

**TRI-SURE INDIA LTD v. AF FERGUSON AND COMPANY AND ORS.**

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**Vivek Malhotra\***

Company - negligence - Sections 4,10, 23, 34, 39 and 211 of Companies Act, 1956 - petitioner appointed defendant No. 1 as auditors - figures ending 31.08.1974 manipulated to show sharp increase in profits as company about to issue shares to public - after revelation of manipulation defendant No. 1 directed to take confidential investigative audit investigation revealed that goods delivered after 31.08.1974 shown in earlier financial year to boost profits - after revelation shares tumbled shareholders demanded refund - defendant No. 1 did not request Income Tax Authorities to with - hold assessment Order resulting in higher payment of Income tax on inflated figures - petitioner charged auditors for negligence as it failed to take notice of fraud committed by accounts department - claimed damages from defendant No. 1 on account of loss of reputation and goodwill - whether there was any negligence on part of respondent No. 1 - whether such negligence caused damages - facts proved that all staff and officers involved in manipulation - internal control systems were functioning smoothly - objective of company audit to conduct an independent review of financial statements - auditor does not conduct audit with objective of discovering frauds - defendant No. 1 carried out selective verification which was justified - petitioner contended that defendant should take additional care in view of steep rates and company going public - circumstances could not have made auditors suspicious about maintenance of accounts - steep increase in sale figures not sufficient to conclude that auditors should have suspected foul play - evidence provided by plaintiff not sufficient to prove auditors guilty of negligence in discharge of duties - claim of damages cannot be entertained as plaintiff led no evidence to establish damage suffered on account of loss of reputation and goodwill .<sup>1</sup>

**FACTS OF THE CASE**

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The offended parties, Tri-Sure India Ltd., have established this suit on September 20, 1978, for recuperation of the amount of RS. 63,84,792 with premium consequently at the pace of 16.25% per annum from the date of the suit till recuperation and expenses of the suit from the respondents. The offended parties were joined as a private restricted organization in

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<sup>1</sup> AIR 1987 61 COMPCAS 548 BOM

West Bengal under the name of Indian Flange Mfg. Co. Ltd. on February 10, 1960. The name was changed to Tri-Sure India (PVT) Ltd. on April 22, 1960, and the enrolled office was moved to Bombay in the year 1962. The organization was a completely possessed auxiliary of American Flange Mfg. Co., United States of America. On February 24, 1975, the offended parties turned into a public restricted organization. The monetary year of the offended parties is from September 1 to August 31.<sup>2</sup>

Litigant No. 1 is an organization firm of contracted bookkeepers and is carrying on business for last more than 85 years and has gained notoriety everywhere in the country. Litigants Nos. 2 to 13 were the accomplices of respondent No. 1 at the applicable time. Respondent No. 1 was delegated as reviewers of the offended parties directly from the year 1960. Litigant No. 1 was additionally taking care of the annual duty evaluation of the offended party organization. The litigants examined the records of the offended parties for the year finished August 31, 1974, and the review work was over by about October 1974, and respondent No. 1 sent the long-structure report to the offended parties and the duplicate thereof to the holding organization in the United States of America. The review showed steep expansion in deals and gross benefit, charges payable and net benefits contrasted with the important figures for the earlier year.

On February 19, 1975, the records were accounted for by respondent No. 1 to the offended parties as needed under area 227 of the Companies Act and the said accounts were endorsed by the investors at the yearly comprehensive gathering held on February 20, 1975. Before this date, on December 9, 1974, the Controller of Capital Issues had passed a request for weakening the unfamiliar value holding so as to consent to the Foreign Exchange Regulation Act, 1973, and immediately the offended parties had chosen to issue to the public 2,63,680 value portions of the presumptive worth of RS. 10 each at a higher cost than expected of Rs. 7.50 per share. After the records for the year 1973-74 were affirmed by the investors in the yearly comprehensive gathering, the offended parties gave the plan on February 26, 1975, welcoming the public to buy in to the offers. As needed by the arrangements of the Companies Act, the report dated February 19, 1975, made by

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<sup>2</sup> Section 4 in The Companies Act, 1956

4 Meaning of "holding company" and "subsidiary".

(1) For the purposes of this Act, a company shall, subject to the provisions of sub-section (3), be deemed to be a subsidiary of another if, but only if,--

(a) that other controls the composition of its Board of directors

respondent No. 1 was added to the outline. The report, *bury alia*, states that the inspectors had the analysis of the records for the monetary period finished April 30, 1970, and the ensuing four monetary years, and the figures of benefits after changes were set out. A scrutiny of this report demonstrates that there was, for the most part, a steady example of an upward pattern for the monetary years 1970 to 1973, however, the figures of the year finishing with August 31, 1974, showed a strikingly steep increment and unusual ascent in the pace of benefits. The public issue was intensely over-bought in and the offended parties got a total amount of RS. 22,96,000 at the pace of RS. 5 for each offer and the top-notch measure of RS. 19,77,600. The offers were then apportioned in the compatibility of the plan.<sup>3</sup>

The records for the following monetary year finishing with August 31, 1975, likewise demonstrated a precarious expansion in the pace of benefits and huge volume of deals were affected over the most recent three months of the monetary year. On October 3, 1975, SINGARAVELU, top of the buy division of the offended parties, educated Mr. C.J. E. Grundy, one of the heads of the offended parties and an accomplice of Little and Co. that the records of the monetary year 1974-75 were controlled by the staff to show enormous deals in the long stretches of June, July and August 1975. Mr. Grundy, in his turn, conveyed the reality to Mr. Richard L. Area who was likewise one of the overseers of the offended parties and dwelling at New York and who was additionally ahead of the holding organization. The revelation by SINGARAVELU drummed up some excitement and Mr. Area coordinated Mr. Wheaton to continue to Bombay to find out the greatness of extortion submitted by the staff of the offended party organization. Simultaneously, Mr. Ward likewise exhorted litigant No. 1 on October 6, 1975, to embrace secret analytical review to discover the real essence of the exchanges claimed to have been affected by the offended parties. Litigant No. 1 was educated that there was motivation to accept that completed merchandise had been sent to different godowns in Bombay to keep away from their being recorded in the year in the inventories and therefore being treated as sold in the monetary year. Mr. Wheaton

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<sup>3</sup> Section 10 in The Companies Act, 1956

10. Jurisdiction of Courts.

(1) The Court having jurisdiction under this Act shall be-

(a) the High Court having jurisdiction in relation to the place at which the registered office of the company concerned is situate, except to the extent to which jurisdiction has been conferred on any District Court or District Courts subordinate to that High Court in pursuance of subsection (2);

showed up in Bombay on October 10, 1975, and quickly continued to the processing plant of the offended parties arrange at MAHUL, CHEMBUR, and saw that completed products were in reality taken out to the private godowns and an incorrect record was set up to show expansion in deals over the most recent three months. Mr. Wheaton did the review within the sight of K. Shankar HEDGE who was the overseeing chief at the pertinent time. During the insightful review embraced by litigant No. 1 in regard to the records of the monetary year 1974-75, a few anomalies were seen and immediately litigant No. 1 expanded the analytical review in regard to the records of the earlier year, that is the monetary year 1973-74 consummation on August 31, 1974, and which records were at that point concluded.

Over the span of the examination, it was noted by litigant No. 1 that in regard of 35 deals solicitations and 38 conveyance challans arranged in the names of the clients for deals conglomerating to RS. 55.20 lakhs, different records of the resulting year showed a date of conveyance ensuing to the furthest limit of the bookkeeping year, besides in one situation where the conveyance doesn't seem to have been made till the date of finish of the analytical review. Litigant No. 1 additionally noticed that as on account of the year finished August 31, 1975, pre-printed and sequentially numbered conveyance challans have been given out on the town before August 31, 1974. In regard to 20 conveyance challans for deals conglomerating to RS. 19.13 lakhs, there were transporters' bills, both dated August 31, 1974, from the organization's principle transport transporter, that is, M/s. SONAVANE Transport Service for having booked these things to different objections/clients on changing dates inside the bookkeeping year finished August 31, 1974. The examination, in any case, uncovered that in regard of in any event 16 of these conveyance challans for deals amassing to RS. 17.21 lakhs, there were further bills in the resulting year from the transporters for booking these equivalent things to similar objections/clients on ensuing dates. It was likewise seen by litigant No. 1 that out of the 38 conveyance challans, 6 identified with the Directorate-General of Supplies and Disposals and in regard of two solicitations of this client, the merchandise was set up for investigation preceding August 31, 1974, while in regard of one receipt, however, the products were set up for examination on September 9, 1974, the organization had composed a letter routed to the General Manager, Ordnance Factory, BHUSAWAL, dated August 9, 1974, that game plan ought to be made for assessment of the merchandise at the organization's premises at the most punctual comfort. It was additionally noticed that all the review notes showed that after the merchandise had

been examined, the applicable number of cases were stepped with certain ID markings. The investigation, hence, uncovered that however the products were conveyed to the client resulting to August 31, 1974, the deals appeared in the previous monetary year so as to support the benefits. There were a few different abnormalities noted by respondent No. 1 while undertaking the analytical review for the monetary year 1974-75 and, appropriately, a point by point report was presented by respondent No. 1 to the offended parties on April 20, 1976. During the insightful review, it came to see that the records were controlled by K. Shankar Hedge with the dynamic co-activity of heads of different divisions of the organization. K. Shankar Hedge was working with the offended parties since its origin that is the year 1960, and in January 1972, was designated as whole-time chief. Support was then selected as overseeing chief on January 21, 1975, however, offered his abdication on October 17, 1975, when controls of the records became visible and HEDGE couldn't give palatable clarification to Mr. Wheaton and Mr. Area, the two American overseers of the holding organization just as the offended party organization. At last, on April 27, 1976, the offended parties documented a private criminal objection against HEDGE and two different officials in the Court of the Metropolitan Magistrate Bombay.<sup>4</sup>

### ISSUES OF THE CASE

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1. Whether the defendants failed or neglected to apply their minds to or enquire into ascertaining the true facts?
2. Whether the correct figures of sales, etc., have been set out or not?
3. Whether the publication of the report for the year ended August 31, 1974, caused and set-back to the credibility, prestige or goodwill of the plaintiffs?
4. Whether the said alleged manipulations, frauds, etc., could have been discovered by the defendants had they carried out their duties as auditors with reasonable diligence?

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<sup>4</sup> Section 23 in The Companies Act, 1956

23. Registration of change of name and effect thereof.

(1) Where a company changes its name in pursuance of section 21 or 22, the Registrar shall enter the new name on the Register in the place of the former name, and shall issue a fresh certificate of incorporation with the necessary alterations embodied therein; and the change of name shall be complete and effective only on the issue of such a certificate

5. Whether the defendants failed and neglected to carry out their audit in accordance with accepted principles of accounting?
6. Whether the plaintiffs have actually suffered the damages?
7. Whether the defendants are liable to compensate the plaintiffs for the said alleged damages?
8. What reliefs, if any?

### **JUDGEMENT OF THE CASE**

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On the side of the case, the offended parties had the analysis that Mr. NARAYANSWAMY CHELLA Krishnan, a sanctioned bookkeeper, rehearsing from the year 1950, and the observer dismissed the act of inspecting and different advances needed to be taken by the inspector in the release of his obligations. The offended parties additionally inspected Mohan Narayan Menon who is a plant supervisor and who was working with the offended parties from the year 1972. The following observer inspected by the offended parties is ARUN MADAN KELKAR the bookkeeper, who was filling in as records associate from July 1970, and the last observer is Satish MAHADEV Pradhan, a sanctioned bookkeeper, taking care of the personal duty evaluation procedures of the offended party organization after the year 1976. In the interest of the litigants, Mr. KAIKI RUSTOM ALPAIWALLA, respondent No. 3 entered the observer box and Mr. Mahindra, who had done the review work for the year 1973-74, under the oversight of Mr., ALPAIWALLA was likewise inspected. Mr. Vasant RAIJI, a sanctioned bookkeeper rehearsing from the year 1945, was inspected by the litigants and the observer ousted about the practices followed by the examiners in endeavour review work. The gatherings by assent recorded assemblages containing different reports and likewise, a few archives were delivered during the preliminary and were appropriately displayed.

From an examination of the issues, clearly, the chief issue needed to be resolved is whether the litigants fizzled and fail to complete their review as per the acknowledged standards of bookkeeping and whether such disappointment or disregard has made harms the offended parties. Prior to the thought of this issue, it is important to set out certain undisputed realities which were either revealed in the proof or are expressed by counsel at the Bar.

The offended party organization was an entirely possessed auxiliary of American Flange Mfg. Co. fused in the United States of America till the finish of the monetary year August 31, 1974, and every one of the portions of the offended party organization was held by the American Company. Mr. Ward and Mr. H. F. Wheaton, the heads of the offended party organization, were likewise overseers of the American organization. The enlisted office and plant of the offended parties are arranged at MAHUL and CHEMBUR, and the important items fabricated by the offended parties are ribs and bungs (barrel plugs). The activity of the offended parties is especially completed by five offices headed by various officials. The divisions are deals, accounts, buys, stores and creation, and in the monetary year 1973-74, these offices were in the charge of Banerjee, RAMAMURTHY, SINGARAVELU, SUDHIR and Satish Kumar, separately. Banerjee was in the work of the organization from the year 1965 from 196 RAMAMURTHY 3 and SINGARAVELU from 1969. K. Shankar HEDGE was related with the organization directly from its commencement that is from the year 1960, and was designated as a whole time chief in 1972 and as overseeing chief in the year 1975. HEDGE was a man of certainty of the American chiefs and however, the Americans found that was following up on certain events in opposition to the settled standards and strategies of HEDGE the holding organization, it was felt that it would not be feasible to abstain from his administrations. The American organization had total authority over the working of the offended parties and data was outfitted routinely to New York even in regard to minor issues. The month to month asset report and benefit and misfortune account were routinely sent by the offended parties to New York and the holding organization had named Mr. YIEN as a monetary regulator in regard to a few auxiliary organizations spread over the world. KELKAR removed in passage 20 of his proof that the offended party organization used to plan month to month monetary records and benefit and misfortune accounts and these assertions were shipped off America consistently. KELKAR was shown an example letter going with the benefit and misfortune proclamation and accounting report sent to the United States and the letter is dated August 29, 1974, and the duplicate of which is on page 23 of volume 16 of the accumulation of the respondents. The letter was endorsed by RAMAMURTHY, the bookkeeper responsible for the records office, and furthermore by K. Shankar HEDGE. KELKAR at the pertinent time was functioning as a subordinate of Mr. RAMAMURTHI. Duplicate of the letter dated August 31, 1974, at page 10 of volume 16 of the gathering of the respondents, shows that K. Shankar HEDGE had given guidelines that the act of extra time in the plant ought to be totally halted and surprisingly a duplicate of this

letter was sent to America. On page 5 of volume 16 is a duplicate of a note dated June 4, 1973, from SINGARAVELU to HEDGE in regard to an investigation completed by the industrial facility overseer on the earlier day. A duplicate of this note was likewise sent to New York. On page 16 of volume 16 is a duplicate of the letter dated February 12, 1974, from Mr. RAMAMURTHI to Mr. YIEN positioned at New York, and is in answer to the update got from America in regard to the use of fuel for the long stretch of November 1973, and handling charges paid to Gannon Dunkley in 1974. These letters and the note undeniably build-up that the holding organization was practising total authority over the working of the offended party organization. The way that duplicates of notes in regard to inner control were sent to America and surprisingly in regard to minor things, similar to the visit of a plant examiner or the guidelines not to allow staying at work past 40 hours or the over the top client of the petroleum, are obvious conditions to set up the degree of control practised by the American Company.

The American organization was additionally giving guidelines about different practices acquainted from time with time and different frameworks of support of record to the offended parties and in this association, reference can be helpfully made to the duplicate of the letter dated August 7, 1973, from Mr. Area to Mr. HEDGE. The overseers of the holding organization were completely aware of the activities of the offended parties and on May 13, 1974, a wire message was sent by Mr. Area whining that the offended parties are tolerating all the instalments against master forma solicitations despite the fact that the merchandise was not created. The wire message requests that the legitimate bookkeeping of the assets ought to be sent to New York to empower the holding organization to know the commitments of the offended parties. Mr. HEDGE sent an answer on June 7, 1974, promising that the framework embraced by the offended parties would not be rehashed in future, and money would be gathered from the clients just when the organization is in a situation to dispatch the products directly from the rack. The duplicate of the wire and the answer of HEDGE are on pages 90 and 91 volume 10 of the aggregation of the respondents

There are two letters dated July 5, 1974, and August 8, 1974, on pages 17 and 18, separately, of volume 16 of the arrangement of the litigants to which a reference is essential. The letter dated July 5, 1974, is routed to Mr. YIEN by RAMAMURTHY and, entomb Alia, presents that the beat of creation is getting since the workers got back to obligation. The letter at that

point discusses that the deals up to the furthest limit of June 1974, were of RS. 114 lakhs and the deals expected for the leftover two months of the year, that is July and August 1974, would associate with RS. 46 lakhs. Mr. Ramamurthy expressed that the typical exercises initiated from the most recent seven- day stretch of May and the offended parties hope to return to a solid money position. The letter further recounts that because of the endeavors of the administrative staff, it is feasible to make conveyance of the deals affected in the year, and the conveyances which were postponed because of the rail line strike would be finished in the long periods of May and June 1974, and full assortment would be recuperated. The subsequent letter dated August 8, 1974, is additionally from Ramamurthy to Mr. Yen and sets out the money position for the time frame August 1974, to January 1975. The letter recounts that the deals for the long stretch of August 1974, has been taken at RS. 25 lakhs, however, the actuals may end up being a lot higher if the beat of working was kept up and report would be made during the principal seven- day stretch of September. These three letters undeniably demonstrate that the way that the deals were mounting up over the most recent three months of the monetary year finishing with August 31, 1974, was known to the heads of the holding organization, even before the year was finished. The correspondence to which reference is made hereinabove further shows that Mr. Ward was cognizant that Mr. Hedge was now and again acting in opposition to the settled act of the organization and directions were given to guarantee that the offended party organization doesn't withdraw from settled standards. This correspondence combined with the proof of KELKAR builds up that the data provided by the offended parties to the holding organization was broad in nature and the chiefs, including Mr. Area and Mr. Wheaton, and the monetary regulator, Mr. YIEN knew that the deals of the offended party organization during the most recent three months of the year 1973-74 were huge in nature. It is likewise needed to be expressed that genuine duplicates of each receipt and credit notes were shipped off the United States of America and this reality could be assembled from the affirmation dated November 30, 1977, documented by Mr. Area in Company Petition No. 308 of 1977. The testimony discusses:

The intermittent explanations which were sent by the Indian organization to American Flange predominantly included the monetary records, the pay articulations, income proclamation, and periodic spending projections and furthermore duplicates of solicitations and buy orders. Such of these as were put together by departmental tops of the Indian organization were initiated by Mr. Hedge as per the practices referenced previously. On the off chance that

American Flange had any remark or guidelines in regard to any such intermittent assertions, and so on, such remarks and directions were conveyed straightforwardly to Tri-Sure (I.) Ltd. regularly by a letter promotion.

### **ANALYSIS OF THE CASE**

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The auditors play a totally critical function in overseeing the employer's economic topics. As consistent with section 141 of the Companies act, 2013 only chartered accountants can be auditors. Section 143 tells that the auditor of a company shall have the right of entry to the books of money owed of the agency laws. An organization courting comes into existence whilst a predominant engages a character as their agent to perform a provider on their behalf and such overall performance is contingent upon the delegation of sure authority to such an agent. At the same time as such delegation of responsibility and the resultant division of labour interprets in the promoting of green control practice, such delegation is simplest and successful if the main trusts the agent enough to act of their fine hobbies now an easy employer version would propose that because of facts asymmetries between the foremost and agent and differing reasons, principals lack motives to agree with that their agents are in reality, working off their high-quality hobby and so one can remedy such concerns, positive mechanisms might be installed region to align the pursuits of the agents with that of the foremost, thereby decreasing the scope of records asymmetries and opportunities behavior, this is where the company governance mechanism steps in.