Inspection, Investigation and other Similar Provisions In the Companies Act 1956

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< EXECUTIVE SUMMARY >

◆ In this article the author has analysed the various provisions of the companies Act, 1956 dealing with (i) Inspection of books of accounts etc. of companies; (ii) power of Registrar to call for information or explanation and (iii) investigation. Various provisions of the companies Act has been stated and explained to bring out the need for inspections, procedure and requirements of inspection and other formalities related with it such as who has the power to initiate the inspections. Section 234 has also been dealt with the explain the powers of the Registrar of Companies to call for information. Also the grounds and course of Action in seizure of Documents by the Registrar of companies as per section 234 A of the Companies Act, 1956.

SETTING THE STAGE

From the day I started learning commerce, I have been hearing the age old definition of 'company', which reads as follows – 'Company is a voluntary association wherein people invest money or money's worth to a common stock to deploy it in some trade or business and to earn dividends depending upon the profitability". This definition is valid especially in the case of public limited companies wherein the ownership and management are divorced and large volumes of public money in the form of share capital are involved. In such situations public accountability should be the driving mantra for ensuring good corporate governance.

The readers may be wondering as to why I am chewing the cud by going back to my student days. The newspaper reports about the malpractices of certain western as well as Indian corporates promoted me to pause for a while, think and write. Accounting jugglery has become the world order (rather disorder) now. Many U.S. corporates like Enron, Worldcom, Xerox, Qwest etc. were caught red handed in the recent past. At this juncture I feel that for us, the Indians, there is a scope for a sigh of relief, for, our corporates, have not become so degraded as to follow their western counterparts, though certain stray cases have been reported.

The author is a member of the Institute. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.

Why we Indians are better off in this regard? – Three points can be given as answers to this question. They are:

a. The provisions of Companies Act, 1956 show the red signal to the prospective wrong doers.

b. Every company in India is subject to an independent audit byChartered Accountants. Such an audit carried out in accordance with the norms laid down by the Institute of Chartered Accountants of India would definitely unearth most of the irregularities.

c. Vast majorities of Indian Corporates are honest.

In this article, an attempt is made to analyse the provisions of the Companies Act, 1956 relating to the inspection and investigation.

CONTENTS

I. Inspection of books of accounts etc. of companies {Section 209A}
II. Power of the Registrar to call for information or explanation {Section 234}
III. Seizure of Documents by the Registrar {Section 234A}
IV. Investigation {Section 235 to Section 251}

I. INSPECTION OF BOOKS OF ACCOUNT ETC. OF COMPANIES {SECTION 209A}

1. What is inspected?

   Books of accounts and other books and papers.

2. Who can conduct the inspection?

   a. The Registrar of Companies or

   b. Any government Officer authorized by the Central Government or

   c. Any Officer of the Securities and Exchange Board of India authorized by it.

   The Officer of the Securities and Exchange Board of India can exercise these powers only with respect to matters covered in Section 55A

3. Why inspection?

   To ensure that the books are maintained as required by law.

4. Other points

   a. An Inspection may be conducted without giving any prior notice to the Company.

   b. An Inspection must be carried out during the business hours of the Company.

   c. In addition to books the Inspecting Authorities can also inspect deeds, vouchers, writings, documents etc.

   d. An Inspection is much narrower in scope when compared to an investigation. Hence the Inspecting Authorities are not supposed to make roving inquiries about the working of the Company.

   e. The Directors, Officers and Employees of the Company shall produce books and other papers to the Inspecting Authorities and furnish the required information on time.

   f. The Directors, Officers and Employees of the Company shall extend reasonable assistance to the Inspecting Authorities during the course of their inspection.

5. The Powers/Duties of the Inspecting Authorities

   a. the Inspecting Authorities can take copies of the books or place marks of identification thereon.

   b. During the course of an inspection they can exercise the following powers that are vested in the Civil Courts.

   - ◆ Discovery and production of books of account and other documents at such place and at such time as may be specified.
   - ◆ Summoning and enforcing attendance of persons and examining them on oath.
   - ◆ Inspecting any books, registers or other documents of the company at any place.

   c. The Inspecting Authority shall give it's Report to the Central Government. If the inspection is carried out by a person other than the Registrar of Companies, he shall exercise all the powers vested in the Registrar of Companies under Section 234 of the Companies Act, 1956. It may be noted that the Company is not entitled for a copy of the Inspection Report nor is the Inspection Report a public document.

6. Penalties:-

   a. Any person who gives a false statement to the

Inspecting Authority shall be liable to fine and prosecution. (Section 629)

b. Any person who does not comply with the requirements of Section 209A shall be liable for fine and imprisonment. {Section 209A(8)}

c. A Director who is convicted of an offence under the above Sections shall be deemed to have vacated his office forthwith and shall be disqualified form holding such office in any company for the next five years. (Section 209A (9))

7. Secretarial Action Points:-

a. Ensure that statutory books are kept upto date

b. Books of Accounts, Cost Records (if applicable) and the Copies of the Balance Sheet and the Profit and Loss Account for the last eight years must be maintained.

c. Copies of the Annual Returns must be properly filed and kept

d. Minutes of the General Body Meeting as well as the meetings of the Board of Directors should be properly maintained.

II. POWERS OF THE REGISTRAR OF COMPANIES TO CALL FOR INFORMATION {SECTION 234}

a. Suo-motto: While perusing any document filed by a Company, if the Registrar requires additional information he may order the Company to produce such additional information or explanation that he thinks fit, within the time stipulated by him. Upon receipt of such an order, the Directors and other Officers are duty bound to produce the information and explanation called for.

b. On a representation made to him by a Creditor or a Contributory or any other interested person on any of the following grounds:-

i. the business of the company is carried on to defraud the Creditor or any other person dealing with the Company, or

ii. the business of the Company is carried out for a fraudulent or unlawful purpose.

Here the Registrar of Companies may call for the Company to furnish the requisite information and explanation. Upon the receipt of such an Order, the Directors and the other Officers are duty bound to produce the information and explanation called for. If upon such inquiry, the Registrar of Companies is satisfied that any representation on which he took action under this provision was frivolous or vexatious, he shall disclose the name of the informant to the Company.

2. Default and Consequences:-

a. Where no information is furnished or the information furnished is inadequate, the Registrar of Companies may order for the production of books and other papers for inspection within a stipulated time.

b. The Directors and other Officers and Employees of the Company are bound to comply with the aforesaid order. If they fail to comply with the Order, they will be liable for fine (Section 234(4)(a)). The Registrar of Companies can approach the Company Court and accordingly the Court may direct the Company to produce the books etc. before the Registrar of Companies.

c. Where no information or explanation is furnished or the information or explanation furnished discloses an unsatisfactory state of affairs or does not disclose a full and fair statement of any matter to which the document purports to, the Registrar of Companies shall report the matter in writing to the Central Government.

3. Applicability to Foreign Companies:-

These provisions shall apply in relation to documents that are to be filed by a foreign company in India with the Registrar(s) of Companies.

III. SEIZURE OF DOCUMENTS BY THE REGISTRAR OF COMPANIES (SECTION 234A)

1.Grounds:

Where the Registrar of Companies has reasonable grounds to believe that the books and papers of a Company may be destroyed, mutilated, altered, falsified or secreted, he may apply to the Magistrate for an Order to seize such books and papers.

2. Course of Action:-

a. On receipt of an order from the Magistrate, the

Registrar of Companies can:

- ❑ enter the place or places where the books etc. are kept;
- ❑ search those places and
- ❑ seize such books and papers as he considers necessary;

b. He can take copies or extracts from them or place marks of identification on them in any manner, as he thinks fit.

3. Culmination:-

The Registrar of Companies shall return the books etc within 30 days and inform the same to the Magistrate.

IV. INVESTIGATION:-

Though the real owners of a Company are its shareholders, the Management of the Company will be 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 companies, especially in cases of an alleged fraud or even the oppression of the minority shareholders.

Types of Investigation:-

A. An Investigation into the affairs of the Companies [Section 235 & 237]

B. An Investigation into the affairs of the related Companies [Section 239]

C. An Investigation into the ownership of the Companies [Section 247]

A. Investigation into the affairs of the Companies

1. Discretionary Powers

i. On a Report of the Registrar of Companies under Section 234(6) – (Section 235(1))

The Central Government MAY appoint one or more competent persons to investigate into the affairs of the Company, if a report has been made to it by the Registrar of Companies, that a document filed with him, discloses an unsatisfactory state of affairs, or does not disclose the full and fair statement of matters to which it purports to.

ii. Based on the Opinion of the Company Law Board (Section 237 (b))

The Central Government MAY appoint one or more competent prsons as inspectors to investigate the affairs of the Company, if in the opinion of the Company Law Board, there are circumstances suggesting:

a. Fraud etc in any of the manner given below:

- ❑ the business of the company is conducted to defraud its Members, Creditors, or other persons or
- ❑ the business of the Company is conducted for a fraudulent or unlawful purpose or is oppressive to any Member or
- ❑ the Company was formed for any unlawful or fraudulent purpose

b. The persons connected with the formation or management of the Company have been found guilty of fraud, misfeasance, or other misconduct towards the Company or any of its Members

c. The Members of the Company are deprived of any information, which they are entitled to including the particulars of commission, if any, payable to the Managing Director or other Director or the Manager.

The Company Law Board can form an opinion as aforesaid, even based upon a complaint received from a single shareholder, irrespective of the fact that he didn't have the requisite number of shares as mentioned in Section 235(2). The reason is that Section 235(2) and Section 237(b) are two independent provisions.

2. Mandatory Powers

i. Appointment Under Section 237(a)

The Central Government SHALL appoint one or more Inspectors to investigate into the affairs of the Company and to report thereon if:

a. the company by a Special Resolution (Section 237(a)(i)); or

b. the Court by an Order (Section 237(a)(ii))

declare that the affairs of the Company ought to be investigated by an Inspector appointed by the Central Government.

Issues

a. The Company itself passing a Special Resolution as aforesaid will be a rare happening.

b. Powers of Court Under Section 237(a)(ii)

- ❑ The Court can direct an investigation whenever it suspects that all is not well with the company.
- ❑ In V.V. Purie Vs.EMC Steel Ltd. ((1980) 50 Comp. Cases 127) it was held that the following classes of persons can approach the court in order to obtain an order as above mentioned:
  - ● A creditor who cannot bring an action under

Section 235 of the Companies Act, 1956.

- Aggrieved Members who are unwilling to move to the Company Law Board under Section 235 or are unable to fulfill the requirements under Section 236.
- Persons who have applied to the Company Law Board under Section 235(2) or 237(b) but their application had been rejected.
- A Company which wants an investigation but fails to pass a Special Resolution

ii. Appointment On a Declaration By The Company Law Board:-

On a declaration being made by the Company Law Board that the affairs of the Company ought to be investigated, the Central Government SHALL appoint one or more competent Inspectors to investigate into the affairs of the Company and to report thereon, in such manner, as the Central Government may direct.

When Will The Company Law Board Make Such Declaration?

For this purpose the following persons can apply to the Company Law Board:

1. Where the Company has share capital
   - ❑ Not less than 200 Members or
   - ❑ Members holding not less than $1/10^{th}$ of the total voting power therein
2. Where the Company does not have Share Capital
   - ❑ Not less than $1/5^{th}$ of the persons in the Company Register of Members

Before making a declaration as aforesaid, the Company Law Board give the parties concerned an opportunity of being heard.

The Application by Members mentioned above, should be supported by the necessary evidence, to show that the Applicants have good and sufficient reasons for requiring an investigation. The Central Government may, before appointing the Inspectors, require the Applicants to give security not exceeding Rs.1000 to meet the costs of such investigation.(Section 236).

B. Investigation into the affairs of Related persons (Section 239)

1. During the course of, and for the purposes of the investigation of the affairs of the Company, the Inspectors can also investigate into the affairs of related Companies/persons.
2. What is a Related Company/Person?
   a. any other body corporate which is, or has, at any relevant time, been:
   * The Company's subsidiary or
   * The Company's holding company
   * Subsidiary of the Company's holding Company
   * Holding Company of the Company's subsidiary
   b. any other Body Corporate, which is or has at any relevant time been managed by any person as the Managing Director or Manager, who is or was, at any relevant time the Managing Director or Manager of the Company
   c. any other body Corporate which is, or has, at any relevant time, been managed by the Company OR whose Board of Directors comprises of Nominees of the Company OR is accustomed or any Directors of the Company or any Company, any of whose Directorships is held by the Employees or Nominees of those having control and management of the first mentioned Company.
   d. Any person who is, or has been, at any relevant time, been the Company's Managing Director or/the Manager.
3. If the Inspector wants to extend the investigation to the persons mentioned in (b), (c) or (d) above, prior approval from the Central Government must be obtained.
4. The Central Government shall, before granting such approval, issue a Show Cause Notice to the other party as to why the approval should not be granted.

C. Investigation Into the ownership of Companies (Section 247):-

1. The purpose of appointing an Inspector under this provision is to investigate and report on the membership of the Company for the purpose of determining the REAL PERSONS who are or have been
   a. Financially interested in the success or failure, whether real or apparent of the Company. Or
   b. Able to control or materially influence the policies of the Company.
2. Appointment of Inspectors under this Section may be sometimes mandatory and sometimes discretionary as well:
   a. Mandatory: The Central Government SHALL

appoint Inspectors if the Company Law Board, in the course of any of the proceedings before it, declares that the ownership of the Company needs to be investigated.

b. Discretionary: The Central Government may appoint Inspectors if there are good and sufficient reasons to do so.

3. The scope and manner of conducting the investigation will be as defined by the Central Government.

Powers of the Inspectors:-

1. Investigating into the affairs of related Companies with the prior approval of the Central Government.
2. To call for the production of books, documents etc. of the Company under investigation as well as of related companies.
3. With the previous approval of the Central Government to call for the production of books and other papers of any other Body Corporate.
4. The Inspector may examine on oath, and take evidence in writing, from the following persons:
   a. Officers, Employees and Agents of the Company under investigation, and also those of the related companies. For this purpose Agents include Bankers, Advocates and the Auditors.
   b. Any other persons with the previous approval of the Central Government.
5. The Inspector may make an application to the Magistrate for entry, search and seizure. The Magistrate may, by order, authorise the Inspector to:
   a. enter the place where the books, documents etc are kept
   b. search that place and
   c. seize the books and documents he considers necessary for the purposes of investigation.

The Inspector's Report (Section 241)

1. the Inspector shall submit his Final Report to the Central Government.
2. He may furnish an Interim Reportm if he so desires, and shall furnish an Interim Report if called for by the Central Government.
3. The Central Government shall forward a copy of the Report (only the Final Report) to the Company, as well as to any other Body Corporate, covered under the investigation.
4. The Central Government may furnish a copy thereof to any Member or any interested Body Corporate or a Creditor, on request and payment, of the prescribed fee.
5. Where the Inspectors are appointed under Section 235(2) pursuant to an Application made by the Shareholders, the Central Government shall give a Copy of the Report to them on request. A Copy thereof, shall also be given to the Company Law Board.
6. Where Inspectors are appointed under Section 237, pursuant to a Court Order, Copy of the Report shall be sent to the Court.
7. In all cases a Copy of the Report is filed with the Registrar of Companies.
8. Sometimes the Central Government may cause the Report to be published.

Follow-Up Action:-

1. Prosecution for criminal liability under Section 242
2. Application for winding up the Company on just and equitable grounds as envisaged under Section 433(f) or an Application for relief against the oppression and mismanagement under Section 397 and 398 or both.

BOOK CLOSURE:-

Gone are the days where these provisions were sparingly used. From the recent press releases of our Honourable Finance Minister Mr. Jaswant Singh, it is clear, that the Government of India is taking lessons from the series of accounting malpractices, that have rocked the United States of America. The Government is bent upon ensuring that such malpractices don't happen in India. The recent development is the announcement by the Finance Minister of setting up of Serious Fraud Offices (SFO) to monitor the Corporate crimes. This is a tough time for all the Indian Corporates to prove that they are honest, and that, they will abide by the legal requirements and the Accounting Principles. Let them sail through in this endeavour despite all tempests, turmoils and temptations. ■