holding and the associates.

In ***Gauri Shankar Kayan*** **v.** ***East India Investment Co. Pvt. Ltd***.,[33]investigation was not ordered when ostensible ownership of shares and real control of company vest in different persons. There was no case made out to order an investigation as the entire estate was controlled by one person only.

In ***Bakhtawar Construction Co. Pvt. Ltd.*** **v.** ***Blossom Breweries Ltd***.,[34]it was alleged that the names of shareholders given by the company were fictitious, non-existent or benami and that the Registrar for Shares & Securities had not complied with the provisions of law in processing the applications for shares, their allotment and transfers where applicable and urged that an investigation under section 247(1A) [corresponding to section 216(2) of the Act of 2013] would help to find out the relevant facts about the true owner of the shares. The CLB (now, Tribunal) dismissed the petition on the ground that it had been instituted purely on unfolded appreciations and suspicion. The power of investigation under section 216(2) could be invoked *bona fide* in public interest only.

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32. sub section (3) of the section 216
33. (2005) 128 Comp. Cas. 145 (CLB)
34. (1997) 24 CLA 211 (CLB)

4.6 INVESTIGATION BY POLICE NOT BARRED BY THE PROVISIONS OF COMPANIES ACT

The nature and scope of investigation to be conducted under Sections 235 to 242 of the Companies Act, 1956 [now, Section 210 to 229 of the Act of 2013] is different from the nature and scope of the investigation to be conducted by the Police. An investigation under these sections of the Companies Act is not an investigation of a criminal case. The purpose of investigation under the Companies Act is only to streamline the working of the company. The provisions of the Companies Act do not create any bar against an investigation by a Police officer if cognizable offences punishable under the Indian Penal Code, were suspected to have been committed in the affairs of the company.[35]

4.7 WHO CAN APPLY FOR INVESTIGATION OF THE COMPANY?

As stated earlier, Central Government is empowered by Section 210 of the Act of 2013 to pass an order to investigate into the affairs of a company in following circumstances-

(i) on the receipt of a report of the Registrar or inspector under section 208;

(ii) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(iii) in public interest,

The Central Government has discretion to order investigation as the expression used is "may" in the Section 210, whereas under Section 237(a) (i) of the 1956 Act it was binding on the Central Government to appoint inspectors to investigate when company passed such special resolution.

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35. *S.P. Gupta* v. *State (NCT of Delhi)*, (2006) 132 Comp. Cas. 402 (Delhi)

Section 210(2) further provides that it is mandatory for the Central Government to order an investigation into the affairs of a company if there is order by a Court or a Tribunal directing that the affairs of a company ought to be investigated.

In this way, the following person can apply for the investigation of the affairs of the company-

(a) Registrar of Company/Inspector

(b) Members of the company

(c) Company, by passing special resolution

(d) The Court/Tribunal- by order [36]

(e) Central Government

4.7.1 REGISTRAR OF COMPANY/INSPECTOR

Where an inspection of the books of account and inquiry has been made, a report is prepared by the person inspected and submitted to the Central Government. Section 208 requires that the Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

According to the provision of section 208, it is the duty of the Inspecting Officer to submit the report to the Central Government. The Central Government shall decide the further course of action and the same time the Central Government is not bound to forward a copy of the inspection report to the company.

On such a report having made, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of the company and to report thereon in such manner as it may direct.

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36. S. 210(2)

Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar for the purpose to carry out the inquiry of such company. Where a Registrar calls for the books of account and other books and papers under section 206, it shall be the duty of every director, officer or other employee of the company to produce all such documents to the Registrar and furnish him with such statements, information or explanations in such form as the Registrar may require and shall render all assistance to the Registrar in connection with such inspection.[37]

If the Registrar, on scrutiny of any document, filed by a company or on any information received by him, is of the opinion that any further information or explanation or any further documents relating to the company is necessary, he may require the company to furnish in writing such information or explanation or produce such documents. The Registrar will give written notice to the company to provide the desired information within reasonable time.[38] It is the duty of the company and of its officers concerned to furnish such information or explanation to the best of their knowledge and power and to produce the documents to the Registrar within the time specified in the notice.

4.7.2 MEMBERS OF THE COMPANY

Under Section 213 of the Act of 2013, members of the company can apply to the Tribunal for the investigation of the affairs of the company. The Tribunal is empowered to pass order for investigation by the inspector(s) appointed by the Central Government. The Central Government is bound to appoint inspector(s) to investigate such company. The Tribunal may pass an order for such investigations in the following conditions-

(i) on an application made by not less than one hundred members or members holding not less than one-tenth of the total voting power, in the case of a company having a share capital; or not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital.

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37. S. 207 of the Act
38. s. 206(1) of the Act of 2013

An application as such need to be supported by such evidence as may be necessary for the purpose of showing that the applicants have good reasons for seeking an order for conducting an investigation into the affairs of the company.

(ii) on an application made to it by any other person or otherwise, if it is satisfied that there are circumstances suggesting that—

(a) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose;

(b) persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or

(c) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, or the manager, of the company,

It is necessary that before passing an order under Section 213, the parties concerned shall be given a reasonable opportunity of being heard[39].

If the report of the investigation proves that the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, then, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud in the manner as provided in section 447.[40]

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39. S.213
40. Proviso of section 213 of the Act

4.7.3 COMPANY, BY PASSING SPECIAL RESOLUTION

Under Section 210(1) (b), the Central Government may order investigation into affairs of a company on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated. The Central Government shall appoint inspector(s) to investigate such company in such manner as may be directed. For passing an order for investigation, it is not necessary that a proceeding be pending before the court; even a petition simplicities can be entertained.[41]

4.7.4 THE COURT/TRIBUNAL

A Court or Tribunal is empowered to pass the order of investigation if it is necessary to do so. Under Section 210(2), it is mandatory for the Central Government to order an investigation into the affairs of a company if there is such order by a Court or a Tribunal directing that the affairs of a company ought to be investigated.

The Central Government shall appoint one or more competent person(s) as inspector(s) to investigate such company in such manner as may be directed and to report thereon. It is not necessary that a proceeding is pending before the court or the Tribunal, for passing an order for investigation under this section.

The object of an investigation under this section is to discover something which is not apparently visible to the naked eye[42]. Where a petition discloses merely facts which are apparent from the balance sheet of the company, an investigation will not be ordered At least prima facie evidence should exist concerning circumstances which would lead to the conclusion that an investigation was necessary.

Under section 237 (now, section 213), the power of the Central Government is independent and operates without prejudice to its powers under section 235 (now, section 210). In other words, there can be simultaneous investigations under both sections, or an investigation can be ordered under section 237 if the investigation

41. *re Delhi Flour Mills Co. Ltd, (1975)* 45 Comp. Cas.33
42. Ramaiya, *Guide to the Companies Act* (16th edn.) p. 2529, Lexis Nexis

ordered by Central Government under section 235 cannot be proceeded with for some reason or the other.[43]

The court has no power to appoint an inspector; it can only make an order directing the Central Government to do so.[44]The judicial conscience must be satisfied that there has been mal-administration in the affairs of the company.

The Gujarat High Court has expressed opinion that the legislature has conferred wide jurisdiction on the court to entertain a petition under the section 237(a) (ii) of the Act 1956 [now, section 210(2)]. In fact, the power of the Central Government to appoint an inspector *suo motu* under section 237(b) is limited to its subjective satisfaction in respect of one or other matters contained in three sub-clauses of clause (b). The legislature in its wisdom has not put any such condition before the court can make an order, though the court may in its wisdom expect *prima facie* proof of some of these conditions on the subjective satisfaction of which the Central Government would appoint an inspector, before directing the Central Government to appoint an inspector. While conferring jurisdiction on the court to direct the Central Government to appoint an inspector, the legislature has not thought fit to circumscribe the discretion or jurisdiction in any manner. It would, therefore be utterly inappropriate to curtail or circumscribe or fetter the jurisdiction of this court by reading into the section something which is not there[45].

4.7.4.1 *LOCUS STANDI*- PERSON HAVING LEGAL RIGHT ONLY MAY APPLY

Though the section 237(a) (ii) of the Act 1956 [now, section 210(2)] is couched in very wide terms, a person having no interest in or concern with the company as a shareholder, creditor or otherwise has no *locus standi* to apply to the Court for an order under this sub-section of section 210 of the Act of 2013.[46] Though Section 237 [now, section 210(2)] is in a very wide language, the basic limitation is that the

43. *Id.*
44. *Deo Dutt Purshottam Patel v. Alembic Glass Industries Ltd.*, (1972) 42 Comp. Cas. 63 (Guj)
45. *Id.*
46. *Purie (V.V.)* v. *E.M.C. Steel Ltd.*,(1980) 50 Com. Cases 127 (Del)

Courts will not entertain action on behalf of private parties to enforce the observance of public rights and duties unless they have a personal interest in the matter and unless their rights and interests are in some way affected, is implicit in the interpretation of the section. The section should be so interpreted as to enable relief to be obtained only by a person whose rights have been affected by the manner in which the affairs of the company have been conducted or accounts maintained and has therefore a grievance in the eye of law for which he seeks relief from the Court.[47] A creditor who is unable to move the Central Government under Section 235 (now, section 210) of the Act, a member who though aggrieved is unwilling to move the Central Government or unable to fulfill the requirements of Section 236 of the Companies Act, 1956 (Now, section 214 of the Act of 2013) and hence unable to move the Central Government, the members who approach the Central Government under Sections 210 and 213 are aggrieved by the Government's rejection of their applications, the company which wants an investigation but is unable to have a Special Resolution passed are some of the illustrations of persons who would be able to move the Court under Section 213 of the Act of 2013.

In ***Barium Chemical Ltd.* v. *Company Law Board***,[48] it was held that the provisions of Sections 235 to 237 are not violating the Article 14 of the Constitution of India. An incorporated company under the Companies Act is not a citizen and cannot, therefore invoke the provision of Article 14 or 19 of the constitution of India.

The Tribunal may also pass an order to the Central Government to investigate the affairs of a company. This has been discussed in Para. 4.4.2 (*supra*).

A new provision has been added in the section 221 of the Companies Act, 2013 that empowers Tribunal to freeze assets of company under inquiry or investigation for period not exceeding 3 years.

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47. Dutta C.R. *The Company Law*, 6th Edn. 2008, p.4259, Lexis Nexis
48. AIR 1967 SC 295

4.7.5 CENTRAL GOVERNMENT

Under sub-clause (c) of Section 210(1) the Central Government is empowered to order to investigate the affairs of a company. The Central Government has discretion to order an investigation into the affairs of company '**in public interest**'. This is a new provision stating the clear mandate of the Central Government to encourage the functioning of the companies in modern welfare State. The term public interest has a wide meaning and mainly concerns here with the common interests of the investors of the company and its management.

In ***N.R. Murthy* v. *Industrial Development Corporation of Orissa Ltd***,[49] it was held that a company intended to operate in modern welfare State, the concept of public interest takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community.

4.7.5.1 PRE-REQUISITES TO MAKING AN ORDER BY THE CENTRAL GOVERNMENT

Prior to making an order for investigation the Central Government must be satisfied that the circumstances mentioned in Section 237(b) [now, section 213] exist. Section 237 does not allow the Central Government to take arbitrary decision in making an order for investigation of a company. The existence of the circumstances is a condition fundamental to the forming of an opinion. If the existence of the circumstances is challenged the Central Government has to prove at least *prima facie* that the circumstances exist. In case of contrary, the action of the Central Government in directing investigation would be *ultra vires* the Act. The formation of the opinion might be the subjective satisfaction of the Central Government but the materials leading to the formation of such opinion must exist and if challenged in Court it must be proved to exist.[50]

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49. (1977) 47 Comp. Cas. 389 (Ori)
50. *Barium Chemical Ltd.* v. *Company Law Board*, AIR 1967 SC 295

In ***Kasturi and Sons Ltd.* v. *Sporting Pastime India Ltd*.**[51]the company did not have a whole time Director, or a Manager in accordance with Section 269 of the Companies Act, 1956. Even the Company did not have a Company Secretary and the company being a public company did not have three directors on its Board as required under Section 252 of the Companies Act, 1956. These irregularities and violations of the Act caused prejudice to the company and its members. The state of affairs of the company warranted an investigation into its affairs to find out who were guilty of irregular conduct of the affairs of the company. The facts and materials were sufficient to form a prima facie opinion in terms of Section 237(b)(i) of the Companies Act, 1956 that the company's day to day management was conducted in a manner oppressive to the minority shareholder which warranted the central Government to appoint inspectors to investigate the affairs of the company.

In ***IFCI Ltd.* v. *Usha(India) Ltd.***,[52]the investigation under Section 237(b)[now, section 213 of the Act of 2013] is not itself, is only a means to find out the full facts of the acts complained of. In this case, the Loan amount advanced by the petitioner financial institutions was siphoned out. The siphoning off of huge amounts by fraudulent manner by the company was also indicated by the income tax authorities. Without investigation under Section 237 (b), it would not be possible to discover true and correct facts and modus operandi adopted by the respondents in cheating the petitioners and siphoning off the public money. It was held that the Central Government should appoint inspectors for the enquiry and take appropriate action on the enquiry report.

4.7.5.2 CAN CENTRAL GOVERNMENT EXERCISE THE POWER OF INVESTIGATION SUO *MOTU*?

The Central Government can exercise power under Section 237 (now, section 216) *suo motu* but this is circumscribed by the conditions laid down in clauses (i) to (iii) of Section 237(b) [now, clauses (i) to (iii) of Section 213(b)]. This power of the

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51. (2007) 139 Comp. Cas.623 (CLB)
52. (2006) 129 Comp. Cas. 534 (CLB)

Central Government has, now conferred to Tribunal. In a complaint of oppression of minority by the majority shareholders, it was held that remedy would not be available merely because minority feels aggrieved about the manner of carrying on affairs of the company. The Court will look into the allegations relating to fiduciary duties. Mere allegation of mismanagement is not sufficient for an order under this section.[53]

4.8 GUIDELINES FOR ORDERING INVESTIGATION INTO AFFAIRS OF THE COMPANY

In exercising the discretionary powers under section 210(1)(c), the Central Government, while examining each case on its merit, applies certain tests which are calculated to ensure that a substantial and worthwhile basis exists, warranting investigation. Where the allegations are more of a recriminatory nature arising out of factional fights between two or more predominant groups of shareholders, the Government will not ordinarily lend itself to be party to such disputes. In other cases, based on the relevant provisions of the company law or any law in force, the following objective may generally form the prerequisite for ordering of an investigation.

- Where an inspector can bring to light any major contravention of company law or any other law on the basis of which necessary corrective or remedial measure can be applied.
- Where the application of such measures alone will be enough to lend succor so as to bring them in conformity with the accepted principles and standards of good and efficient management.
- Where the allegations bring out clearly or, by implication, a charge of irregular accounting, the truth of which can be established only by the analysis of the books by a qualified chartered accountant[54].

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53. *M. Subbaih v. Madras Cricket Club,* (2007) 140 Comp. Cas. 463 (CLB)
54. As quoted by Kapoor G.K and S. Dhamija, *Company Law and Practices*, Taxmann, 19th edn., 2014, p.682

4.9 APPOINTMENT OF INSPECTOR FOR INVESTIGATION

The Central Government appoints inspector(s), once decided to investigate the affairs of a company. Section 210 states that the Central Government appoints inspectors to investigate into the affairs of a company in following circumstances-

(i) on the receipt of a report of the Registrar or Inspector under section 208;

(ii) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(iii) in public interest,

(iv) when a Court or a Tribunal passes an order that the affairs of the company ought to be investigated.

Generally a person having experiences of the conduct of the company and handling of books of record is appointed as inspector to investigate the company. But, Section 215 of the Act, 2013 disallows the appointment of a firm, body corporate or other association as an inspector. Thus only an individual is appointed as an inspector.

4.10 POWERS OF INSPECTOR

When the Central Government appoints inspector(s) to investigate the affairs of a company, they have the following powers for the smooth function during investigation under the Companies Act, 2013-

1. Power to carry investigation into affairs of the Company
2. Power to carry investigation into affairs of related companies- Section 219
3. Power to compel production of documents – Section 217
4. Power to examine on oath
5. Power to take down notes of examination in writing
6. Power of seizure of documents
7. Power to seek support from other authorities

8. Power to seek evidence in other countries

4.10.1 POWER TO CARRY INVESTIGATION INTO AFFAIRS OF THE COMPANY

The Central Government defines the scope of the investigation by inspector with respects to the matters or the period to which it is to extend or otherwise, and in particular, may limit the investigation to matters connected with only. The inspector is required to follow up accordingly. Section 210 describes investigation into the affairs of the company which has been dealt in Para 4.3.1 whereas Section 213 deals with investigation into company's affairs in other cases has been dealt in Para 4.3.2 of this chapter. Section 216 empowers inspector(s) to investigate the ownership of the company which has also been dealt in Para 4.3.3, *supra*.

4.10.2 POWER TO CARRY INVESTIGATION INTO AFFAIRS OF RELATED COMPANIES

An Inspector may investigate the affairs of any other body corporate which is company's subsidiary or holding company or a subsidiary of its holding company or a holding company of its subsidiary. Section 219 [Earlier Section 239 of the Act of 1956] states that the inspector appointed under section 210 or section 212 or section 213 may, if thinks necessary, investigate even the affairs of another company under the same management or in the same group.

This Section empowers an inspector to investigate into the affairs of the following persons and/or bodies corporate and report on their affairs also, if he considers that such an investigation is relevant to the affairs of the company under investigation:

(a) Any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

(b) Any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;

(c) Any other body corporate, whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or

(d) Any person who is or has at any relevant time been the company's managing director or manager or employee.

4.10.2.1 PRIOR APPROVAL OF CENTRAL GOVERNMENT IS NECESSARY

The Inspector is required to obtain the prior approval of the Central Government before exercising his power of investigation into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed. As a safeguard against possible abuse of his power by the inspector, it is provided by section 219. Thus when the tests of necessity and relevancy are satisfied the inspector is permitted to investigate such matters.

In ***Coimbatore Spinning and Weaving Co. Ltd*** **v.** ***N.S. Srinivasan***[55], it was held that the investigation of the affairs of a company by the inspector is not judicial or quasi-judicial act. The inspector has only to investigate the affairs of a company and report thereon so that the Central Government may take further action, if necessary. In this way, investigation by inspector is a fact finding process.

In ***Swadeshi Cotton Mills Ltd.*** **v.** ***Swadeshi Polytax***,[56]it was held that a report of the inspector made under section 239 [now, section 213 of the Act of 2013], is not to be disclosed to the public before its acceptance by the Central Government. If the Government was to pass further orders against a company or its official based on report, it may raise an occasion for the production of the document. However if it is found that the document contains revelations which affect the public interest

55. (1959) Comp. Cas. 97 (Mad.).
56. (1982) 52 Com. Cas 483

then in that event the public officer cannot be compelled to produce the document or disclose its content once privilege is claimed on this count.

4.10.3 POWER TO COMPEL PRODUCTION OF DOCUMENTS

Section 217 of the Act empowers inspector to compel production of documents and cast duties of every director, officer or other employee of the company to produce all such documents to the Inspector and furnish him with information or explanations in such form as the Inspector may require and shall render all assistance to him in connection with such investigation.

This Section further states that it shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter, and where the affairs of any other body corporate or a person are investigated under section 219, of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person—

(a) to preserve and to produce to an inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power; and

(b) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.

The inspector can keep in his custody such books and papers produced, up to one hundred and eighty days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced.

If any person fails without reasonable cause or refuses to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty under section 217 to produce or to furnish any information which is his duty or to appear before the inspector personally when required to do so or to answer any

question which is put to him by the inspector in pursuance of investigation or to sign the notes of any examination, he shall be punished with imprisonment for a term which may extend to six months and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.[57]

4.10.4 POWER TO EXAMINE ON OATH

The inspector may examine on oath any of the persons referred to in sub-section (1) of Section 217 and with the prior approval of the Central Government, any other person, in relation to the affairs of the company, or other body corporate or person, as the case may be, and for that purpose may require any of those persons to appear before him personally. In case of an investigation under section 212, the prior approval of the Director, Serious Fraud Investigation Office (SFIO) is sufficient.

The person making the investigation shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, regarding the discovery and production of books of account and other documents, and summoning and enforcing the attendance of persons and examining them.

There is provision of penalty if any director or officer of the company disobeys the direction issued by the inspector, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees. If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.[58]

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57. S.217(8)
58. S. 217(6)

4.10.5 POWER TO TAKE DOWN NOTES OF EXAMINATION IN WRITING

Inspector is also empowered under Section 217(7) of the Companies Act, to take down, in writing, the notes of examination in relation to investigation. This Section also permits the notes of examination, when reduced to writing, to be signed by the person examined after the notes have been read over to him. Thereafter, these notes may be used as evidence against him.

4.10.5.1 PENALTY FOR REFUSAL

In case of refusal to sign the notes of examination, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to ten thousand rupees, and where the contravention is continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues.[59]

4.10.6 POWER OF SEIZURE OF DOCUMENTS

Section 220 of the Act also empowers an Inspector to seize the documents. This section provides that where in the course of an investigation, the inspector has reasonable grounds to believe that the books and papers of, or relating to, any company or other body corporate or managing director or manager of such company are likely to be destroyed, mutilated, altered, falsified or secreted, the inspector may-

(i) enter, with such assistance as may be required, the place or places where such books and papers are kept in such manner as may be required; and

(ii) seize books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books and papers at its cost for the purposes of his investigation.

59. S. 450 of the Act

Further, inspector must return these books and papers to the company or the other body corporate or to the managing director or the manager or any other person from whose custody or power they were seized, after conclusion of the investigation. Before returning the books and papers, the inspector can take copies of, or extracts from them or place identification marks on them or any part thereof as he considers necessary. The provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures shall apply *mutatis mutandis* to every search or seizure.

Here, it is important to mention that Section 220 of the Act of 2013 allows the inspector to exercise this power on his own without having to obtain the order of a Magistrate whereas under section 240 A of the 1956 Act, the inspector could exercise his powers of search and seizure after making an application to the Magistrate of First Class or, as the case may be, the Presidency Magistrate, having jurisdiction and obtaining an order for seizure of such books and papers. Thus, the Act of 2013 has made this process speedier and less technical.

4.10.7 POWER TO SEEK SUPPORT FROM OTHER AUTHORITIES

The inspector may with the prior approval of the Central Government seek support from the other officers of the Central Government, State Government, police or statutory authority for the purpose of inspection, inquiry or investigation. Such authorities or officers are bound to provide necessary assistance or support to the inspector.

4.10.8 POWER TO SEEK EVIDENCE FROM OTHER COUNTRIES

Section 217(11) provides that if the inspector has reason to believe that any evidence is or may be available in a country outside India, it may make an application to a court to issue a letter of request to a court or competent authority in such country to examine orally or otherwise a person who is supposed to be

acquainted with the facts or may be in possession of documents pertaining to the case. For this purpose the Central Government may enter into a reciprocal agreement with the government of a foreign State to assist in any inquiry or investigation under this Act or under the corresponding law in force in that State.

4.11 REPORT OF INSPECTOR

An inspector appointed for the investigation purpose is required to prepare and submit a report to the Central Government. Section 223 of the Act states that the inspector, if so directed by the Central Government, shall submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government. Every report made under section should be in writing or printed and also authenticated either-

(i) by the seal of the company whose affairs have been investigated; or

(ii) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872.

Section 223(4) further states that such report is admissible in any legal proceeding as evidence in relation to any matter contained in the report. A copy of the report made under this section may be obtained by making an application in this regard to the Central Government. These provisions do not apply to investigation report of SFIO under section 212 of the Act.

4.11.1 DELAY IN SUBMISSION OF REPORT

The provision contained in Section 223 does not fix a time for submission of the report of inspector. The failure on the part of the inspector in submitting his report within the time administratively fixed, though amounts to breach of duty on his part, does not automatically bring the investigation to an end. The authority can condone the expiry of time and further extend the time for making the report.[60]

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60. *New Central Jute Mills Co. Ltd.* v. *Deputy Secretary,* (1966) 36 Com. Cas. 512 (Cal)

4.12 FOLLOW UP ACTION BY THE CENTRAL GOVERNMENT ON THE INVESTIGATION REPORT OF THE INSPECTOR

The main assignment of inspector is to submit investigation report to the Central Government after duly investigation of the affairs of the company. On receipt of such report, the Central Government shall study the report and if the company is not functioning in accordance with the provisions of the Companies Act and detrimental to the investors, may take the following actions-

(a) Initiation of Criminal Prosecution

(b) Recovery of loss or property or damages

(c) Winding up of the company

4.12.1 INITIATION OF CRIMINAL PROSECUTION

Section 224(1) of the Companies Act, 2013 provides the provisions to prosecute the person(s) who is/are criminal liable. This section provides that if, from an inspector's report, made under section 223, appears to the Central Government that any person has, in relation to the company or in relation to any other body corporate or other person whose affairs have been investigated under this Chapter been guilty of any offence for which he is criminally liable, the Central Government may prosecute such person for the offence and it shall be the duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution.

Therefore, if the report of inspector reveals that the person has been guilty of any offence for which he is criminally liable, the Central Government, after taking such legal advice as it thinks fit, prosecute such person. In such cases, it shall be the duty of all officers and other employees and agents of the company to render to the Central Government all assistant in connection with the prosecution which they are reasonably able to give.

As mentioned earlier, investigation by police is not barred by the provisions of the Companies Act. In ***S.P. Gupta* v. *State (NCT of Delhi)*,**[61] it was held that the nature and scope of investigation to be conducted under Sections 235 to 242 of the Companies Act, 1956 [now, Section 210 to 229 of the Act of 2013] is different from the nature and scope of the investigation to be conducted by the Police. An investigation under these sections of the Companies Act is not an investigation of a criminal case. The purpose of investigation under the Companies Act is only to streamline the working of the company. The provisions of the Companies Act do not create any bar against an investigation by a police officer if cognizable offences punishable under the Indian Penal Code, were suspected to have been committed in the affairs of the company.[62]

In ***B.M Bajoria* v. *Union of India***,[63]it was held that prosecution of this type of contemplated by the section 242 [now, section 224 of the Act, 2013] is not violation of Article 14 of the Constitution.

In ***Indian Express (Madurai) Pvt. Ltd.* v. *Chief Presidency Magistrate***,[64] it was held that no show cause notice etc. is necessary for initiating a prosecution under the section.

4.12.2 ACTION FOR RECOVERY OF LOSS OF PROPERTY

This is another significant follow up action of the Central Government in pursuance of inspector's report. Section 224(3) states that where from the report of the inspector, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or anybody corporate whose affairs have been investigated-

(*a*) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such company or body corporate; or

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61. (2006) 132 Comp. Cas. 402 (Delhi)
62. *Titagarh Paper Mills Co. Ltd. v. Union of India,* (1986) 59 Com. Cas. 94 (Cal).
63. (1972) 42 Com. Cas. 338, 347 (Del)
64. (1974) 34 Comp.Cas. 106 (Mad.)

(*b*) for the recovery of any property of such company or body corporate which has been misapplied or wrongfully retained,

The Central Government may itself bring proceedings for winding up in the name of such company or body corporate. In such proceedings the report of inspector is treated as admissible as evidence. The Central Government shall be indemnified by the company against any cost or expenses incurred by it or in connection with any proceeding bought by it.[65]

4.12.3 WINDING UP OF THE COMPANY

If the inspector's report reveals that-

(a) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose;

(b) persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members,

The Central Government, unless the company is already being wound up, may cause taking of the following action, by a person authorised by the Central Government namely-

(i) present a petition to the Tribunal for the winding up of the company or body corporate on the ground that it is just and equitable to do so; or

(ii) make an application for order under section 241 of the Act for grant of relief against oppression or mismanagement of the company; or

(iii) make an for winding up as well as make application for relief under section 241 of the Act.[66]

65. subsection (4) of S. 224.
66. S. 224(2) of the Act

4.13 EXPENSES OF INVESTIGATION

It was desirable that the Central Government should have power to effect recovery of costs of investigation instituted *suo motu* or on the report of the Registrar from the company or such other party, as it thinks fit. Now, the expenses of investigation by an inspector appointed by the Central Government and any other incidental other than expenses of inspection under section 214 are paid by the Central Government. In other investigations, the Central Government is reimbursed.

Section 225 provides that the expenses of, and incidental to, an investigation by an inspector appointed by the Central Government (other than expenses of inspection under section 214) are to be defrayed in the first instance by the Central Government. But the Central Government is entitled to be reimbursed by the following persons, namely:—

(i) any person who has been convicted on a prosecution instituted in pursuance of the report or required to pay damages as a result of the report.

(ii) the company or body corporate in whose name proceedings are brought. The company is bound to reimburse the Central Government, to the extent of the amount or value of any sums or property recovered by it as a result of the proceedings.

(iii) any company, body corporate, managing director or manager dealt with the report of the inspector under section 224, when as a result of the investigation, a prosecution has been instituted

(iv) any applicant who applied for the investigation under section 213 and inspector was appointed. It is the discretion of the Central Government to claim reimbursement from such applicant.

Any amount for which a company or body corporate is liable as mentioned above shall constitute a first charge on the sums or property mentioned as such.

4.14 VOLUNTARY WINDING UP OF COMPANY, ETC., NOT TO STOP INVESTIGATION PROCEEDINGS

An investigation may be initiated notwithstanding that an application has been made for an order for prevention of oppression or mismanagement under section 241or the company has passed a special resolution for voluntary winding up or any other proceeding for the winding up of the company is pending before the Tribunal. No such investigation shall be stopped or suspended on aforesaid reason only.[67]

If a winding up order is passed by the Tribunal in a proceeding, the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him and the Tribunal shall pass such order as it may deem fit. A winding up order does not absolve any director or other employee of the company from participating in the investigation proceedings before the inspector or any liability arising there from.[68]

4.15 PROTECTION OF EMPLOYEES DURING INVESTIGATION

As we know that Section 217 of the Act empowers inspector to compel production of documents and cast duties of every director, officer or other employee of the company to produce all such documents to the Inspector and furnish him with information or explanations in such form as the Inspector may require and shall render all assistance to him in connection with such investigation. Any employees of the company may make disclosure against company during investigation, which may lead into his dismissal or discharge or removal or reduction of rank or change of the terms of employment to his disadvantage. Section 218 of the Act provides safeguard to such employees of the company against evil consequences.

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67. S. 226 of the Act
68. Proviso. of section 226.

Despite above, if the company or body corporate proposes to dismiss or discharge or removal or reduction of rank or change of the terms of employment to his disadvantage then the company must take approval of the Tribunal of the action proposed to be taken, it must send a notice thereof to the employer. If the Tribunal has any objection to the action proposed, it shall send by post notice thereof in writing to the company, other body corporate or person concerned. If the company, other body corporate or person concerned does not receive any notice of objection from the Tribunal within thirty days of making of previous application of the action proposed against the employee, then, the company, other body corporate or person concerned may proceed to take the action proposed against the employee.

If the company, other body corporate or person concerned is dissatisfied with the objection raised by the Tribunal, it may, within a period of thirty days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal in such manner and on payment of the prescribed fees.[69] The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company, other body corporate or person concerned.

4.16 POWER OF TRIBUNAL IN FREEZING OF ASSETS OF COMPANY ON INQUIRY AND INVESTIGATION

Under section 221, the Tribunal may, by order prohibit the company from removing, transferring or disposing its funds, assets, properties during the specified period not exceeding three years. Tribunal may also impose appropriate conditions or restrictions upon such transfer, removal or disposal of the funds, assets or properties. The Tribunal may pass such orders-

(i) on a reference made to it by the Central Government, or

(ii) in connection with any inquiry or investigation into the affairs of a company, or

69. subsection (3) of the S.218

(iii) on any complaint made by such number of members as specified under section 244(1), or

(iv) on any complaint made by a creditor having one lakh amount outstanding against the company or

(v) on any complaint made by any other person

There should be a reasonable ground to believe that the funds, assets or properties of the company may be transferred, removed or disposed in a manner prejudicial to the interests of the company or its shareholders or creditors or in public interest.

In case of contravention of the order of the Tribunal, there is the provision of stringent punishment. Such default company shall be held liable to fine which shall not be less than rupees one lakh but which may extend to rupees twenty five lakhs. Every officer of the company who is in default shall be punishable –

(i) with imprisonment for a term which may extend to three years, or

(ii) with fine which shall not be less than rupees fifty thousand but may extend to rupees five lakh, or

(iii) with both.[70]

4.17 IMPOSITION OF RESTRICTIONS UPON SECURITIES

Under section 222, the Tribunal is empowered to impose restrictions upon securities of the company. Where it appears to the Tribunal, in connection with any investigation under section 216 or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed, the Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding three years as may be specified in the order.

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70. S. 221(2)

In case of contraventions, where securities in any company are issued or transferred or acted upon, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

4.18 INVESTIGATION OF FOREIGN COMPANIES

Section 228 of the Act states that all the provisions of Chapter XIV shall apply *mutatis mutandis* to inspection, inquiry or investigation in relation to foreign companies, as well.

4.19 INVESTIGATION BY SERIOUS FRAUD INVESTIGATION OFFICE (SFIO)

Section 211 of the Companies Act, 2013 provides that the Central Government shall constitute the Serious Fraud Investigation Office (SFIO). Accordingly, the Central Government has also set up the Serious Fraud Investigation Office (SFIO) in the ministry of corporate affairs. This is a specialized, multi-disciplinary organization to deal with serious cases of corporate fraud. This was also a major recommendation made by the Naresh Chandra Committee which was set up by the Government on 21 August 2002 on corporate governance.

Headquarters of this office is located in New Delhi, with field offices located in major cities throughout India. The SFIO is headed by a Director not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with the matters relating to corporate affairs and also consist of experts from various disciplines. The SFIO will only deal with investigation of corporate frauds characterized by

(a) Complexity and having inter- departmental and multi-disciplinary ramifications.

(b) Substantial involvement of public interest in terms of monetary misappropriation or in terms of number of persons affected and

(c) The possibility of investigations leading to or contributing towards a clear improvement in systems, law of procedure[71].

The other experts are appointed by the Central Government from amongst persons of ability, integrity and experience in the field of banking, Corporate Affairs, Taxation, Forensic audit, Capital Market, Information Technology, Law, or Other fields as required[72].

4.20 ROLE OF SERIOUS FRAUD INVESTIGATION OFFICE

SFIO, in following circumstances, investigate into the affairs of a company when the Central Government assigns[73]–

(a) on receipt of a report of the Registrar or inspector under section 208 where further investigation into the affairs of the company is necessary;

(b) on intimation of a special resolution passed by a company that its affairs are required to be investigated;

(c) in the public interest; or

(d) on request from any Department of the Central Government or a State Government,

Director of SFIO, may designate such number of inspectors, as he may consider necessary for the purpose of such investigation and such investigating officer have the power of the inspector according to section 217 of the Act[74]. Hence, inspectors may also be empowered to investigate the affairs of –

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71. Ramaiya, *Guide to the Companies Act*, 16th edn. p.2525, Lexis Nexis
72. Please refer, further, the Article of author written with guide Prof.(Dr.) Tabrez Ahmad, “Role of Serious Fraud Investigation Office (SFIO) in Protection of Investor’s Interest”: An Overview, *AD VALOREM*, Vol.1 Issue III (Jul-Sep 2014)
73. S. 212(1)
74. S. 212(4)

(a) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

(b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;

(c) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or

(d) any person who is or has at any relevant time been the company's managing director or manager or employee, he shall investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company.[75]

4.21 THE CASE SHALL NOT BE INVESTGATED BY OTHER DEPARTMENT WHEN ASSIGNED TO SFIO

In order to bring integrity and acceleration in investigation in serious corporate frauds, when any case has been assigned by the Central Government to the SFIO for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to SFIO.[76]

The company and its officers and employees, who are or have been in employment of the company, shall be responsible to provide all information, explanation,

75. S. 219 of the Act
76. S. 212(2)

documents and assistance to the investigating officer as he may require for conduct of the investigation. SFIO shall conduct the investigation in the manner and follow the procedure provided in chapter XIV of the Companies Act, 2013 and submit its report to the Central Government within such period as may be specified in the order.

4.22 POWERS OF SFIO

As we know that the SFIO deals only with serious cases of corporate fraud, when it appoints any person as investigating officer to cause the affairs of any company to be investigated, such person enjoys with certain powers during investigation. Section 212(4) of the Act prescribed the powers of the investigating officer. It states that such investigating officer shall have the power of the inspector under section 217 of the Act. It means such investigating officer has the following powers-

(a) Power to compel production of documents

(b) Power to examine on oath

(c) Power to take down notes of examination in writing

(d) Power of seizure of documents

(e) Power to seek support from other authorities

(f) Power to seek evidence in other countries

These powers of inspector have already been discussed (*supra*). In addition to these, the Director or Additional Director or Assistant Director of SFIO also has the power to arrest the accused, if authorised by the Central government[77].

4.23 POWER OF SFIO TO ARREST THE ACCUSED

Under Section 212(8) of the Act, Director, Additional Director or Assistant Director of SFIO, if authorized by Central Government by general or special law,

77. S. 212(8)

may arrest such person, who is found guilty of cases of fraud as mentioned in Section 212(6) which are as below-

Section	***Particulars/nature of offence***
7(5)	Furnishing of false or incorrect information or suppression of any material information in any document required to be filed with the Registrar at the time of incorporation of company.
7(6)	If at any time after incorporation of company it is proved that the incorporation was obtained by furnishing false or incorrect information or suppressing any material information, the first directors and the persons making declaration under clause (b) of sub-section (1).
34	If a prospectus issued, circulated or distributed includes any misleading or false statement or where any inclusion or exclusion is likely to mislead, the person authorizing the issue of such prospectus.
36	Making of any statement, promise or forecast knowingly or recklessly which is false, deceptive or misleading or deliberately conceals any material fact to induce another person to invest money into any security.
38(1)	Making or abetting the making of any application in a fictitious name for acquiring securities of any company, making multiple applications by using different combinations of his name or surname or otherwise fraudulently inducing the company to allot or register any transfer of securities to him or to any other person in fictitious name.
46(5)	If a company with an intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crore whichever is higher and every

	officer of the company who is in default.
56(7)	Any depository or depository participant guilty of transferring any shares with intent to defraud a person.
66(10)	If any officer of the company is guilty of knowingly concealing the name of any creditor entitled to object to the reduction of share capital, knowingly misrepresents the debt due to any creditor or abets or is privy to any such concealment or misrepresentation.
140(5)	If any auditor is guilty of acting in a fraudulent manner and against whom any final order has been made by the Tribunal.
206(4)	Where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default.
213	Every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs.
229	Furnishing false statement, mutilation or destruction of documents in respect of a company under investigation or inspection.
251(1)	Fraudulently making an application for removal of name of a company to the Registrar with intent to evade a liability or to deceive its creditors, the person in-charge of management of the company.
339(3)	If in the course of winding up of a company, it is found that any business of the company is being carried on with intent to defraud its creditors or any other persons, every person who was knowingly a party to the carrying on of the business in the manner aforesaid.
448	Any person makes a false statement- (i) which is false in any material particulars, knowing it to be false; or

	(ii) which omits any material fact, knowing it to be material.

These activities come under the ambit of fraud as well as cognizable offence and punishable under section 447 of the Act. Every person arrested shall, as soon as possible, be intimated the ground of arrest and within twenty-four hours, be taken to a Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction; provided that the period of twenty-four hours shall be excluded the time necessary for the journey from the place of arrest to the Magistrate's court.[78]

No person accused of any offence under those sections shall be released on bail or on his own bond unless—

(i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

A person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs. The Special Court shall not take cognizance of any offence except upon a complaint in writing made by—

(i) the Director, Serious Fraud Investigation Office; or

(ii) any officer of the Central Government authorised, by a general or special order in writing in this behalf by that Government.

4.24 SUBMISSION OF INVESTIGATION REPORT BY SFIO

SFIO has to submit the investigation report, on completion of the investigation to the Central Government. If the Central Government so desire, SFIO shall also

78. S. 212(6)

submit interim report before submission of final investigation report. The detail and final report is to be submitted, in due course of time, after completion of investigation.

4.24.1 SUBMISSION OF INTERIM INVESTIGATION REPORT

The Central Government if so directs, the SFIO will submit an interim report to the Central Government within stipulated time. This report may contain the preliminary findings related with seriousness, wrongdoers of the fraud etc.

4.24.2 SUBMISSION OF FINAL INVESTIGATION REPORT

SFIO shall submit the detail and final investigation report on completion of the investigation to the Central Government. A copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court.

On receipt of the investigation report, the Central Government will, after examination of the report (and after taking such legal advice, as it may think fit), may direct the SFIO to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company. The investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973.

In case, SFIO has been investigating any offence under this Act, any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of such offence shall provide all such information or documents available with it to the SFIO.

The SFIO will also share any information or documents available with it, with any investigating agency, State Government, police authority or income tax authorities, which may be relevant or useful for such investigating agency, State Government,

police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law.[79]

4.25 CRIMINAL LIABILITIES OF COMPANY IN CASES OF FRAUD

The following corporate activities have been regarded as fraud and kept under the category of cognizable as well as non-bailable offences and punishable under section 447 of the Companies Act, 2013.

(a) Furnishing False or incorrect information during registration of company-If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company[80].

(b) Incorporation of company by fraudulent means- Any company incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action[81].

(c) Untrue or Misleading Prospectus- When a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead[82].

(d) Inducing a person to enter into financial matter- Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into

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79. S. 212(17)
80. S. 7(5)
81. S. 7(6)
82. S. 34

(i) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting securities; or

(ii) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(iii) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution[83].

(e) Any person who **makes or abets** making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name[84].

(f) If a company with **intent to defraud** issues a duplicate certificate of shares.[85]

(g) Without prejudice to any liability under the Depositories Act, 1996, where any depository or depository participant, with an intention to defraud a person, has transferred shares.[86]

(h) If any officer of the company knowingly **conceals the name of any creditor** entitled to object to the reduction; knowingly misrepresents the nature or amount of the debt or claim of any creditor; or abets or is privy to any such concealment or misrepresentation as aforesaid.[87]

(i) When the **auditor of the company has acted fraudulently or abetted or colluded** in any fraud by, or in relation to, the company or its directors or officers, such auditor are held liable for fraud and may be removed from office.[88]

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83. S. 36
84. S. 38(1)
85. S. 46(5)
86. S. 56(7)
87. S. 66(10)
88. S. 140(5)

(j) Where business of a company has been or is being carried on for a fraudulent or unlawful purpose, or if the **grievances of investors are not being addressed**, every officer of the company who is in default shall be held liable for fraud.[89]

(k) if after investigation it is proved that the business of the company is being conducted with **intent to defraud its creditors**, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, then, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be held liable of fraud.[90]

(l) **Furnishing false statement mutilation, destruction of documents**- Where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation,—

(i) **Destroys, mutilates** or falsifies, or conceals or tampers or unauthorized removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate;

(ii) makes, or is a party to the making of, a **false entry** in any document concerning the company or body corporate; or

(iii) provides an explanation which is false or which he knows to be false.[91]

(m) **Fraudulent application for removal of name**- Where it is found that an application by a company under sub-section (2) of section 248 has been made with

89. S. 206(4)
90. S. 213
91. S. 229

the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons, the persons in charge of the management of the company shall, notwithstanding that the company has been notified as dissolved—

(i) be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved; and

(ii) be punishable for fraud as per section 447.[92]

(n) Fraudulent conduct of business- If in the course of the winding up of a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other persons or for any fraudulent purpose, the Tribunal, on the application of the Official Liquidator, or the Company Liquidator or any creditor or contributory of the company, may, if it thinks it proper so to do, declare that any person, who is or has been a director, manager, or officer of the company or any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible for fraud.[93]

(o) False Statement[94]- any return, report, certificate, financial statement, prospectus, or other document required by, or for the purposes of any of the provisions of this Act or the rules made there under, any person makes a statement-

(i) which is false in any material particulars, knowing it to be false; or

(ii) which omits any material fact, knowing it to be material.

4.26 PUNISHMENT FOR FRAUD IN THE COMPANIES ACT

It is worth to discuss here the punishment of various frauds prescribed by the Companies Act, 2013. The Act prescribes punishment for following frauds-

92. S.251
93. S. 339
94. S. 448

(a) any person who is found to be **guilty of fraud**, is punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.[95]

(b) where the **fraud in question involves public interest**, the term of imprisonment shall not be less than three years.

(c) **Giving false statement** in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act, shall be punishable as per section 447.[96]

(d) **Giving intentionally false evidence** upon any examination on oath or solemn affirmation, authorised under this Act; or in any affidavit, deposition or solemn affirmation, in or about the winding up of any company or otherwise in or about any matter arising under this Act, shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to seven years and with fine which may extend to ten lakh rupees.[97]

(e) Punishment where no specific penalty or punishment is provided[98]**-** If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made there under, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to ten thousand rupees, and where the contravention is continuing one, with a further fine which

95. S. 447
96. S. 448
97. S.449
98. S. 450

may extend to one thousand rupees for every day after the first during which the contravention continues.

(f) Punishment in case of repeated default- If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.[99]

4.27 EVALUATION OF THE ROLE OF SFIO

SFIO is a specialist organisation that investigates only the most serious type of corporate frauds. It has been empowered by the Companies Act, 2013 to investigate all the matters pertaining to frauds occurred in any company where the investors lost their hard earned money. An inspector can examine on oath any person involved in the fraud and may thereafter be used in evidence against him. In this work of inspector, the officers of the Central Government, State government, police or statutory authorities shall provide assistance to him. They enjoy all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely[100]:—

(i) the discovery and production of books of account and other documents, at such place and time as may be specified by such person

(ii) summoning and enforcing the attendance of persons and examining them on oath; and

(iii) inspection of any books, registers and other documents of the company at any place.

Here, it is worth to mention that investigation proceedings are not judicial proceedings but only investigatory and quasi-judicial in nature[101]. If any director or

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99. S. 451
100. S. 217(5)
101. *Coimbatore Spinning & Weaving Co. Ltd* v. *M.S Srinivasan* (1959) 29 Comp. Cases 97 (Mad)

officer of the company disobeys the direction issued by the Registrar or the inspector, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

If a director or an officer of the company has been convicted of an offence under section 217, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company. The notes of examination of the person as mentioned above are to be taken down in writing and to be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him. If any person fails without reasonable cause or refuses—

(i) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty to produce; or

(ii) to furnish any information which is his duty to furnish; or

(iii) to appear before the inspector personally when required to do so or

(iv) to answer any question which is put to him by the inspector in pursuance of that; or

(v) to sign the notes of any examination referred to;

he shall be punished with imprisonment for a term which may extend to six months and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, and also with a further fine which may extend to two thousand rupees for everyday after the first during which the failure or refusal continues.[102]

Satyam Computers Scam was investigated by the SFIO in record three months of time. This scam of worth Rs.7,200 crore and caused loss of Rs. 14,162 crore (approx.) to its investors in 2009, has happened with the help of audit firm

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102. S. 217(8)

PricewaterhouseCoopers which is big blow for corporate governance in India. The role and liability of Independent director were also held suspicious. Satyam Computer Services Ltd was founded in 1987 by B.Ramalinga Raju. The company offers information technology (IT) services spanning various sectors, and was also listed on the New York Stock Exchange and Euronext. Satyam's network has covered 67 countries across six continents. The company employed 40,000 IT professionals across development centers in India, the United States, the United Kingdom, the United Arab Emirates, Canada, Hungary, Singapore, Malaysia, China, Japan, Egypt and Australia. It was serving over 654 global companies, 185 of which were Fortune 500 corporations. Satyam has strategic technology and marketing alliances with over 50 companies. Apart from Hyderabad, it has also development centers in India at Bangalore, Chennai, Pune, Mumbai, Nagpur, Delhi, Kolkata Bhubaneswar, and Visakhapatnam.[103]

SFIO questioned the independent directors and found that allegedly at the behest of the chairman and other top executives of the IT giant, it has occurred. SFIO concluded had no knowledge about the falsification of accounts and overstated profits, which the Independent directors of Satyam were not involved in the multi-crores accounting fraud in the IT Company and were kept in the dark by the chairman.

SFIO has also investigated **Deccan Chronicle Holding Ltd (DCHL)** loan default case of Rs. 1,230 crore(approx).[104] This is also Hyderabad based company, which owns the English dailies Deccan Chronicle and Asian Age, was under probe for alleged financial irregularities and failure to repay loan during 2009-11. In a report to the ministry, the SFIO has pointed to violations of several provisions of the Companies Act, 1956. The SFIO report has confirmed that the money was availed by the company's management from various banks through sale of non-convertible debentures and other commercial papers. Later, DCHL declared itself sick and

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103. Ahmad Tabrez, "*Satyam Scam in the Contemporary Corporate World*", retrieved from SSRN, id. 1460022
104. The Hindu, Hyderabad, Jul 09, 2013

registered with the Board for Industrial and Financial Reconstruction (BIFR). Although the BIFR has accepted the company's plea under the Sick Industries Act, the move does not deter DCHL's lenders from taking action against the company under the Securitisation Act.

The famous **Sardha Chit Fund Scam** of West Bengal is, now, being investigated by the SFIO. The investigation was ordered by the Corporate Affairs Ministry, in 2013, following huge public outcry over the scam that duped hundreds of gullible investors by running fraudulent money-pooling schemes in the garb of chit funds. More than 60 companies, most of them from the eastern states of the country, which are believed to have cheated the public of their money, are being probed by SFIO. In its interim report, SFIO had said that companies under the scanner indulged in serious financial mismanagement besides siphoning off the funds by their promoters, who exploited regulatory gaps[105]. There has been proliferation of innovative financial products in the market due to technological advancement and extensive use of the internet to market such products to investors. In this scam many politician are allegedly involved and investigation are still going on, till date.

4.28 POWER OF SEBI TO INVESTIGATE THE TRANSACTIONS OF SECURITIES MARKET

The Stock Exchange Board of India (SEBI) can investigate any irregularity of transaction taken place into the security market. Section 11 C of the SEBI Act, 1992 empowers the SEBI to investigate when there is reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board there under, it may, at any time by order in writing, direct any person specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.

105. The Hindu, New Delhi, April 20, 2014

4.29 DIFFERENCES BETWEEN INSPECTION AND INVESTIGATION

The primary objective of Inspection and Investigation is to check the conduct of a company as per the provisions of the Companies laws, but they differ with their nature and scope, which are as follows-

(a) Section 206 to 208 of the Companies Act, 2013 deals with Inspection of books of account, other books and papers by the Company Registrar or inspector appointed for this purpose and making of reports. It is initiated based upon the scrutiny of books of account, other books and papers, the inspecting authority need not assign any reason. The primary aim of inspection is to keep a watch over the companies to ensure that the statutory books and papers are maintained and business of the company is being managed at proper level of efficiency. On the other hand, the Central Government appoints inspectors under section 210, to investigate either on its own if it is of the opinion that such investigation is required on the report of the Registrar or Inspector under section 208 or in public interest or on the request of the company on the basis of a special resolution or on the direction of the court/Tribunal or from such members of the company having requisite number of shares as specified in section 213 of the Companies Act 2013. Section 212 also empowers the Central Government to order an investigation by SFIO under certain circumstances. Section 216 also empowers the Central Government to order investigation as to the ownership of the company. Under section 219, the inspector may, if considered necessary, investigate even the affairs of another company under the same management or in the same group.

(b) Inspection of books of account and other books and papers is not an investigation though it may lead to investigation in case anything wrong or objectionable is found during inspection. The object of inspection is to ensure that there is nothing abhorrent in the books of account and other books and papers, but investigation into affairs of the company is wider in scope. It includes investigation of all the business affairs, profit & loss, assets including goodwill, contracts and

transactions, investment and other property interests and control of subsidiary, holding and other related companies also.

(c) Inspection of books of account and other books and papers can be done either by the Registrar or by an officer authorised by the Central Government. But, investigation can be conducted by the competent persons only, appointed as inspector for investigation by the Central Government or Serious Fraud Investigation Office (SFIO).

(d) In inspection, a inspector can examine only that company for which he is so authorised by the Central Government but cannot investigate, further, *suo motu*. On the other hand, in investigation, under section 239, the inspector has the power to investigate the affairs of the holding company, or the subsidiary of the company being investigated and the affairs of the managing director or the manager of the company without the approval of the Central Government and the affairs of the connected companies with the approval of the Central Government.

(e) The expenses of the inspection are borne completely by the Central Government and not recoverable. But, in investigation, the expenses, prima facie, are borne by the Central Government but under section 225 of the Act, it may be reimbursed partly or fully by the applicants in the case of investigation in accordance with any direction of the Central Government in this regard. The Central Government under section 214 of the Act, may also ask for the security deposit not exceeding rupees twenty five thousands from the applicant seeking investigation of a company.

(f) Copy of report- No company or member can ask for a copy of inspection report but a copy of investigation report may be obtained by anybody by making an application to the Central Government.

4.30 CONCLUSION

Though investors are the real owners of a company but the power of management of the company is vested in the Board of Directors. This may, sometimes, lead to

abuse of power by few directors as the power of management of the company are vested in few hands. Like **Lord Acton** has said in this regard that ***'Power corrupt; absolute power corrupt absolutely***'. Hence, to avoid monopoly of Board of directors, the Central Government reserves its right to investigate the affairs of the companies, especially in the cases of alleged frauds or the oppression of the minority shareholders, to protect their interests. In previous chapter we have seen that the Central Government is empowered to appoint inspectors to investigate the affairs of such companies, which are not complying the provision of the Companies Act, 2013, either, on its own if it is of the opinion that such investigation is required on the report of the Registrar or Inspector under section 208(i.e. report on inspection made) or in public interest.

Investigation of a company is the process to examine the management of the company's affairs to find out whether the company is functioning according to the provisions of the Company Act and other relevant laws of the country. Investigation of the affairs of a company is the investigation of all its business affairs i.e. profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too.

The Central Government is empowered to order investigation into the affairs of a company either on the receipt of report of the Registrar or inspector under Section 208 that has pointed out the huge financial irregularities, or on intimation of a special resolution passed by a company that its affairs are required to be investigated, or the Tribunal has passed order in the public interest. Investigation may be also carried out when there is allegation that the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or any person concerned in the formation of the company or the management of its affairs have in connection therewith. The Tribunal may pass an order that the affairs of a company ought to be investigated by an inspector appointed by the Central Government. If such an order is passed by the Tribunal, it is necessary for the Central Government to

appoint inspector(s) to investigate the affairs of the company in respect of such matter.

The Central Government is also empowered to investigate the ownership of a company when satisfied that there is good reason, in public interest, to know the persons who are financially interested in the company and who control the policy or materially influence it. The Central Government, on the order of the Tribunal appoints one or more inspectors to investigate and report on matters relating to the company and its membership for the purpose of determining the true persons who are or have been financially interested in the success or failure, whether real or apparent, of the company or who are or have been able to control or to materially influence the policy of the company.

The purpose of investigation is to discover something which is apparently not visible to the naked eye or on the face of it. An order of investigation can, *inter alia*, be made when the Tribunal is of opinion that the persons in management are guilty of fraud, siphoning off of funds, misfeasance, mismanagement or other misconduct in carrying on the day to day affairs of the company. Thus the main objective of investigation is to redress the issue of mismanagement of a company and to protect the interest of members/shareholders, debenture holders, creditors and other investors of the company. The Central Government may also define the scope of the investigation by inspector with respects to the matters or the period to which it is to extend or otherwise.

Inspector(s), appointed by the Central Government to investigate the affairs of a company, they enjoy certain powers for the smooth function during investigation which includes power to carry out investigation into affairs of the company and its related subsidiary companies, to compel directors and its officers for the production of documents, to examine them on oath, to take down notes of examination in writing, seizure of documents, to seek support from other authorities etc. Inspector is required to prepare and submit a report to the Central Government. Under Section 223 of the Companies Act, 2013, the inspector, if so

directed by the Central Government, shall submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government. Employees of the company are protected against dismissal or discharge or removal or reduction of rank or change of the terms of employment to his disadvantage during investigation.

On receipt of such report, the Central Government studies the report and if the company is not functioning in accordance with the provisions of the Companies Act and detrimental to the investors, the follow up action taken may be initiation of criminal prosecution against such company or recovery of loss or property or damages or order for winding up of such company. There are various criminal liabilities has been provisioned in the Companies Act, 2013.

Under Section 211 of the Companies Act, 2013, the Central Government has, now, constituted the Serious Fraud Investigation Office (SFIO) in the ministry of corporate affairs. This is a specialized, multi-disciplinary organization to deal with serious cases of corporate fraud. This was also a major recommendation made by the Naresh Chandra Committee which was set up by the Government on 21 August 2002 on corporate governance. Headquarters of this office is located in New Delhi, with field offices located in major cities throughout India. The SFIO is headed by a Director not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with the matters relating to corporate affairs and also consist of experts from various disciplines. The SFIO will only deal with investigation of corporate frauds characterized by Complexity and having inter-departmental and multi-disciplinary ramifications. SFIO enjoys all the powers as provided to inspector during investigation. In addition, he has also the power to arrest the accused, if authorised by the Central Government.

It is concluded that investigation of the affairs of the company is an important means of protection of the interest of the investors. Investigation by Inspectors/SFIO can reveal the occurrence of various corporate frauds in speedy manner. SFIO is involved, when the Central Government finds that there is

allegation of serious fraud in the company. The Central Government is empowered by the Companies Act, 2013 to investigate all the matters pertaining to frauds occurred in any company where the investors lost their hard earned money. An inspector can examine on oath any person involved in the fraud and may thereafter be used in evidence against him. In this work of inspector, the officers of the Central Government, State government, police or statutory authorities are duty bound to provide necessary assistance to him. An inspector/SFIO also enjoys all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit during investigation. But it is also expected from them to work honestly and in responsible way in the investigation. Since SFIO is a Government agency and its officials are appointed by the Central Government so there is strong apprehension for its unbiased and unfair working like CBI as we often heard that the later is being used against the leaders of oppositions during investigation of any crime. Similarly the SFIO may, sometimes, be used against the rival company of the Government. Therefore, Inspector/SFIO should conduct fair investigation of any alleged corporate fraud and then they should submit the detail report to the Central Government; otherwise the share price of the company will fall sharply in a single day, in reaction, merely on this bad news, which will result into huge loss, again to investors.

Annual Report on the working and administration of the Companies Act, 1956, in pursuance of Section 638 of the Companies Act, 1956 (now, section 461 of the Act of 2013) which lays down that the Central Government shall cause a general annual report on the working and administration of this Act to prepared and laid down before each House of Parliament within one year of the close of the year to which the report relates.

57th Annual Report for the year ended March 2013, disclosed that total 46 cases were referred to Serious Fraud Investigation Office (SFIO) under section 235/237 of the Companies Act, 1956 (now, section 210/213 of the Act of 2013), by the Ministry of Corporate Affairs, where the size of the alleged fraud was estimated to be at least Rs. 50 crores or more in each cases, for further

investigation. The Ministry has received 22 investigation reports from SFIO during the period the financial year 2012-13 and prosecutions have been launched in various courts.[106]

The report also states that total 139 cases were referred to SFIO for investigation up to 31 March 2013. Out of these, SFIO has submitted investigation report in 104 cases to the Ministry of Corporate Affairs till 31 March 2013. In 10 cases the order for investigation were either stayed or quashed/withdrawn as on 31 March 2013 and the remaining 25 cases are under investigation.

The report, further, states that a total of 49950 prosecutions launched under the Companies Act, were pending in various courts as on 31 March 2012 and 6062 prosecutions were instituted during the year 2012-13 against 3293 companies and their officers. Thus, in all 56012 prosecutions were pursued in the courts during 2012-13. Out of these 6542 prosecutions were disposed of and 49470 were pending at the end of the year.

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106. 57th Annual Report on the working and administration of the Companies Act, 1956, 31 March 2013, p. 53-61

CHAPTER V

AUDIT AS A MEANS OF PROTECTION OF INVESTORS

5.1 INTRODUCTION

Audit is a formal examination and verification of financial accounts and records of an organisation. It has become an essential requirement for good corporate governance as it plays a major role in ensuring transparency and accountability in the corporate financial administration, so auditors are, often, referred to as gatekeepers. A company carries on business with capital provided by persons who are not in control of the use of the money supplied by them. They would, therefore, like to see their investments are safe, being used for intended purposes and the annual accounts of the company present a true and fair view of the state of affairs of the company. For this purpose, the accounts of the company must be checked and audited by a duly qualified and independent person who is neither employed in the company nor is in any way indebted or otherwise obliged to the company.[1] The contract under which the work of a company's auditor is with the company should be as a separate person. Like anyone who renders professional services for reward, a company's auditor owes the company an implied contractual duty of care in and about the manner in which the audit is performed.[2] The nature of an auditor's duty of care in the performance of an audit was considered by **Lopes LJ** in *Re Kingston Cotton Mill Co (No-2)*[3] which is relevant, even, today also-

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1. Majumdar A.K and Kapoor, *Company Law and Practice*, 15th ed, Taxmann, Page No. 819
2. *Equitable Life Assurance Society* v. *Ernst and Young* (2003) EWCA Civ. 1114 (2003)
3. (1896) 2 Ch 279 at pp 28-89

"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 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……an auditor does not guarantee the discovery of all fraud."[4]

According to **Lord Denning**,

"An auditor is not bound to be confined to the mechanics of checking vouchers and making arithmetical computations. He is not to be written off as a professional adder-upper and subtractor. His vital task is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths. To perform this task properly he must come to it with an inquiring mind- not suspicious of dishonesty, I agree- but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none."[5]

Sections 138 to 148 of the Companies Act, 2013 deal with audit and auditors. Now, internal audit by qualified auditors has been made mandatory as per section 138 of the Act. The Board of directors shall decide for internal audit in the manner prescribed by the Central Government. Every company appoints an individual or firm as an auditor in the annual general meeting (AGM) who hold office for five years and he is also be present in every AGM. Section 144 of Companies Act, 2013 provides for the services which the auditor cannot perform directly or indirectly to the company or its holding company, subsidiary company or associate company.

There are civil and criminal liabilities, through section 147, imposed on auditor and on the partner(s) of an auditor firm who has audited in contravention of

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4. As quoted by Mayson, French and Ryan in their book "*Company Law*" 26th edition, Oxford at p.528
5. *Fomento (Sterling Area) Ltd* v. *Selsdon Fountain Pen Co Ltd* ,(1958) 1 WLR 45

provisions of the Companies Act, 2013. In the present chapter, meaning of audit, qualification of auditors, essentials for their appointment, their powers and duties, their civil and criminal liabilities have been dealt in the light of the Companies Act, 2013 and how audit is an important means to protect the investor's interests has been discussed.

5.2 MEANING OF AUDIT

As stated above, Audit is a formal examination and verification of financial accounts and records of any organisation. It is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report. The purpose is then to give an opinion on the adequacy of controls (financial and otherwise) within an environment they audit, to evaluate and improve the effectiveness of risk management, control, and governance processes.[6]

When there is inequality of information between parties, it is desirable, not only between parties concerned, but also from a wider social perspective that the accounts should be attested by an independent third party. A prospective purchaser of a company's share will require this information before he commits himself to investing in the company. The established convention is to have an independent third party, an auditor, to validate this information.[7]

An audit must adhere to generally accepted standards established by governing bodies. These standards assure third parties or external users that they can rely upon the auditor's opinion on the fairness of financial statements, or other subjects on which the auditor expresses an opinion.

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6. Audit and Assurance Standard (AAS-1), ICAI.
7. Charlesworth's *Company Law*, 18th edn.(London Sweat and Maxwell, 2011) at page No. 481

Audit has revealed many corporate frauds in the past and it is an important means to protect the interests of investors. It plays a major role in ensuring transparency and accountability in the corporate world, thus they are often called as gatekeepers. Auditing is the central to the public confidence in financial disclosures especially as an auditor is considered to be an intermediary between firms and investors in respect of corporate financial statements. Auditors act as eyes and ears of the shareholders and prospective investors, thus, to instill confidence in market and to provide a true and fair account of the company the role of an unbiased objective auditor is an undeniable necessity.

5.3 OBJECTIVE AND SCOPE OF AUDIT

A company carries on business with capital provided by persons who are not in control of the use of the money supplied by them. They would, therefore, like to see whether their investments are safe, being used for intended purposes or not. At the same point of time annual accounts of the company present a true and fair view of the state of affairs of the company.[8] Thus, to maintain investor's confidence in the reliability of company, the accounts of the company must be checked and audited by a duly qualified and independent person who is neither employed in the company nor in any way indebted or otherwise obliged to the company. It is a formal examination and verification of financial accounts and records of any organisation and now, it has become an indispensable part of good corporate governance as it plays a major role in ensuring transparency and accountability in the corporate financial administration. It is also a mechanism through which interest of the investors can be safeguarded.

Originally, the audit function was primarily a public function. Its objective was to detect fraud and error.[9] **Dicksee** in his text book on auditing has outlined the objectives of an audit as[10]-

(i) The detection of fraud

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8. Majumdar A.K and Kapoor, *Company Law and Practice*, 15th edn, p. 821,Taxmann,
9. *Ibid* at p. 819.
10. I. R Dicksee, *Auditing- A Practical manual for Auditors*, p.7

(ii) The detection of technical errors

(iii)The detection of errors of principle

The means for achievement of such an objective is a detailed analysis of transactions. He has mentioned the concept of internal check and pointed out that when a good system of internal check exists, a detailed audit is frequently not necessary in its entirety.

With the passage of time and the growth of enterprises to the size that made significantly improved internal system of control economical, a detailed audit of transactions became impractical and the objectives of the audit function changed significantly. The auditor's report on financial statements became an end product rather than merely an evidence of absence of fraud.

The **Institute of Chartered Accountants of India** has also enumerated the following as the objective of auditing the financial statements[11]-

1. Objective of auditing the financial statements prepared within a framework of recognized accounting policies and practices and relevant statutory requirement, if any, is to enable an auditor to express an opinion on such financial statements.

2. The auditor's opinion helps in determination of the true and fair view of the financial position and operating results of an enterprise. The user however should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.

5.4 INTERNAL AUDIT OF THE COMPANY

A new provision is added in the Companies Act, 2013, regarding internal audit of the company. Section 138 of the Act provides that such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other

11. Statement on objective and scope of audit of financial statement, ICAI.

professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board. There was no such provision for mandatory internal audit in the Act of 1956.

Therefore, the main objective of auditing is the evaluation of financial statement to see whether they truly and fairly represent the actual financial status of the organization. Detection of frauds and errors is only an incidental objective. Auditor is often in a position to discover frauds. If after the auditor has completed his audit, a fraud is discovered pertaining in that period, it does not necessarily mean that the auditor has been negligent or that he has not performed his duties completely. The auditor does not guarantee that once he has signed the report on the accounts, no fraud exists. If he has conducted his audit by applying due care and skill in consonance with the professional standards expected, the auditor would not be held responsible for not having discovered that fraud.[12]

5.5 ELIGIBILITY AND QUALIFICATIONS OF AUDITOR

In India, an auditor should be a chartered accountant under the Chartered Accountants Act, 1949 who is appointed to examine the books of account and the accounts of a company registered under the Companies Act, and to report upon them to the company's shareholders.[13] A firm may be appointed in its name provided majority of partners practicing in India are qualified for appointment as auditor.[14]

Where a firm including a limited liability partnership is appointed as an audit firm of a company, only the partners who are chartered accountants are authorised to act and sign on behalf of the firm.[15]Therefore, only a practicing chartered accountant holding a certificate of practice is eligible to be appointed as an auditor

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12. Majumdar, A.K and Kapoor, *Company Law and Practice*, 15th edn, Taxmann, p. 821
13. S. 141 of the Companies Act, 2013(hereafter referred as the Act)
14. Proviso of s.141 of the Act
15. S.141(2) of the Act

of the company. Further, such a chartered accounted is also subjected to the requirements of ethical conduct as contained in the Chartered Accountant (C.A) Act, 1949.

In ***Council of the Institute of Chartered Accountants of India* v. *B. Ram Goel***,[16] the Delhi High court held that the Chartered Accountant concerned is guilty for writing a letter to the shareholders of a company where he rendered professional service, for sale of their shares in that company (originally the Council of the Institute held the Chartered Accountant as guilty).

In ***Institute of Chartered Accountants of India* v. *S.K. Jain,***[17] the Delhi High court held that the Chartered Accountant concerned as guilty of gross negligence in certifying a statement of export of leather goods, without verifying facts from relevant books or documents of the concerned company.

In United Kingdom, an auditor is an officer of the company for the purpose of a misfeasance summons under section 212 of the U.K's Insolvency Act, 1986 and for the purposes of offences under sections from 206 to 211 and section 218 of that Act.[18] Where an Auditor is retained to conduct and carry out the audit function without appointment as an Auditor, he may not be treated as officer of the company.[19]

5.6 DISQUALIFICATIONS OF AUDITOR

The following persons are **not eligible** for appointment as an auditor of a company[20], namely:—

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(b) an officer or employee of the company;

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16. [2001] 29 SCL 257
17. (2001] 29 SCL 265
18. Charlesworth's *Company Law*, 18th edn.(London Sweat and Maxwell, 2011) at page No. 487 and in *Re London and General Bank (1895) 2 Ch. 166 CA.*
19. Dutta C.R., *Company Law*, 6th edn. 2008, p. 3733 (Lexis Nexis, Wadhawa and Co. Nagpur,),
20. S. 141(3) of the Act

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: or

(ii) is indebted to the company, or its subsidiary, or

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary.

(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company,

(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

5.7 APPOINTMENT OF AUDITORS

Section 139 of the Companies Act, 2013 describes the various provisions for the appointment of auditors having requisite qualifications and other eligibilities. They

can be appointed by the Board of directors as first auditors, or by shareholders in the Annual General Meeting as subsequent auditors. Thus they are appointed by-

(a) by Board of directors

(b) by shareholders in the Annual General Meeting

(c) by the Central Government

5.7.1 APPOINTMENT BY BOARD OF DIRECTORS

The first auditor of a public company is appointed by the Board of directors within thirty days from the date of registration of the company. The auditor(s) so appointed shall hold office until the conclusion of the first annual general meeting. If the Board fails to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.[21]

In case of casual vacancy, which has been created as a result of the resignation of an auditor, such appointment against the vacancy should be filled up by the company at a general meeting convened within three months of the recommendation of the Board and such auditors shall hold the office till the conclusion of the next annual general meeting.[22]

The appointment of the first auditor of a company through the Memorandum of Association and Article of Association of the newly company is not a valid appointment since the Companies Act grants no recognition. Therefore, the first auditors would be validly appointed only by a resolution of the Board of directors or that of the company in the general meeting.

21. S, 139(6) of the Act
22. S. 139(8)

5.7.2 APPOINTMENT BY SHAREHOLDERS IN THE ANNUAL GENERAL MEETING

Generally, auditors are appointed by shareholders in annual general meeting either through passing ordinary or special resolution. Appointment of subsequent auditors of the company is made in the first annual general meeting through passing ordinary resolution.

Section 139(1) of the Act provides that every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting. But, matter relating to such appointment shall be placed for ratification by members at every annual general meeting.

In this way, the subsequent auditors are appointed by the members of the company in annual general meeting by passing an ordinary resolution. The tenure of such subsequent auditors is fixed for five years.

The proviso of the section 139(1) further provides that before such appointment is made, the written consent of the auditor proposed to be appointed should be obtained along with a certificate from him. The Companies (Audit and Auditors) Rules 2014 require the auditor to certify that –

(i) he is eligible for appointment and not disqualified for appointment under the Act, the Chartered Accountant Act, 1949 and the rules or regulations made there under,

(ii) the proposed appointment is as per the term provided under the Act,

(iii) the proposed appointment is within the limit laid down by the authority of the Act,

(iv) the list of proceedings against the auditor of audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate is true and correct.

Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of Audit Committee.[23]

Intimation of Appointment- the Company should inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.[24]

5.7.3 APPOINTMENT OF AUDITOR BY THE CENTRAL GOVERNMENT

Section 139(7) of the Act prescribes that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor is appointed by the Comptroller and Auditor-General of India (CAG) within sixty days from the date of registration of the company

In case the CAG of India does not appoint such auditor within the abovementioned period, the Board of directors of the company shall appoint such auditor within the next thirty days and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting.

The first auditor so appointed hold office till the conclusion of the first annual general meeting.

5.8 CEILING ON AUDIT

According to section 141 (3) (g), the following persons are not eligible for appointment as an auditor of a company, namely:—

(a) a person who is in full time employment elsewhere, or

23. S. 139(11)
24. Proviso of s. 139(1)

(b) a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

So, a person cannot be auditor of more than twenty companies at a time. In case of a firm of auditors, it shall be construed as partner of the firm who is not in full time employment elsewhere. As the expression used here is 'twenty companies' without any exception, it implies that the restriction applies to private companies, one person companies and small companies as well.[25]

5.9 TENURE OF OFFICE OF AUDITOR

An individual auditor or an audit firm is appointed, at the first annual general meeting who shall hold office from the conclusion of that meeting to till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.[26] Such meeting is called the first meeting. If the annual general meeting (AGM) is not held within the period as prescribed by section 96 of the Act, the office of auditors shall not be vacant. He is expected to continue in office till the AGM is actually held and concluded. In this way, if an AGM is adjourned, the tenure of auditor will extend till the conclusion of the adjourned meeting.

If no auditor is appointed in AGM- section 139 (11) of the Act provides that if at an AGM no auditor is appointed or reappointed, the existing auditor shall continue to be the auditor of the company.

Nevertheless an auditor is appointed for a period of five years as aforesaid, the matter relating to such appointment needs to be placed before the members at every AGM for their ratification. The company has also a right to remove the auditor before completion of his tenure.

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25. Kapoor, G.K and S. Dhamija, *Company Law and Practices*, Taxmann, 19th edn. 2014, p.607
26. S.139(1)

5. 10 COMPULSORY ROTATION OF AUDITOR

A new provision of compulsory rotation of auditors by listed companies and classes of companies has been prescribed in the Companies Act, 2013. Section 139 (2) of the Act has prescribed for compulsory rotation of the auditors for the listed companies and certain class or classes of companies. Such class of companies is notified in the Rule 5 of Companies (Audit and Auditors) Rules, 2014[27]. Under this section, such companies shall not appoint an individual as auditor for more than one term of five consecutive years whereas an audit firm shall not be appointed for than two terms of five consecutive years. After the expiry of the period as aforesaid the auditors are required to be rotated. Rule 6 (3) (i) of Companies (Audit and Auditors) Rules, 2014 prescribed that for the purpose of calculating the period of five consecutive years or ten consecutive years as prescribed , the period for which the auditor has held office prior to the commencement of the Act shall also be taken into account. The proviso to section 139 (2) allows a period of three years to the company from the commencement of the Act to comply with the requirements relating to rotation of auditors.

5.11 COOLING OFF PERIOD OF AUDITORS

In order to ensure auditor independence and to prevent any kind of nexus that may develop between the company and auditor, a new provision of cooling off period of auditor(s) has been incorporated in section 139 (2) in the Companies Act, 2013. Proviso of Section 139 (2) states that an individual auditor or audit firm that has completed the prescribed tenure of five years or ten consecutive years respectively shall have the cooling off period of five years during which he shall not be eligible

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27. **Rule 5 of The Companies (Audit and Auditors) Rules, 2014,** as notified w.e.f. 1st April 2014 -For the purposes of sub-section (2) of section 139, apart from listed companies, the class of companies shall mean the following classes of companies excluding one person companies and small companies:-
(a) all unlisted public companies having paid up share capital of rupees ten crore or more;
(b) all private limited companies having paid up share capital of rupees twenty crore or more;
(c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

for re-appointment as auditor in the same company. Therefore the Act has prescribed a compulsory break up of five years before the auditor or the firm becomes eligible for re-appointment as auditor in the same company. The proviso further provides that the cooling off requirement even applies to an audit firm which has one or more common partner with the audit firm that is being rotated. Rule 6 (3) (ii) of Companies (Audit and Auditors) Rules, 2014 also provides that an the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms i.e. the firms operating or functioning under the same brand name, trade name or common control.

5.12 REMUNERATION OF AUDITORS

The remuneration of the auditor of a company is fixed in its AGM or in such manner as may be determined in AGM. The Board of director may fix remuneration of the first auditor appointed by it.[28] It is not necessary that the amount of remuneration be specified by the company in its AGM. It would be enough if the manner in which the remuneration is to be fixed is laid down in the AGM. It is also not necessary that the remuneration be fixed in the same AGM in which the auditor is appointed.

The term 'remuneration' means any sum paid by the company in respect of the auditor's expenses in carrying out his duties including the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility provided to him. However, an auditor may receive separate remuneration for services rendered other than the audit work (e.g., for advising on taxation matters).

5.13 RE-APPOINTMENT OF RETIRING AUDITORS

A retiring auditor may be re-appointed as auditor for the same company. Section

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28. S.142(1)

139(9) of the Act provides that a retiring auditor may be re-appointed at an AGM, if-

(i) he is not disqualified for re-appointment;

(ii) he has not given the company a notice in writing of his unwillingness to be re-appointed; and

(iii) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

The re-appointment of auditor is not automatic. It is subject to approval of members in the AGM. If a retiring auditor is not re-appointed in AGM, it does not mean that he has been removed. In such cases it is the simple retirement of the auditor.

5.14 FILLING UP CASUAL VACANCY OF AUDITORS

A casual vacancy of auditor denotes a vacancy caused by a validly appointed auditor ceasing to act as such, (*e.g.* due to death, disqualification etc.). Therefore a casual vacancy is not a vacancy created by any deliberate omission on the part of the company to appoint an auditor at its AGM. According to the section 139 (8) of the Act, the Board of directors is empowered to fill any casual vacancy of the auditor caused other than resignation of an auditor within thirty days. If the casual vacancy is caused by the resignation of an auditor, it can only be filled by the company in AGM which is to be convened within three months of the recommendation of the Board of directors. Such appointed auditors shall hold the office till the conclusion of the next AGM.

In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the CAG of India, be filled by the Board of directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company in AGM which is to be convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next AGM.

Section 140(2) of the Act prescribes that, if an auditor resigns from his office before the expiry of his term, he is required to file a statement with the Registrar within thirty days of the date of resignation. The statement stating the reasons and other facts relevant to resignation shall be filed in the form ADT-3 prescribed in the Companies (Audit and Auditor) Rules, 2014. If the auditor does not comply, he shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.[29]

5.15 REMOVAL OF AUDITORS

A company has right to remove an auditor, at any time, from the office.[30] However in order to make the removal of independent and conscientious auditors difficult, the Act has laid down specific procedure in this regard. Similarly obligation has been casted on the resigning auditor to clearly mention the reasons thereof.

5.16 REMOVAL OF AUDITORS BEFORE EXPIRY OF THEIR TENURE

Section 140(1) of the Act states that a auditor may be removed at any time from his office before the expiry of his term only by passing a special resolution of the company, after obtaining the previous approval of the Central Government and giving a reasonable opportunity of being heard to such auditor. The matter of the removal is first considered in the Board's meeting and necessary resolution is passed. The auditor proposed to be removed need to be given an opportunity of being heard. An application is made to the Central Government in Form ADT-2 prescribed under the Companies (Audit and Auditors) Rules, 2014 within thirty days of passing such resolution of the Board. Within sixty days of the Central Government's approval, the general meeting of the members shall be held for passing the special resolution to remove such auditor.[31]

29. S.140(3)
30. Proviso of s.139(2)
31. Rule (7) of the Companies (Audit and Auditors) Rules, 2014

In ***D.K. Jain* v. *Union of India***,[32] the High Court of Delhi upheld the removal of auditor when illegality of removal procedure was challenged by the petitioner, as according to him the decision was already taken by the Board and only subsequent approvals of the Central Government and of the general meeting were obtained. The court was of the view that legally laid down procedure has been followed. The earlier decision of the Board does not matter.

In ***M.S. Kabli* v. *Union of India***,[33] the Delhi High Court declined to uphold removal of the statutory auditor as it found that all the grounds concerning the job performance cited by the company in its application to the Regional Director seeking approval of the removal of the statutory auditor were rejected by the Regional Director, who surprisingly accepted the remaining ground that the company has lost its confidence on the statutory auditor. The court held that the Regional Director will have to be satisfied that the reasons for removal are genuine, keeping in view the best interest of the company and consistent with the need to ensure professional autonomy to the auditor.

Therefore, the prior approval of the Central Government may be taken even after passing the Board's resolution to remove but it must be before the AGM to pass decision and actual act of removal. It may even be permissible for the AGM to pass a resolution to remove an auditor, subject to approval taken from the Central Government, before actually issuing the removal communication. The High Court is not likely to interfere in the matter without any strong legal justification.[34]

5.17 REMOVAL OF AUDITORS BY THE TRIBUNAL

The Tribunal is empowered to direct the company to remove the auditors in certain circumstances. Section 140 (5) states that the Tribunal is satisfied either *suo motu* or on an application made to it by the Central Government or by any person concerned, that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the

32. [2007] 78 SCL 268
33. [2011] 109 SCL 557
34. *Basant Ram and Sons* v. *Union of India* (2000) 39 CLA 238 (Delhi)

company or its directors or officers, it may, by order, direct the company to change its auditors.

If the application under Section 140(5) as aforesaid is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and such auditor shall also be liable for action for fraud, under section 447.[35]

In case of auditor is a firm, the restriction applies to its partners, parent, subsidiary or associate entity or an entity in which the firm or partner, in which the firm or any partner of the firm has significant influence or control. If the auditor, individual or firm is using name trade mark or brand of another entity, the restriction also applies to that other entity.[36]

5.18 POWERS OF AUDITOR

It is an established rule that the auditors are to play a vigilant and objective role in ensuring that the investor's interests are well protected and that the management of the company has acted within reason[37]. It is the investors who primarily depend on the good faith and efficiency of the company's auditor to ensure that company's actions in the day-to-day operations are verified.[38] The Companies Act, 2013 enjoins certain duties upon the auditor and also gives him certain powers to enable him to discharge these duties effectively.[39] These duties and rights cannot be

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35. Proviso of s. 140 (5)
36. Explanation of S. 144
37. Please refer, further, the Article of Author written with guide Prof.(Dr.) Tabrez Ahmad, "Role Of Audit to Protect Investor's interest under Companies Act, 2013" *Emerging Researcher*, Vol.1 Issue III (Jul-Sep 2014).
38. *Institute of Chartered Accountants* v. *P.K. Mukherjee* (1968) 38 Com. Cases 628
39. S.143

limited or abridged in any way. Thus, a resolution limiting the powers of the auditor or a provision to this effect in the Articles of Association will be void.[40]

In ***Newton* v. *Birmingham Small Arms Co. Ltd*,** it was held that any regulations which preclude the auditors from availing themselves of all the information to which they are entitled are inconsistent with the Act.[41] The rights of auditor includes-

1. Right of access to books and accounts, etc.
2. Right to obtain information or explanation
3. Right to visit and inspect branch accounts of the company
4. Right to sign audit reports
5. Right to attend and speak in general meeting
6. Right to view and study the Article of Association, Memorandum of Association, Prospectus, important contracts of the company etc.

5.18.1 RIGHT OF ACCESS TO BOOKS AND ACCOUNTS, ETC

Every auditor has right of access to the books and accounts and vouchers of the company. He may require from the officers of the company any information he thinks necessary for the performance of his duty.[42] If any of the provisions of Act (i.e. sections 139 to 146) is contravened, the company shall be punished with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.[43]

The auditor has to submit a report on the accounts of the company, prepared by its directors, to the members of the company. The report is required to state whether

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40. Dutta C.R, *The Company Law*, 6th edn. (Lexis Nexis), 2008 at p.3772
41. (1906), 2 Ch. 378
42. Singh Dr. Avtar, *Company Law*, 15th edn 2007, p.455, EBC
43. S. 147

the accounts are kept in accordance with the provisions of the Act and whether they give a true and fair view of the state of affairs of the company according to accounting standards. In order to prepare an auditor's report, investigations must be carried out which are sufficient to enable the auditor to form an opinion on whether the accounting records have been kept by the company and whether the accounts for the financial year and the director's remuneration report agree with those accounting records.[44]The auditor is required to sign the audit report after duly verification.

The signed and certified audit report of every financial year is required to be submitted to the members of the company and also to be laid before the company in general meeting. This report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made with that effect and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed. The auditor has also duty to state[45]-

(a) the details of all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(b) the proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

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44. Mayson, French and Ryan, *Company Law*, 26th edition (2009-10), p.527, Oxford
45. S.143(3)

(d) whether, in his opinion, the financial statements comply with the accounting standards;

(e) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

5.18.2 RIGHT TO OBTAIN INFORMATION OR EXPLANATION

Section 143 (1) is also entitled the auditor of a company to seek such information and explanation as he may consider necessary for the performance of his duties as auditor, from the officers of the company into the following matters, namely:—

(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company,

(d) whether loans and advances made by the company have been shown as deposits,

(e) whether personal expenses have been charged to revenue account,

(f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in

respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

5.18.3 RIGHT TO VISIT AND INSPECT BRANCH ACCOUNTS OF THE COMPANY

Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.[46]

5.18.4 RIGHT TO SIGN AUDIT REPORTS

The mandate of the section 145 requires that only the person appointed as an auditor of the company has the right to sign the auditor's report or sign or certify any other document of the company. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.[47]if a audit firm is appointed for the audit of the company, only a partner in the firm can sign the audit report or authenticate any other documents required to be signed or authenticated by an auditor. The practice of fixing the "firm name" is not allowed,

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46. S. 143 (8)
47. S. 141(2)

at present. The partner should sign his own name for and behalf of the firm which has been appointed auditors of the company.

5.18.5 RIGHT TO ATTEND AND SPEAK IN GENERAL MEETING

The auditor of the company has the right to attend the AGM. Section 146 entitles the auditor with this right and also with the right to be heard in general meetings on any part of the business which concerns him as the auditor. The auditor also has right to send his authorised representative to attend the meeting in place of attending the meeting himself personally. In such a case the authorised representative should also be qualified to be an auditor.

Section 145 makes it obligatory that any qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company. The entire auditor's report need not be read out but only that portions that have any adverse effect on the functioning of the company as aforesaid need to be read in the general meeting.

5.19 DUTIES OF AUDITOR

The primary duty of an auditor is auditing and auditing is a formal examination and verification of financial accounts and records of any organisation. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and

such other matters as may be prescribed[48]. Most of the auditor's duty has been specifically laid down by the Companies Act and Institute of Chartered Accountants (ICAI). Broadly an auditor has the following two important duties-

1. Statutory duties
2. Duty to exercise standard of care and skill

5.19.1 STATUTORY DUTIES OF AUDITOR

Statutory duties of an auditor is mostly prescribed by the Companies Act and ICAI which includes the following important duties-

(i) Duty to comply with the auditing standards

(ii) Duty to make certain inquiries

(iii) Duty to make report of audit

(iv) Duty to report frauds

(v) Duty to attend general meeting

(vi) Duty to make statement in prospectus

(vii) Duty to produce documents and evidence

(viii) Duty not to render certain services

5.19.1.1 AUDITOR SHOULD COMPLY WITH THE AUDITING STANDARDS

Every auditor should comply with the auditing standards during auditing of any company. Section 143(9) of the Act requires that auditor to comply with the auditing standards as may be prescribed for the performance of the audit. For this purpose the Central Government may prescribe auditing standards as recommended by ICAI in consultation with the National Financial Reporting Authority (NFRA). Till such auditing standards are notified, the standards already specified by the ICAI shall be followed.[49] The ICAI has issued various standards

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48. S. 143(2)
49. Proviso of S. 143 (10)

as auditing, review and other standards (SQC). Till auditing standards are notified under the Act, these standards shall be deemed to the standards of audit.

5.19.1.2 DUTY TO MAKE CERTAIN INQUIRIES

Section 143 (1) has imposed a duty to the auditor of a company to make inquiries as he may consider necessary for the performance of his duties, from the officers of the company into the following matters, namely:—

(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company,

(d) whether loans and advances made by the company have been shown as deposits,

(e) whether personal expenses have been charged to revenue account,

(f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

5.19.1.3 DUTY TO MAKE REPORT OF AUDIT

It is the significant duty of an auditor to report to the members of the company on the accounts examined by him and on every financial statement which are required by or under this Act to be laid before the company in general meeting also that the

report shall confirm the position, envisaged in the under-mentioned manner in which the requirements are to be met[50].

The Act specifically requires that the auditor should report whether to the best of his information and knowledge of the said accounts and financial statements give a true and fair view of the state of company's affairs at the end of financial year and the profit and loss and cash flows for the financial year.

Auditor is duty bound to report on the following matters as required by section 143(3) of the Act-

(a) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for audit-

The significance of such a requirement is that the auditor must obtain due satisfaction about the scope of work carried out by him and affirm that in the discharge of his duties he has maintained professional standards of diligence and care. If the answer to this question is negative, he needs to provide details thereof and also report the effects of such information on the financial statements.

Justice Lindley in his famous judgment, in the ***Re London and General Bank case***[51], propounded his view. The relevant passage from the judgment is quoted below-

> *"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 guarantee that his balance sheet is accurate according to the books of the company, if he did, he would be responsible for an error on his part, even if he were himself deceived without any want of reasonable care on his part say, by the fraudulent concealment of a book from him."*

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50. S.143(2)
51. (1895) 2 Ch. 166 CA

Similarly, Lopes L.J. also held in his judgment in the case of ***Re Kingston Cotton Mills***[52] that auditors must not be made liable for not tracking out ingeniously and carefully laid scheme of fraud when there is nothing to arouse their suspicion and when those frauds have been perpetrated by the trusted servants of the company and have been undetected for years by the directors. The relevant passage from his judgment which is still relevant today, quoted below-

> *"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 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……an auditor does not guarantee the discovery of all fraud."*

Therefore, for the collection of information, the auditor is entitled to rely upon trusted servants of the company; he can accept representations made by them either orally or in writing, provided reasonable care was taken to ensure that the data or information furnished are true and could be trusted to have been prepared in the course of the working of the company. If, however, there are any circumstances that should arouse suspicion, it would be the auditor's duty to probe it to the bottom. So long as there is not such suspicion, he is only expected to exercise normal caution and care[53].

(b) Whether in his opinion, proper books of account as required by law have been kept by the company, so far as papers from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him.

The term 'proper books of account' has not been defined in the Act, However, it is defined indirectly under sub-section (1) of section 128 wherein it is stated that a

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52. (1896) 2 Ch 279
53. Kapoor G.K and S. Dhamija, *Company Law and Practices*, 19th edn. 2014, p.623, Taxmann

company shall prepare and keep books of account and other relevant papers and financial statements which give a true and fair view of the state of affairs of the company including its branch office or branch offices, as the case may be. Further Section 129 (1) requires that the financial statements shall comply with the notified accounting standards. If the books of account are not meeting these requirements then it shall not be considered ‘proper’.

Further, in section 338 (2), it is provided that a company that is being wound up shall be deemed not to have maintained proper books of account if it had not kept;

(i) such books of account as are necessary to exhibit and explain the transactions and financial position of the business of the company including books containing entries made from day to day in sufficient detail of all cash received and all cash paid; and

(ii) where the business of the company has involved dealing in goods. Statement of annual stock-taking and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing particulars of goods and those of buyers and sellers in sufficient detail to enable those goods and those buyers and sellers are to be identified.

In the circumstances, proper books of account as required by law are those which contain a record of all the transactions specified both in section 128 and section 338 (2) in a manner that they present a true and fair view of the state of affairs of the financial position and profitability of the company.

The cost records prescribed under section 148 (1) also form part of books of account required to be maintained under the Act.

(c) Whether the report on the accounts of any branch office audited under

143 (8) by a person other than the company’s auditor has been sent to him and how he has dealt with the same in preparing the auditor’s report-

The Research Committee of the ICAI had expressed the views on this matter and an extract there from will be appropriate to quote here-

> *"Having regard to the scheme of sub-section 228 (2) [corresponding to Section 143 (8) of the Act of 2013], It is clear that though the company in general meeting appoints a branch auditor, the company's auditor still has a certain measure of responsibility in respect of the accounts and papers of the branch. This is shown by the fact that he has a right to visit the branch and has access to the papers and documents of the branch. He must discharge this responsibility by looking into the branch auditor's report and satisfying himself that having regard to the report and what he has seen of the branch and documents of the branch, affairs of the branch are in order."*

(d) Whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of accounts and returns-

The work of an auditor culminates in the verification of statements of account. It is apparent that the duty in this regard, would not be properly discharged if he fails to verify them on making a reference to the books of account before proceeding to make a report thereon. When the auditor reports that proper books of account have been kept and the accounts are in agreement therewith, he confirms that he has discharged the specific duty in this regard imposed on him by the law. If proper books of account have not been kept and if there is a discrepancy in the statements of account and the entries as they appear in the books, he should refer to such a position in his report.

(e) Whether, in his opinion, the profit and loss account and balance sheet have complied with the accounting standards.

As mentioned earlier, Section 129(1) requires that the financial statements shall comply with the accounting standards notified under Section 133. The auditor is required to confirm that the financial statements are in compliance with the accounting standards.

(f) The observations and comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.

The auditor of a company will have to report on all the financial transactions or all matters which have any undesirable effect on the performance of the company.

(g) Whether any director is disqualified from being appointed as director under section 164 (2) of the Act

The auditor of a company will have to report whether any director of the company under audit is disqualified from being appointed as a director of that company because of section 164 (2). Under this section, no person who is or has been a director of a company which-

(i) has not filed financial statements or annual returns for any continuous period of three financial years; or

(ii) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

(h) Any qualification, reservation or adverse remarks regarding maintenance of account and other matters connected therewith.

Any reservation or adverse remarks on maintenance of accounts and related matters need to be reported by the company auditor.

(i) Whether the company has adequate internal financial controls system on place and the operating effectiveness of such controls –

The auditor is also required to comment upon the presence and effectiveness of internal financial controls. Maintaining such controls is the primary responsibility of the management. Any weakness observed by the auditors, during the course of the audit shall be mentioned in the auditor's report.

(j) Such other matters as may be prescribed-

Rule 11 of the Companies (Audit and Auditors) Rules, 2014 has also prescribed the following additional reporting requirements in the auditor's report:

(a) Whether the company has disclosed the impact of pending litigations on its financial position in its financial statement;

(b) Whether the company has made provisions, as required under any law or accounting standards, for material foreseeable losses on long term contracts including derivative contracts.

5.19.1.4 AUDITOR'S DUTY IN CASE OF DETECTION OF FRAUD

As discussed earlier, Auditor is often in a position to discover frauds. In circumstances, when the auditor discover that a senior employee of a company has been defrauding that company on a grand scale, and is in a position to go on doing so, then it will normally be the duty of the auditor to report what has been discovered to the management of the company at once.[54] The Auditing guidelines, 2000 of ICAI also provides that "during the course of his work the auditor identifies the possible existence of a fraud, other irregularity or error the following action should be taken. The auditor should endeavor to clarify whether a fraud other irregularities or error has occurred …… unless fraud by senior management is suspected; the auditor should inform senior management of his suspicions. In case of serious fraud or irregularities which is likely to cause to result in material gain or loss for any person or is likely to affect a large number of persons, the auditor may report directly to a third party without the knowledge or consent of the management".

Section 143(12) of the Act also imposed a duty on the auditor to report to the Central Government if in the course of the performance of his duties as auditor, he has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company.

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54. Ramaiya, *Guide to the Companies Act*, 16th edn pp.2398-2399

Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has prescribed the manner in which the auditor will report the matters related to fraud to the Central Government. According to this rule, the auditor first needs to forward his report immediately to the audit committee or the Board seeking their reply within forty five days. On receipt of reply from the Board or the audit committee, the auditor is required to forward his report, reply or observations of the Board or the audit committee and his comments upon such reply or observations to the Central Government within fifteen days of receipt of such reply Corporate Affairs in a sealed envelope followed by an e-mail as a confirmation.

Punishment for contravention- It may be noted here that the duty on the auditor under section 143 (12) is to report any fraudulent activities that he observed in the performance of his duties as auditor. He is not under an obligation to start with the suspicion that a fraud is being committed. If the auditor fails to comply with section 143 (12), he shall be punished with fine which shall not be less than rupees one lakh but may extend to rupees twenty five lakh[55].

In this context, Enron scandal of U.S.A and Satyam Computer scam of India are glaring examples of serious corporate frauds which was occurred with the help of their auditors and auditing firm. These cases have been dealt in detail in Para 5.23 and 5.24 respectively.

5.19.1.5 DUTY TO ATTEND GENERAL MEETING

The auditor of the company has the duty to attend the general meeting. Section 146 has imposed this duty on the auditor to attend general meetings either by himself or through his authorized representative unless exempted by the company. The authorized representative shall be the person who should also qualified to be an auditor.

Scope of duties of an auditor- The statutory duties of the auditor cannot be limited in any way either by the Article of Association or by the directors or

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55. Sub section 15 of Section 143.

members but a company may extend them by passing a resolution at the AGM or making a provision in the Article.[56]

5.19.1.6 DUTY TO MAKE STATEMENT IN PROSPECTUS

Under sub-clause (iii) of section 26 (1) (b) an auditor is required to make a report which is to be included in the prospectus of a company. Such a report should be made out on -

(a) The profits and losses of the business of the company for each of the five financial years immediately preceding the issue; and

(b) Assets and liabilities of its business on the last date to which the accounts of the business were made up (not more than one hundred and eighty days before the issue the prospectus).

In case of a new company for which the period of five years since incorporation has not lapsed, the report on the profit and losses should cover the period from the date of incorporation.

5.19.1.7 DUTY TO PRODUCE DOCUMENTS AND EVIDENCE

For the purposes of inspection under section 217 of the Act, auditor may be called as an agent of the company and thereby he is duty bound for preserving and producing all books and papers relating to the company to an inspector or any person authorized by him in this behalf with the previous approval of the Central Government, Moreover he is under a duty to give to the inspector all assistance in connection with the investigation which he is reasonably able to give.

5.19.1.8 DUTY NOT TO RENDER CERTAIN SERVICES

Section 144 of the Companies Act, prohibits the auditor to render certain prescribed services directly or indirectly to the company or its holding company or subsidiary company. This is new provision incorporated in the Companies Act, 2013 to ensure that the auditor's independence and objectivity is not compromised

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56. *Newton* v. *Birmingham Small Arms Co. Ltd*., (1906), 2 Ch. 378

because of the fees earned by him by rendering other services to the company for which he is acting as an auditor. These services are namely:—

(a) accounting and book keeping services

(b) internal audit

(c) design and implementation of any financial information system

(d) actuarial services

(e) investment advisory services

(f) investment banking services

(g) rendering of outsourced financial services

(h) management services and

(i) any other kind of services as may be prescribed

The Audit committee or the Board of directors is empowered to define the scope of services which are to be rendered by the auditor excluding the services mentioned above. The restriction applies to rendering of such services by the individual auditor, his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control.

5.19.2 AUDITOR'S DUTY TO EXERCISE STANDARD OF CARE AND SKILL

A member of the accounting profession, when he is in practice, offers to perform a large diversity of professional services and he also holds himself out to the public as an accountant qualified to accept these assignments. Therefore, when he is appointed under a statute or under an agreement to carry out some professional work it is to be presumed that he shall carry out them completely and with care and diligence expected of a member of the profession. In view, however, of the fact that the standards of competency may vary from individual to individual and also the concept of the function of an audit and that of its technique, may undergo

change from time to time. The auditor is expected to discharge his duties according to "generally accepted auditing standards" obtaining at the time when the professional work is carried out[57].

The Auditors owe a number of duties to the company and its shareholders. The foremost among them is to check the accuracy of accounts. But his duty is not to confine himself merely to the task of verifying the arithmetical accuracy and to ascertain that it was properly drawn up, so as to contain a true and correct representation of the state of the company's affairs. They should not act merely as a professional adder-upper and subtractor. Here the opinion of **Chief Justice Chakravarti** of Calcutta High Court is relevant as he expressed in the case ***Dy. Secretary* v. *S.N Das Gupta***[58]-

> *"A certificate from the management can obviously be no substitute for such verification. The whole object of an audit is an examination of what the management have done and if the statements of the very persons who constitute the management were to be accepted in all matters, even in matters capable of direct verification, an audit would be an idle farce."*

In ***Re Kingston Cotton Mill Co.*** case,[59] it was held that in certain matters of technical nature (for example valuation of stock-in-trade), the auditor will have to rely on some skilled person. Secondly, it has always been the law that an auditor must exercise reasonable care and skill in the discharge of his duty. **Justice Romer** described this duty in ***City Equitable Fire Insurance Co. Re***[60] case and said-

> *..."He must be honest, i.e., he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient. Where suspicion is*

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57. ICAI, Liability of Auditor
58. AIR 1956 Cal. 414
59. (1896) 2 Ch 279 at pp 28-89
60. (1925) Ch. 407 pp. 481-482

aroused more care is obviously necessary; but, still an auditor is not bound to exercise more than reasonably care and skill even in a case of suspicion and he is perfectly justified in acting on the opinion of an expert where special knowledge is required".

The nature of an auditor's duty of care in the performance of an audit was considered by **Lopes LJ** in ***Re Kingston Cotton Mill Co (No-2)***[61] which is relevant, even, today also-

"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 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……an auditor does not guarantee the discovery of all fraud."

An auditor is, however, is not concerned with the policy of the company. In the words of **Lindley LJ**[62]

"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 ascertained and stated the true financial position of the company at the time of the audit.

It is also universal true that the auditor owes duty to the company and the company only, but they also owe duty towards the society. Where an auditor is appointed to check the accounts of the Employees' provident fund maintained by a company, he

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61. (1896) 2 Ch 279 at pp 28-89
62. *Re London and General Bank (1895) 2 Ch. 166 CA*

owes not merely to the company, but also to the beneficiaries of the fund and will be responsible to them for professional misconduct if he fails to report that the trustees have allowed irregular loans to the company out of the fund.[63]

In ***Sasea Finance Ltd* v. *RMPG***,[64] it was held that the auditors of a company discovered that a senior employee had been defrauding the company at a grand scale and that he was in a position to go on doing so, in such a situation it would be the auditors' duty to report the matter to the company's management and not to postpone it till they submit their report.

5.20 AUDITOR NOT LIABLE IF HE IS DECEIVED

Auditor does audit of the books of account and other related papers what has been produced by the employees of the company including directors. He checks and verifies the books and accounts and vouchers of the company as presented before him. If the auditor himself is deceived by the management of the company and if he has conducted his audit by applying due care and skill in consonance with the professional standards expected, the auditor would not be held responsible for not having discovered that fraud.

In ***Trisure India* v. *A F Ferguson & Co.,*** [65] it was held that auditor must be honest and should have reasonable skill and care in ascertaining the company s books of account, balance sheet and profit & loss account. Reasonable care and skill is not exercised when in spite of the presence of unusual features in the accounts which *prima facie*, give reasons for believing that the accounts are not in order, the examination is not detailed. Where there is nothing at all to excite suspicion and in relying upon the statement of the management, the auditor is himself deceived, then he cannot be said to have failed in discharge of his duties.

In this way, auditing is the central to the public confidence in financial disclosures especially as an auditor is considered to be an intermediary between firms and

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63. *ICAI* v. *P.K.Mukherjee* (1968) 2 Comp LJ 211
64. (2000) All ER 676 CA
65. (1987) 61 Comp Cas. 548 (Bom. HC)

investors in respect of corporate financial statements. Auditors act as eyes and ears of the shareholders and prospective investors, thus to instill confidence in market and to provide a true and fair account of the company, the role of an unbiased objective auditor is an undeniable necessity. Audit has revealed many corporate frauds in the past and it is an important means to protect the interests of investors. It plays a major role in ensuring transparency and accountability in the corporate world, thus they are often called as gatekeepers.

Adversely, if an auditor fails in performing duty of standards of care and skills, he will be held either with civil liabilities or criminal liabilities or with both.

5.21 LIABILITIES OF AUDITOR

The Companies Act, 2013 has prescribed the liabilities of auditor of companies in which he may be held either with civil liabilities or criminal liabilities or with both. There was a significant demand to incorporate stringent criminal liability on auditor(s) in the light of various scams in recent times.

5.21.1 THE CIVIL LIABILITIES OF AUDITOR

The civil liability of an auditor may be for- (i) Negligence,
(ii) Misfeasance.

5.21.1.1 LIABILITY FOR NEGLIGENCE

An auditor performs his duties as an agent of the shareholders, so he is expected to safeguard the interests of the shareholders. He must exercise reasonable care and diligence in the performance of his duties. If he fails to do so and in consequence the principal suffers any loss, he may be liable to compensate loss caused to the company resulting from his negligence. If an auditor of a company contravenes any of the provisions of section 139, section 143 to145 of the Companies Act, 2013, he will be punished with fine which shall not be less than twenty-five thousand rupees but which may be extended up to five lakh rupees.[66]

66. S.147 (2)

5.21.1.2 LIABILITY FOR MISFEASANCE

Misfeasance means breach of duty or breach of trust. If the auditor does something wrongfully in the performance of his duties or he does not perform his duties properly resulting in a financial loss to the company, he may be held liable for misfeasance. The auditor, who does not report to the shareholders the fact of the case, when the balance sheet is not properly drawn up, is guilty of Misfeasance.[67]

5.21.2 CRIMINAL LIABILITIES OF AUDITOR

If an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punished with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees. Further if an auditor has been convicted, he will be liable to—

(a) refund the remuneration received by him to the company; and

(b) pay for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.[68]

Here, it is to be noted that the maximum punishment has been prescribed is only up to one year imprisonment to auditor found guilty of offence as mentioned above.

Subsection (4) of the section 147 further provides that the Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (*ii*) of sub-section (*3*) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

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67. *Re London and General Bank* (1895) 2 Ch. 166 CA
68. Proviso of s.147

In addition, Clause (6) Part I, Second Schedule of the Chartered Accountants Act, 1949, provides that, failure of an auditor to report a known material mis-statement in the financial statements of a company, with which he is concerned in a professional capacity, shall be deemed to be '**professional misconduct**'.

5.21.3 PROFESSIONAL MISCONDUCT BY AUDITOR

It is worth to mention here that the Chartered Accountant Act, 1949 has defined serious professional misconducts of an auditor. In these cases of misconduct, the matter is referred to Disciplinary Committee for the decision. Some relevant professional misconduct in respect of false balance sheet in the Second Schedule to the Chartered Accountant Act is mentioned below -

(i) Certifying a report or statement without examination of such statement and related records by him or his partner or employee or other professional in the same field.[69]

(ii) Failing to disclose in the report a material mis-statement known to him to appear in a financial statement, with which he is concerned in professional capacity.[70]

(iii) Not exercising due diligence or being grossly negligent in conduct of professional duties.[71]

(iv) Failed to obtain sufficient information which is necessary for expression of any opinion *or* its exceptions which are sufficiently material to negate the expression of an opinion (in brief, not collecting enough data or ignoring material facts while expressing an opinion).[72]

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69. [Clause 2 Part I of Second Schedule]
70. [Clause 6 Part I of Second Schedule]
71. [Clause 7 Part I of Second Schedule]
72. [Clause 8 Part I of Second Schedule]

5.21.4 PUNISHMENTS FOR PROFESSIONAL MISCONDUCT

The Disciplinary Committee formed under Chartered Accountant Act, 1949 can order any one or more of the following actions[73]-

(a) Reprimand the member

(b) Remove name of member from register permanently or for such period as it thinks fit

(c) Impose fine up to Rs. five lakhs.

5.22 LIABILITY OF PARTNER OF AUDIT FIRM

Section 147 (5) has prescribed that in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

5.23 CASE STUDIES ENRON DEBACLE OF USA

The Enron scandal occurred due to the audit failure in U.S.A in 2001. This was an energy company based in Houston, Texas. This company was formed in 1985 by Kenneth Lay after merging two energy companies Houston Natural Gas and Inter North. After few years, when Jeffrey Skilling was hired, he developed a staff of executives that, by the use of accounting loopholes, special purpose entities, and poor financial reporting, were able to hide billions of dollars in debt from failed deals and projects. This resulted into the company's stock price, which achieved a high of US$90.75 per share in mid-2000, plummeted to less than $1 by the end of November 2001. Chief Financial Officer Andrew Fastow and other executives not only misled Enron's Board of directors and audit committee

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73. [Section 21B(3) of Chartered Accountant Act, 1949]

on high-risk accounting practices, but also pressured their auditor Andersen to ignore the issues.

Enron's audit committee had more expertise than many. It included Dr. Robert Jaedicke of Stanford University, a widely respected accounting professor and former dean of Stanford Business School; John Mendelsohn, president of the University of Texas' M. D. Anderson Cancer Center; Paulo Pereira, former president and chief executive officer of the State Bank of Rio de Janeiro in Brazil; John Wakeham, former U.K. Secretary of State for Energy; Ronnie Chan, a Hong Kong businessman; and Wendy Gramm, former chair of U.S. Commodity Futures Trading Commission.[74]

The executives of Enron deceived Andersen auditors about the nature and material terms of the deals in question in order to obtain favourable accounting treatment. However, Andersen failed to use due care to investigate whether Enron's counterparties in monetization transactions actually had any money at risk in the transactions; and that Andersen failed in its duty to flag unusual transactions and controversial accounting decisions for Enron's board. Although Andersen was fully aware of the extent to which Enron's reported financial results were the product of accounting manipulation, it did not insist on disclosure of these facts to investors and the Stock Exchange Commission (SEC).

Thus, Andersen gave "substantial assistance" to Enron officers seeking to disseminate misleading financial information. If Andersen had not assisted and enabled Enron's deception, Enron would have been caught years before 2001. Indeed, if Andersen had done its job, Enron would not have been able to deceive the investing public in the first place.[75]

Andersen was found guilty of illegally destroying documents relevant to the SEC investigation. He was charged with and found guilty of obstruction of justice for shredding the thousands of documents and deleting e-mails and company files that

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74. Paul M. Healy and Krishna G. Palepu, The Fall of Enron, *Journal of Economic Perspectives Volume 17, Number 2—Spring 2003*

75. Suman Aastha, *Criminal Liabilities of Auditor,* retrieved from SSRN id-1658348

tied the firm to its audit of the company. This resulted into cancellation of its license to audit public companies. The damage to the Andersen name has been so great that it has not returned as a viable business even on a limited scale, hence effectively closed its business.. Many executives at Enron were also indicted for a variety of charges and some were later sentenced to prison.

As post effect of this scandal, new regulations and legislation were enacted to expand the accuracy of financial reporting for public companies. The Sarbanes-Oxley Act (SOX) was enacted and passed by the U.S parliament, which increased penalties for destroying, altering, or fabricating records in federal investigations or for attempting to defraud shareholders. The Act also increased the accountability of auditing firms to remain unbiased and independent of their clients.

5.23 CASE STUDIES SATYAM COMPUTERS SCAM

In **Satyam Computers Scam 2009**, has occurred with the help of international repute audit firm PricewaterhouseCoopers (PwC) which is big blow for corporate governance in India. Satyam Computer Services Ltd was founded in 1987 by Mr. B.Ramalinga Raju at Hyderabad, offered information technology (IT) services spanning various sectors, and was also listed on the New York Stock Exchange and Euronext. Satyam's network soon covered 67 countries across six continents.[76]

This audit firm failed to detect any fraud and certified some thousands of crores of cash lying in bank accounts that apparently did not exist at all. This scam estimated worth of Rs.7,200 crore and caused loss of Rs. 14,162 crore (approx.) to its investors so it is also known as India’s Enron.

Initially this IT Company began its services with just 20 employees in Hyderabad in 1987 and grew rapidly as a global business. It offered IT and business process outsourcing services spanning various sectors. Soon it became as an example of India’s growing success. This company also won plentiful awards for innovation, governance, and corporate accountability. In 2007, Ernst & Young awarded Mr.

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76. Ahmad Tabrez, *Satyam Scam in the Contemporary Corporate World*, retrieved from SSRN, i.d. 1460022.

Raju with the 'Entrepreneur of the Year' award. On April 14, 2008, Satyam also won awards from MZ Consult's for being a 'leader in India in Corporate Governance and accountability'. In September 2008, the World Council for Corporate Governance also awarded Satyam with the 'Global Peacock Award' for global excellence in corporate accountability.[77] Unfortunately, less than five months after winning this Award, Satyam became the centerpiece of a massive accounting fraud.

The internal management of the company led by Mr. Raju was able to show the inflated capital which caused the share price of the company to arise from Rs. 138 to Rs. 526 per share in 2008, just 300% improvement of the initial price in five years. After reveal of fraud, the price plummet to just Rs. 11.50 per share on January 11, 2009, which caused huge loss to shareholders.

Mr. Raju disclosed, on January 7, 2009, in a letter to company Board of directors that he had been manipulating the company's accounting numbers for years. He claimed that he overstated assets on Satyam's balance sheet by $1.47 billion. Nearly $1.04 billion in bank loans and cash that the company claimed to own was non-existent. Satyam also underreported liabilities on its balance sheet, overstated income nearly every quarter over the course of several years in order to meet analyst expectations. For example, the results announced on October 17, 2009 overstated quarterly revenues by 75 percent and profits by 97 percent.

Mr. Raju and the company's global head of internal audit used a number of different techniques to perpetrate the fraud using their personal computer. They also created numerous bank statements to advance the fraud. They also falsified the bank accounts to inflate the balance sheet with balances that did not exist. They inflated the income statement by claiming interest income from the fake bank accounts.

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77. Agrawal S. and R. Sharma, "Beat This: Satyam Won Awards for Corporate Governance, Internal Audit," VCCircle, 2009. www.vccircle.com/news.

Mr. Raju also revealed that he created 6000 fake salary accounts over the past few years and appropriated the money after the company deposited it. The company's global head of internal audit created fake customer identities and generated fake invoices against their names to inflate revenue. The global head of internal audit has also forged board resolutions and illegally obtained loans for the company. It also appeared that the cash that the company raised through American Depository Receipts in the United States never made it to the balance sheets.

There were numerous reasons for not detection of fraud committed by Mr. Raju. One of them was lapses by international auditing firm PwC. This audit firm audited the company's books from June 2000 until the discovery of the fraud in 2009 was criticized callously for failing to detect the fraud. Indeed, PwC signed the company's financial statements and was responsible for the numbers under the Indian law. The large amount of inflated cash should have been a 'red-flag' for the auditors that further verification and testing was necessary. Furthermore, it appears that the auditors did not independently verify with the banks in which Satyam claimed to have deposits. Suspiciously, Satyam also paid PwC twice what other firms would charge for the audit, which raises questions about whether PwC was complicit in the fraud. Furthermore, PwC audited the company for nearly nine years and did not uncover the fraud.

Government of India handled this situation promptly and carefully to protect the interest of the investors and safeguard the credibility of India and the nation's image across the world. Mr. Raju, Mr. Raju's brother, B. Ramu Raju, its former managing director, Srinivas Vdlamani, the company's head of internal audit, and its CFO arrested immediately on various criminal charges of criminal conspiracy, fraud and forgery. Indian authorities also arrested and charged several of the company's auditors (PwC) with fraud. The Institute of Chartered Accountants of India also ruled that the CFO and the auditor were guilty of professional misconduct. This case was investigated by the SFIO in record three months of time. Mr. Ramalinga Raju along with other 9 person were found guilty and sentenced seven years imprisonment and with fine, by the Hyderabad special Court

on 9th April, 2015 but soon granted bail by the Metropolitan Session Court of Hyderabad on May 11, 2015. Matter is *sub judice.*

There was great relief to Indian capital market when Tech Mahindra purchased 51% of Satyam's shares on April 16, 2009. This also proved successful saving of the firm from a complete collapse. ICAI found the two PwC auditors prima-facie guilty of professional misconduct. The SFIO, which investigated the Satyam fraud case, also charged the two auditors with "complicity in the commission of the fraud by consciously overlooking the accounting irregularities".

5.24 CONCLUSION

The audit is intended for the protection of the investors and the auditing is expected to examine the accounts maintained by the directors with a view to inform investors of the true financial position of the company. The investors of the company are mainly depend upon the good faith and efficiency of the auditor appointed to check the accounts and certify the balance sheet of the company, the auditors do have a chance to make a detailed check of the accounts, call for the information and satisfy themselves that the accounts have been properly maintained and the balance sheet are fairly drawn up. The auditors are, therefore, under duty to safeguard the rights of investors *vis-a vis* the activities of the directors in the purported exercise of their powers in dealing with assets of the company. He is also termed as watchdog. It doesn't mean that he owes duty only towards the company to which he has been appointed as auditor. He has also ethical duty to report the cases of fraud to concerned authorities promptly in case of detection. He is not expected to be a detective nor is he required to approach his work with a suspicious or pre-conceived impression that there is something wrong. He is watchdog but not a blood hound. However, if there is anything that excites, suspicion in him, he should examine into the matter. But in the absence thereof, he is only required to be reasonably cautious and careful.

Auditors also play a major role in ensuring transparency and accountability in the corporate world, thus they are often called as gatekeepers, eye and ear of the

company. It is also equally true that a fraud may be discovered pertaining to a particular period after the auditor has completed his audit, it does not necessarily mean that the auditor has been negligent or that he has not performed his duties completely. He checks and verifies the books and accounts and vouchers of the company as presented before him. If he has conducted his audit by applying due care and skill in consonance with the accepted professional standards expected, the auditor would not be held responsible for not having discovered that fraud. Therefore it is expected that the auditor should be vigilant in conducting audit of the company.

The shareholders of a company place a very high trust on the auditor‘s report, which apparently shows the true and fair view of the accounts of a company. The auditors should perform their duties with utmost care and vigilance to ensure that there are no illegal or improper transactions. It is very important for auditor to use their professional skills and make a reasonable examination of the accounts to see that the dealings are not illegal or improper and it is their duty to uncover such activities. As audit has revealed many corporate frauds in the past so it is an important means to protect the interests of investors.

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CHAPTER VI

CONCLUSION AND SUGGESTIONS

Protection of the interest of investors is the paramount duty of a company which ultimately rests on its Board of directors. It paves the way for long term sustainability of the company in modern period and in fact, it is one of the main features of good Corporate Governance. A company is an entity distinct alike its shareholders and directors. Being an artificial person it cannot act without the help of a human agency. The business of the company is either conducted by the majority of shareholders of the company in the general meeting or by the agents appointed by the company (i.e. again the majority of the shareholders acting collectively in the general meeting). The operating procedure for companies might be described in terms of an *hour glass* in form. At the base are the shareholders who elect the Board of directors and delegate certain powers to them.

Capital is the first requirement for the establishment as well as to run successfully of any public company so, often; it is coined as backbone for the company. It is also required for further extension and joint venture process of the company. Any kind of liquidity (capital) crunch will force the company to become sick and it ultimately may lead to winding up of such company. An investor, who invests money, will always have desire, to safety of his investments, liquidity of his investments and a good return with least or at no risk. Sometimes, due to unsound Corporate Governance which results into various scams, he suffers huge loss. He feels helpless in such situation. To avoid such situation several legislations were enacted against bad Corporate Governance and to protect the investors. The Companies Act sets the code of conduct for the administration of corporate sector. It also prescribes rules for the formation of a company, rising of capital through

issuance, allotment of shares and disclosures to be made in public issues. The Act has also empowered the Central Government for the establishment of National Company Law Tribunals and a National Company Law Appellate Tribunal, to exercise and discharge such powers and functions as may be conferred on it by the Act or any other law for the time being in force.

Another important legislation for the protection of investors is Securities Exchange Board of India (SEBI) Act, 1992. This Act gave the legal status to Securities Exchange Board of India (SEBI). The main function of SEBI is the protection of the investors' interest and the healthy development of Indian financial markets. Accordingly, it has made several regulations to check and control the securities market. It is entrusted with quasi-legislative, quasi-judicial and quasi-executive power. There are several other legislations which also aim to protect the interest of investors, which have been briefly discussed in C**hapter I.**

Despite several legislations to protect the rights of the investors, still many scams and serious frauds in capital market are taking place like insider trading, sudden stake selling, cartelization, falsified the bank accounts to inflate the balance sheet with balances that did not exist etc. which have shaken the confidence of domestic as well as foreign investors in India. They feel insecure to invest money in the capital market. It means there are some loopholes either in the provisions of these legislations or in the implementation of the Act/procedures. Keeping in view of this aspect, provision related with inspection, investigation and audit as enshrined in the Companies Act, 2013 as well as SEBI Act, 1992 were dealt to find out the lacunae.

Though there were several provisions in the Companies Act, 1956 for protection of the interests of the shareholders, but it did not keep pace with the changing business environment. The new Companies Act addresses a number of investors concerns and seeks to provide a more generous environment for minority shareholders especially in the light of scams took placed such as Satyam Computer scam, Sahara case etc.

The provision of inspection, investigation and audit of the documents and papers of the company in the Companies Act, 2013 and SEBI Act, 1992, ensure the sound functioning of a company in accordance of the above legislations. This paves in finding any abnormality in Corporate Governance, which, further, ensures the protection of the investors. This chapter has also stated the purpose of the research along with its aim and objectives, meaning, definition and objectives of investment.

In **chapter II,** the meaning of investors, types of investor and a brief study on various protections available to them, civil and criminal liabilities of company and its directors, establishment and role of investor's education and protection fund under Companies Act, 2013 has been dealt. Role of SEBI as regulator of capital market, the investor's protection measures under the Security and Exchange Board of India (SEBI) Act, 1992 and through various regulations and fourth research question i.e., whether the security and exchange board of India (SEBI) is able to check fraudulent or unlawful conduct of the company in order to protect the rights and interests of investors has been tested.

An individual or any entity who commits money to investment products with the hope of financial return is called an investor. Group of such individual may be members or shareholders or creditors or debenture-holders or other depositories of the company. Normally, an investor is regarded as a blind person and he does not know any activities made by the company. Investor cannot guide the fortune or destiny of the company in which he has invested money. An investor to that extent is quite fragile and is exposed to certain risks because the utilizer of his money can commit mistakes. Normally they are contributing the funds for fruitful purpose of the company and they are exposing him to the business decisions that the company has taken or will take. Sometimes they may lose their hard earned money due to mismanagement of the company so they need protection for their investment.

Various protections which are available to investors under the Companies Act, 2013 as well as SEBI Act, 1992, have been dealt in this chapter. **Memorandum of**

Association (MOA) and Articles of Association (AOA) of the company provides numerous protections to its members. Since the AOA constitute a contract between the company and its member, the provision mentioned in the AOA is mandatory. Such rights includes right to have his name in the Register of members, to vote at the meeting of members, to receive dividends when declared, to exercise the right of pre-emption, return of capital on winding-up or on reduction of share capital of the company etc. Since MOA provides the Object Clause of the Company, the member has a right to bring action to restrain the company from doing an *ultra vires* act. Prospectus of the company provides important disclosures and on the basis of that investors do the investment.

In order to protect the interests of the investors and give them an active control over the management, the law as regards the company's meeting etc., giving more rights to shareholders and ensuring their exercise by the shareholders was drastically changed and various statutory provisions were made to make it difficult for the directors to secure the hurried passage of controversial issues (by stating that certain important matters could only be transacted by the general meeting of the shareholders), and as far as possible to encourage shareholders to considered carefully any proposals required by law to be put before the shareholders by the directors (by making provisions regarding notices, resolutions etc. in the Companies Act itself). Although the BODs was declared the primary executive organ of the company, its authority was restricted to the management of the regular business affairs of the company, unless extensive powers are expressly conferred by either the Article or the Act. The fundamental changes in the character of the organisation of the company, winding up of the company, variation of shareholder's right etc. now cannot be made by the BODs, unless expressly authorised to do so, because such matters do not relate to 'ordinary business'. In many cases the Board has to take consent of the shareholders in general meetings and certain transaction are required by the statute to be made by concurrent authorization of the shareholders and BODs.

As stated above, the corporate world has adopted the rule of majority in decision making process and in management of the companies but **oppressed minority** has got right to move to the Tribunal. Whenever the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to any other member or members, an application can be made to the Tribunal under section 241(1) (a) of the Act. Alternatively, an application can be made to the Tribunal under sub-clause (b) of this section on the grounds that the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members.

Section 241 of the Act provides that the requisite number of members, who must sign the application to apply to the Tribunal. In the case of a company having a share capital, the application must be signed by not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares. In the case of a company not having a share capital, the application must be signed by not less than one-fifth of the total number of its members. The Tribunal has got several powers to regulate the affairs of the company.

A new, much awaited, significant provision in the form of Section 245 is provided in the Act of 2013 which empowers to bring **class action** by members or depositories against the mis-management or conduct of the affairs of the company which is conducted in a manner prejudicial to the interests of the company or its members or depositors. The requisite number of members in case of a company

having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less can apply to Tribunal for seeking all or any of the following remedial action to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company or to restrain the company from committing breach of any provision of the company's memorandum or articles.

Another significant protection available to investors is in the form of **inspection, inquiry, investigation and audit**. Since this is the main objective of this research so it has been discussed in detail from chapters III to V.

In the light of Section 125 of the Act, **Investor Education and Protection Fund** (IEPF) for the protection and education of investors have been established. The main objective of IEPF is to equip the investors with better knowledge of protection against frauds. This fund is managed by a committee that consists of the Secretary, Company Affairs, as well as members from RBI, SEBI (Board) and experts on investor protection. The Board ensures maintenance of proper and separate accounts and other relevant records in relation to the fund. Accordingly, Board has made regulations for investors' protection and education fund, 2009, with a view to strengthen its activities for protection of investors. Board also deals with the redressal of investors' grievances related with capital market. Section 11(2) of the SEBI Act gave wide power to Board to implement the legislators' desire of investor protection.

Section 11C of the SEBI Act has empowered the Board to investigate when there is reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board there under, it may, at any time by order in writing, direct any person (Investigating Authority) specified in the order to investigate the affairs of

such intermediary or persons associated with the securities market and to report thereon to the Board.

SEBI has got wide powers to regulate the securities market and to protect the interest of investors in primary market as well as secondary market. The Board has powers to regulate the functioning of stock broker, sub brokers or other intermediaries, so that investor’s money cannot be lost by malpractices or in other way. The Board had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and investor protection) Guidelines, 2009 replacing Guidelines of 2000. These guidelines have been issued by the Board in pursuance of section 11 of the SEBI Act, 1992. SEBI has always been emphasizing on the importance of disclosure standards for corporate in disseminating relevant and correct information of public issues to the investors.

SEBI has also issued Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets Regulations, 2003, to ensure fair, efficient, and transparent markets which are closely linked to protecting investors from unfair, manipulative, or fraudulent practices, including synchronized trading, front-running, mis-selling etc.

SEBI has also passed regulation “Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control.” Section 12 A of Chapter VA of SEBI Act, which was inserted by Amendment Act, 2002, prohibits any person who directly or indirectly uses or employs, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations. This also prohibits engagement in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities, in contravention of the provisions of this Act or the rules or the regulations.

SEBI has viewed insider trading a very serious offence and regarded it as against the investor's interests. To prevent this, SEBI has made Prohibition of Insider Trading) Regulation, 2003 which will soon replaced by another regulation in 2015. If a person found guilty of insider trading, he can be sent to prison for up to 10 years or be required to pay a fine of up to Rs.25 crore or thrice the amount of profits made.

SEBI is empowered to adjudicate and stipulate penalties in case of contravention of its provision, rule and regulation. Section15A to 15HB of chapter VIA of the SEBI Act prescribes penalties for the violation of the provisions of the Act, rules and regulation made there under. Section 15I to 15JB provides the power of SEBI for adjudication.

Section 15HA prescribes that if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

SEBI is also empowered to inspect the Stock Exchanges to review of market operations, organizational structure and administrative control to ascertain as to whether - (a) It provides a fair, equitable, transparent and growing market to the investors, (b) Its organization system and practices are in accordance with the Securities Contracts (Regulation) Act, 1956 [SC(R) Act], 1956 and rules framed there under, (c) It has implemented the directions, guidelines and instructions issued by SEBI/ Government of India from time to time and (d) It has complied with the conditions, if any, imposed on it at the time of renewal / grant of its recognition under section 4 of the SC(R) Act, 1956.

During the year 2013-14, SEBI did comprehensive inspections at ten stock exchanges, namely Bombay Stock Exchange, MCX-SX Stock Exchange, Pune Stock Exchange, Jaipur Stock Exchange, United Stock Exchange, Interconnected Stock Exchange, Bhubaneswar Stock Exchange, Calcutta Stock Exchange, Vadodara Stock Exchange and Madhya Pradesh Stock Exchange. In addition,

during 2013-14, compliance inspections were carried out at Pune Stock Exchange, OTC Exchange and Uttar Pradesh Stock Exchange. The compliance inspections of exchanges were carried out for the purpose of renewal of recognition of stock exchange. Further, inspections were carried out prior to the commencement of various segments at respective stock exchanges. In 2013-14, inspections were conducted before the commencement of debt segment at NSE and BSE, currency derivative segment at BSE and SME segment at MCX-SX.

SEBI has also did comprehensive inspection of Depositories, 350 market intermediaries, stock brokers and 217 sub brokers and reviewed the market operations, organizational structure and administrative control to ascertain as to whether these are providing a fair, equitable, transparent and growing market to the investors, during 2013-14.

Thus, SEBI is empowered by SEBI Act, 1992 and various amendments in the Act from time to time, to protect the investors' interest and promote healthy development of Indian financial markets.

Chapter III has dealt the first research question i.e., whether the inspection of company's documents will serve to check fraudulent or unlawful conduct of the company in order to protect the rights and interests of investors? This chapter described that the inspection of books of account and other books and paper of a company is necessary to know the fairness and transparent functioning of the company accordance with the Act.

Inspection is a useful instrument and the preliminary step for finding out the true and fair view of the state of company's affairs. Every company is required to maintain the books of account, registers, annual returns and other records at the registered office of the company. Therefore a company should prepare its annual report as per the section 92 of the Companies Act, 2013 and it should be duly signed by the company secretary or director if there is no company secretary. This annual reports are also required to be filed at ROC within 60 days from the completion of AGM.

In case of non-compliance, section 94(5) of the Act has prescribed punishment with fine which shall not be less than rupees fifty thousand but which may be extended up to rupees five lakh. The Act has also prescribed to maintain the books of account and other relevant paper in electronic form. Section 400 also clarifies that the electronic form shall be exclusive, or in the alternative or in addition to the physical form.

Inspection of books of account and other books and paper of a company can be done by the ROC or inspector duly appointed by the Central Government under section 206 or any other person/authority as mentioned in the Act. They enjoy with certain powers as mentioned in the section 206 (5) of the Act, during inspection. They also have the power to summon and enforce the attendance of persons and examine them on oath as are vested in a civil court, during inspection. They can also seize the doubtful documents during inspection.

Investor of a company can also inspect such documents and records during office hours without paying any fee and they can also take the extracts or copies of it. Inspection of such documents of a company enables the investors to check the true affairs of the company. They would like to see that their investments are safe and also being used for the intended purpose. If the investors are not satisfied with affairs of the company, they may sell out the shares of that company which may ultimately lead into reduction of company's capital. Therefore, companies are bound to maintain the proper books of account and records according to the provision of the Act in order to sustain and prosper further. This will help in prevention of fraud which ultimately provides better protection of the rights and interests of investors.

Here, it is also to be noted that the inspection under section 206 and 207 is not an investigation, though it may lead to one, in case, anything wrong or objectionable or fraudulent. The right to inspection is limited to books of account and other books and paper only. The inspector cannot under the guise of this right, undertake a roving inquiry into all the affairs of the company. Persons inspecting are merely

report making authority. They are required to submit an inspection report to the Central Government after completion of inspection.

Now, it is on the discretion of the Central Government to order for further investigation into the affairs of the company (section 210), in case the affairs of the company are not in consonance with the Act. Meantime, such default company will get time to destroy, mutilated, alter, falsified or secreted of such documents. Therefore, to prevent such occurrences, it is suggested that inspectors should be empowered to start investigation *suo motto* along with the submission of report to Central Government and recommendation for further investigation into the affairs of the company by giving his reasons in support. Accordingly, insertion of subsection (2) is suggested in Section 208 of the Companies Act, 2013, in this regard.

Draft proposal of subsection (2) is indicated in ***bold italic*** font

208. Report on inspection made

(1) The Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

(2) When there is reasonable ground to belief that serious nature of fraud has occurred, the Registrar of inspector shall start investigation suo moto along with submission of inspection report to the Central Government and recommendation of investigation as mentioned in sub section (1).

The Calcutta High Court has held in *Indra Prakash Karnani v. Registrar of Company* [(1985) 57 Comp. Cas. 662 (Cal)] that Registrar of the Companies has right to inspect the books of account and if he is prevented from rendering inspection of accounts, the directors of the company may be prosecuted. A prior prosecution of company is not a pre-condition for prosecution of director of the

company and he is entitled to demand inspection of the books of accounts even in his office under clause (iii) of subsection (5) of section 209-A of the Act of 1956 [Now, 206(3) (c) of the Act of 2013]. However, it can be made at any time during business hours.

In *Bajoria B.M. v. Union of India* [(1972) 42 Comp. Cases 338 (Del)], the Delhi High Court held that the power of inspection is different from an investigation under the Act and that is not necessary for the Registrar before filling a complaint on the basis of inspection of accounts to give to a company a copy of the inspection report. In this way the courts of India are also vigilant in implementation of the powers of inspector or ROC for the inspection of documents and other records of the company so that the investors can be protected against any intended corporate frauds.

Chapter IV has described the provision related to investigation and how it serves as a means of protection of investors and also tested the second research question. Though investors are the real owners of a company but the power of management of the company is vested in the Board of directors. This may, sometimes, lead to abuse of power by few directors.**Lord Acton** has said in this regard that ***'Power corrupt; absolute power corrupt absolutely***'. Hence, to avoid monopoly of Board of directors, the Central Government reserves its right to investigate the affairs of the companies, especially in the cases of alleged frauds or the oppression of the minority shareholders, to protect their interests.

Investigation of a company is the process to examine the management of the company's affairs to find out whether the company is functioning according to the provisions of the Company Act and other relevant laws of the country. Investigation of the affairs of a company is the investigation of all its business affairs i.e. profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too.

The purpose of investigation is to discover something which is apparently not visible to the naked eye or on the face of it. An order of investigation can, *inter*

alia, be made when the Tribunal is of opinion that the persons in management are guilty of fraud, siphoning off of funds, misfeasance, mismanagement or other misconduct in carrying on the day to day affairs of the company.

The Central Government is empowered to appoint inspectors to investigate the affairs of such companies, which are not complying the provision of the Companies Act, 2013, either, on its own if it is of the opinion that such investigation is required on the report of the Registrar or Inspector under section 208(i.e. report on inspection made) or in public interest that has pointed out the huge financial irregularities. The Central Government is also empowered to order investigation into the affairs of a company on intimation of a special resolution passed by a company that its affairs are required to be investigated, or the Tribunal has passed order in the public interest.

Investigation may be also carried out when there is allegation that the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or any person concerned in the formation of the company or the management of its affairs have in connection therewith. The Tribunal may pass an order that the affairs of a company ought to be investigated by an inspector appointed by the Central Government. If such an order is passed by the Tribunal, it is necessary for the Central Government to appoint inspector(s) to investigate the affairs of the company in respect of such matter.

The Central Government is also empowered to investigate the ownership of a company when satisfied that there is good reason, in public interest, to know the persons who are financially interested in the company and who control the policy or materially influence it. The Central Government, on the order of the Tribunal, appoints one or more inspectors to investigate and report on matters relating to the company and its membership for the purpose of determining the true persons who are or have been financially interested in the success or failure, whether real or apparent, of the company or who are or have been able to control or to materially

influence the policy of the company. In the case of a company intended to operate in modern welfare State, the concept of public interest takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community [***N.R. Murthy* v. *Industrial Development Corporation of Orissa Ltd* (1977)**]. Now, under sub-clause (c) of Section 210(1) of the Companies Act, 2013, the Central Government has discretion to order an investigation into the affairs of company in public interest.

In ***Union of India v. Mukta Arts Ltd*** [(2007) 137 Comp. Cas. 648 (CLB)], it was held that investigation into the affairs of a company can be ordered when the inspection report has pointed out the huge financial irregularities.

The Supreme Court of India has observed in ***Sri Ramdas Motor Transport Ltd.* v. *Tadi Adhinarayana Reddy*** [AIR 1997 SC 2189] that the writ jurisdiction is not appropriate Forum to invoke the investigation of affairs of a company. The power to appoint an inspector to investigate the affairs of the company has to be exercised by the Central Government after preliminary scrutiny by the Registrar of Companies or the CLB (now, Tribunal) under section 234, 235 and 237 of the Companies Act, 1956 (now, section 206, 210 and 213 of the Act of 2013). The investigation cannot be executed on the basis of allegations made by one shareholder.

Thus, the main objective of investigation is to redress the issue of mismanagement of a company and to protect the interest of members/shareholders, debenture holders, creditors and other investors of the company. The Central Government may also define the scope of the investigation by inspector with respects to the matters or the period to which it is to extend or otherwise.

Inspector(s), appointed by the Central Government to investigate the affairs of a company, they enjoy certain powers for the smooth function during investigation which includes power to carry out investigation into affairs of the company and its related subsidiary companies, to compel directors and its officers for the

production of documents, to examine them on oath, to take down notes of examination in writing, seizure of documents, to seek support from other authorities etc.

Inspector is required to prepare and submit a report to the Central Government. Under Section 223 of the Companies Act, 2013, the inspector, if so directed by the Central Government, shall submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government. Employees of the company are protected against dismissal or discharge or removal or reduction of rank or change of the terms of employment to his disadvantage during investigation.

On receipt of such report, the Central Government studies the report and if the company is not functioning in accordance with the provisions of the Companies Act and detrimental to the investors, the follow up action taken may be initiation of criminal prosecution against such company or recovery of loss or property or damages or order for winding up of such company. There are various criminal liabilities has been provisioned in the Companies Act, 2013.

Under Section 211 of the Companies Act, 2013, the Central Government has, now, constituted the Serious Fraud Investigation Office (SFIO) in the ministry of corporate affairs. This is a specialized, multi-disciplinary organization to deal with serious cases of corporate fraud. This was also a major recommendation made by the Naresh Chandra Committee which was set up by the Government on 21 August 2002 on corporate governance.

Headquarters of this office is located in New Delhi, with field offices located in major cities throughout India. The SFIO is headed by a Director not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with the matters relating to corporate affairs and also consist of experts from various disciplines. The SFIO will only deal with investigation of corporate frauds characterized by complexity and having inter- departmental and multi-disciplinary ramifications. SFIO enjoys all the powers as provided to inspector

during investigation. In addition, he has also the power to arrest the accused, if authorised by the Central Government.

Therefore, investigation of the affairs of the company is an important means of protection of the interest of the investors. Investigation by Inspectors/SFIO may reveal the occurrence of various corporate frauds in speedy manner. SFIO is involved, when the Central Government finds that there is allegation of serious fraud in the company. The Central Government is empowered by the Companies Act, 2013 to investigate all the matters pertaining to frauds occurred in any company where the investors lost their hard earned money. An inspector can examine on oath any person involved in the fraud and may thereafter be used in evidence against him. In this work of inspector, the officers of the Central Government, State government, police or statutory authorities are duty bound to provide necessary assistance to him. An inspector/SFIO also enjoys all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit during investigation. But it is also expected from them to work honestly and in responsible way in the investigation.

Since SFIO is a Government agency and its officials are appointed by the Central Government so there is strong apprehension for its unbiased and unfair working. Therefore, it is suggested that inspector/SFIO should conduct fair investigation of any alleged corporate fraud and then they should submit the detail report to the Central Government, otherwise the share price of the company will fall sharply in a single day, in reaction, merely on this bad news, which will result into huge loss, again, to investors.

In ***A. Ravishanker Prasad v. Prasad Production Pvt. Ltd(2007)***, the Andhra Pradesh High Court has also held that the order of investigation should not be ordered on mere suspicion or surmises.

In the Act, there is no provision, as such, by which the **SFIO can *suo moto* investigate** into a case where an alleged serious fraud has been committed. The SFIO lacks a proactive approach in this regard. The SFIO has to wait for the

Central Government's order for the reference to be made to it. So, if there appears to be any fraud SFIO is toothless for taking any action against that particular company on its own motion. Therefore, SFIO should also be empowered to investigate *suo moto* like in the UK where the director of the Serious Fraud Office can *suo moto* investigate into a case.

It is suggested that SFIO should also be given power to **initiate prosecution** or imposing penalties when finds that the company is involved in fraud, like Serious Fraud Office (SFO) of U.K., which is an independent department which investigates and also prosecutes serious and complex fraud and corruption cases.

The appointment of the officers of the SFIO is on transfer and deputation basis which may be changed and permanent appointment may be made solely for the purpose of this agency. The efficiency of the agency may also be impeded due to frequent transfers of its personnel. It is submitted that in order to maintain continuity a permanent and tenure based structure should be made. The members of SFIO should not be transferred to other government departments.

57th Annual Report on the working and administration of the Companies Act, 1956, in pursuance of Section 638 of the Companies Act, 1956 (now, section 461 of the Act of 2013) for the year ended March 2013, disclosed that total 46 cases were referred to Serious Fraud Investigation Office (SFIO) under section 235/237 of the Companies Act, 1956 (now, section 210/213 of the Act of 2013), by the Ministry of Corporate Affairs, where the size of the alleged fraud was estimated to be at least Rs. 50 crores or more in each cases, for further investigation. The Ministry has received 22 investigation reports from SFIO during the period the financial year 2012-13 and prosecutions have been launched in various courts.

The report also states that total 139 cases were referred to SFIO for investigation up to 31 March 2013. Out of these, SFIO has submitted investigation report in 104 cases to the Ministry of Corporate Affairs till 31 March 2013. In 10 cases the order for investigation were either stayed or

quashed/withdrawn as on 31 March 2013 and the remaining 25 cases are under investigation.

The report, further, states that a total of 49950 prosecutions launched under the Companies Act, were pending in various courts as on 31 March 2012 and 6062 prosecutions were instituted during the year 2012-13 against 3293 companies and their officers. Thus, in all 56012 prosecutions were pursued in the courts during 2012-13. Out of these 6542 prosecutions were disposed of and 49470 were pending at the end of the year.

In **Chapter V,** the third research question has been tested i.e., whether audit of books of account and vouchers of the company will serve to check fraudulent or unlawful conduct of the company in order to protect the rights and interests of investors. This chapter has described the provision of audit and how it can serve as an important means to protect the interests of investors.

The audit is intended for the protection of the investors and the auditing is expected to examine the accounts maintained by the directors with a view to inform investors of the true financial position of the company. The investors of the company are mainly depend upon the good faith and efficiency of the auditor appointed to check the accounts and certify the balance sheet of the company, the auditors do have a chance to make a detailed check of the accounts, call for the information and satisfy themselves that the accounts have been properly maintained and the balance sheet are fairly drawn up.

The auditors are, therefore, under duty to safeguard the rights of investors *vis-a vis* the activities of the directors in the purported exercise of their powers in dealing with assets of the company. They are also known as watchdog. It doesn’t mean that an auditor owes duty only towards the company to which he has been appointed. He has also ethical duty to report the cases of fraud to concerned authorities promptly when detected. He is not expected to be a detective nor is he required to approach his work with a suspicious or pre-conceived impression that there is something wrong. He is watchdog but not a blood hound. However, if

there is anything that excites, suspicion in him, he should examine into the matter. But in the absence thereof, he is only required to be reasonably cautious and careful.

Auditors also play a major role in ensuring transparency and accountability in the corporate world, thus they are also, often, called as gatekeepers, eye and ear of the company. It is also equally true that a fraud may be discovered pertaining to a particular period after the auditor has completed his audit, it does not necessarily mean that the auditor has been negligent or that he has not performed his duties completely. He checks and verifies the books and accounts and vouchers of the company as presented before him. If he has conducted his audit by applying due care and skill in consonance with the accepted professional standards expected, the auditor would not be held responsible for not having discovered that fraud. Therefore it is expected that the auditor should be vigilant in conducting audit of the company.

The shareholders of a company place a very high trust on the auditor‘s report, which apparently shows the true and fair view of the accounts of a company. The auditors should perform their duties with utmost care and vigilance to ensure that there are no illegal or improper transactions. It is very important for auditor to use their professional skills and make a reasonable examination of the accounts to see that the dealings are not illegal or improper and it is their duty to uncover such activities. As audit has revealed many corporate frauds in the past so it is an important means to protect the interests of investors.

It is suggested that **severe civil liabilities should be imposed to auditors or auditing firm** in cases of their involvement in corporate fraud if overlooked the account or abetted in the occurrence of fraud. An auditor also performs his duties as an agent of the shareholders, so he is expected to safeguard their interests. He must exercise his reasonable care and diligence in the performance of his duties. If he fails to do so and in consequence the principal suffers any loss, he may be liable to compensate loss caused to the company resulting from his negligence. If an

auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, of the Companies Act, 2013, he will be held liable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees under S.147 (2) of the Act. It is suggested to increase the maximum civil liability of an independent auditor up to rupees twenty five lakh and in case of an audit firm up to rupees one crore.

It is also suggested that **criminal liability of an auditor to be made severe.** If an auditor has contravened provisions of audit as incorporated in the Companies Act knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he should be punished with imprisonment for a term which may extend to one year and with fine as prescribed in Section 147 of the Companies Act. In order to make more deterrent effect, it is suggested that the punishment may be increased for a term which may be extended to three years in place of present term of one year.

Provision of statutory duty of auditors towards third parties/society is lacking in the Companies Act, 2013. They have contractual relationship with the management of appointing company. Under privities of the contract, they are not answerable to any third party including the shareholders of the company. Therefore it is suggested that provision should be made in the Act, for the auditors of public companies to meet the requirement of its shareholders. This will bring transparency in the system and also create accountability of an auditor to the investors of the company.

It is, further, suggested that **duration of appointment of an independent auditor and an audit firm should be made equal.** Section 139 (2) of the Act has prescribed for compulsory rotation of the auditors for the listed companies and certain class or classes of companies. Under this section, such companies shall not appoint an individual as auditor for more than one term of five consecutive years whereas an audit firm shall not be appointed for than two terms of five consecutive years. After the expiry of the period as aforesaid the auditors are required to be

rotated. It is suggested that Audit firm should also be appointed for five years instead of two terms of five consecutive years, in order to ensure auditor's independence and also to prevent any kind of nexus that may develop between the company and auditors of audit firm, in long run.

It is also suggested that **internal audit mechanism to be made more strengthened** and it should also be done by the competent persons. If possible, such work should be entrusted to outside auditors. It also suggested that internal audit should not be done by the departmental people.

The Companies Act, 2013 has minimised several lacunae and provides effective control over arbitrariness of the directors of the companies. This Act did make two pronged attack on the problem, the first one is that shareholders were bedecked with effective weapons for exercising effective control over the BODs and realizing their rights and secondly the directors were restored to their rightful place of power and responsibility in the management of companies. Now the relationship between directors and shareholders has become healthier; much of the humbug and malpractices which were found in managerial actions have gradually disappeared. Directors have started concentrating on the managerial tasks for which they are primary appointed. Now they are not considered paternal guardian of shareholders. The suppliers of capital (shareholders) have started taking interest in the company's affairs and they are able to know, in realistic terms, the current worth of their investment.

Finally, it is concluded that after detail study of the provisions of inspection, investigation and audit in the Companies Act, 2013 as well as in the Security and Exchange Board (SEBI) Act, 1992 and various judicial pronouncements, it is observed these provisions are sufficient to protect the interests of the investors in India and if all the above suggestions are incorporated, it will be more foolproof to prevent occurrence of corporate frauds in India and investors will not be in fear while making investment either in primary market of secondary market.

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BRIEF BIO-DATA OF THE AUTHOR

Mr. Radheshyam Prasad is a faculty of law in Dr. Ram Manohar Lohiya National Law University, Lucknow (U.P.), India. Prior to this, he has served University of Petroleum and Energy Studies (UPES), Dehradun (Uttrakhand), and many other law colleges across the country, as faculty of law. He is pursuing research from College of Legal Studies, UPES, under joint supervision and guidance of Dr. Tabrez Ahmad, Professor of law, College of Legal Studies, UPES and Advocate Dr. Ramjeet Singh Yadav of Allahabad High Court.

Graduated with first class in law and also completed master degree in law with specialization in law of crimes and torts from JNV University, Jodhpur. He has also completed M.A in Political Science in first class from CSJM Kanpur University. Further he has qualified U.G.C (N.E.T) twice in subject law in 1999 and 2000 respectively.

He has participated and presented 16 research papers so far, in various international and national conferences, seminars and workshops. There are also several publications covering diverse areas of law to his credit. He was appreciated for successfully organizing three National Moot Court Competitions (Dr. Paras Diwan Memorial National Energy Law Moot Court Competitions) and intra moot court competitions continuous for three years in UPES.

Criminal law, Law of Torts, Property laws, Corporate laws and Procedural laws are his area of teaching interest. He is a life member of All India Society of Criminology.

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