

## Chapter Summary

- There were 6,79,649 companies registered under Companies Act as on 31.03.2005 in various States and Union Territories. 1,42,432 companies were added during 2000-01 to 2004-05. In addition, 1840 foreign companies as defined under Section 591 of the Act were operating in the country as of 31.03. 2005. The maximum concentration of companies is in Maharashtra, Delhi, Tamil Nadu, Andhra Pradesh, West Bengal, Karnataka and Gujarat.

**(Para 3.1.4)**

- The records and database of companies maintained by the Registrars of Companies were either incorrect or incomplete and not updated. Discrepancies and variations were noticed in the data maintained on the basis of actual receipt of revenue/documents and main database of the system. The database lacked inbuilt validation checks and system to safeguard and prevent unauthorized alterations.

**(Para 3.8.3)**

- In 5 ROCs fine of Rs.1381.76 crore was not recovered against 2353 companies under Section 168 of the Act on account of delay/not holding annual general meeting during the years 2000-01 to 2004-05.

**(Para 3.10.1)**

- In 15 ROCs annual returns were not filed as required under Sections 159 and 160 of the Act in 904709 cases during 2000-05. This resulted in non collection of fee of Rs. 232.63 crore. Prosecution was launched against one per cent of the defaulting companies only.

**(Para 3.10.2)**

- Balance sheets and profit & loss accounts were not filed in 919577 cases during 2000-05 in 15 ROCs under Section 220(1) of the Act which resulted in non-collection of fee of Rs. 237.06 crore.

**(Para 3.10.5)**

- In ROCs Andhra Pradesh, Meghalaya, Tamil Nadu, Rajasthan, Delhi, Maharashtra and West Bengal, fee of Rs. 15.74 crore was not collected despite increase in share capital of certain companies as reflected in their annual returns and balance sheets, as these companies did not file the form 5 as required under Section 97 of the Companies Act. Besides, due to deficiency in the software, additional fee of Rs. 1.07 crore was short recovered.

**(Para 3.10.6)**

- In ROCs West Bengal, Rajasthan, Delhi, Haryana, Bihar and Orissa, fee amounting to Rs. 2.03 crore and fine of Rs. 2.28 crore were not recovered in 5951 cases during 2000-04 from companies with paid up capital of Rs. 2 crore and above for non appointment of company secretary under Section 383(A) and non submission of compliance certificate under Section 383A (1A) of the Act.

**(Para 3.10.8)**

- Suspected fraud of Rs. 98.98 lakh was noticed in ROC, Kolkata where 52 cash receipts for levy of registration fee of Rs. 52.36 lakh and additional fee of Rs. 46.62 lakh towards increase in authorised capital were cancelled. In all these cases the increased authorised capital was not restored back to its earlier limit after cancellation of cash receipts.

**(Para 3.10.10)**

- Investor Education & Protection Fund had not been created, as envisaged under Section 205(C) of the Companies Act. The amount of dividends, matured deposits etc. lying unclaimed for 7 years were credited to the Consolidated Fund of India and the expenditure incurred on investor awareness was met through normal budgetary procedure. The ROCs were not in a position to assess or determine delays made by the companies in the transfer of these funds nor was any system in place for identifying such companies which did not transfer the unclaimed dividends etc. to government account after the expiry of 7 years. ROCs thus had no control over the implementation of the provisions of Section 205(C) of the Act.

**(Para 3.11)**

- In Madhya Pradesh, 100 companies had not opened unpaid dividend account in designated scheduled bank under Section 205(A) of the Act for which they were liable to pay interest of Rs. 4.65 crore and penalty of Rs.14.15 crore. In ROCs, Delhi and Mumbai Rs.28.43 crore was kept under non interest bearing account which resulted in loss of interest of Rs.11.94 crore.

**(Para 3.11.1)**

- Internal controls were inadequate. During the years 2000-05 the inspections conducted by the ROCs under Section 209(A) were negligible. In 5 States against 392066 annual accounts received during 2002-03 to 2004-05, technical scrutiny was conducted in 4369 cases only.

**(Para 3.12.1 & 3.12.2)**

- No institutional mechanism for correlation/coordination of activities and information with data of statutory bodies such as SEBI, RBI etc. was in place. 303 companies were found working as NBFCs in Shillong, Orissa and Rajasthan without being registered with RBI. There was also variation in the number of NBFCs (1274) registered with ROC, Delhi and NBFCs (2438) at work as per RBI records.

**(Para 3.12.3)**

### **Chapter – III : An appraisal of the levy and collection of fees by the Registrar of Companies**

**3.1.1** Ministry of Company Affairs, earlier known as the Department of Company Affairs under the Ministry of Finance, was designated as a separate Ministry in May 2004. The Ministry is primarily concerned with the administration of the Companies Act 1956, other allied Acts and rules and regulations framed thereunder for regulating the functioning of the corporate sector. The Ministry has a three-tier organisational set-up - the ministerial secretariat at New Delhi, four Regional Directorates at Mumbai, Kolkata, Chennai and Noida (U.P) covering the Western, Eastern, Southern and Northern region respectively and 22 offices of Registrars of Companies (RoC) appointed under Section 609 (2) of the Companies Act, covering all the States and Union Territories.

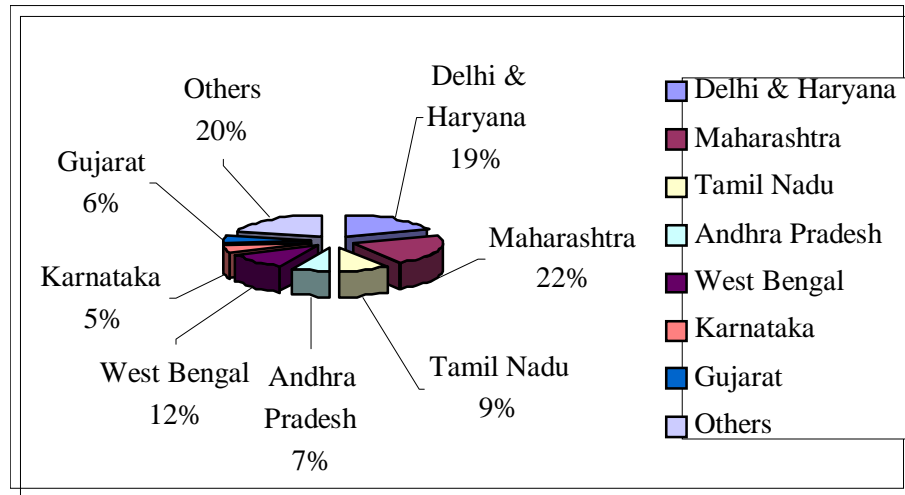
**3.1.2** The Registrars of Companies function under the administrative control of Regional Directors and are vested with the primary duty of registering companies including foreign companies floated in the respective States/Union Territories and ensuring that such companies comply with the statutory requirements under the Act. Every company having a share capital is required to prepare and file with RoC, by the stipulated dates, returns containing particulars of its registered office, its members, debenture holders, its indebtedness etc. and other documents as stipulated in the Companies Act. The RoC charges and collects fee prescribed in Schedule X read with Section 574 and 611 of the Companies Act for filing various returns/documents. The Registrars are empowered to prosecute the defaulting companies for their failure to file the specified returns/documents for safeguarding the interests of the shareholders/ investors/depositors.

**3.1.3** The Ministry has launched an e-governance project from 18 March 2006 for providing easy and secure online access to all its services including registration and filing of documents throughout the country for all the corporates and others at any time and in a manner that best suits them.

**3.1.4** There were 6,79,649<sup>1</sup> companies registered under Companies Act as on 31 March 2005 in various States and Union Territories. 1,42,432 companies were added during 2000-01 to 2004-05. In addition, 1840 foreign companies as defined under Section 591 of the Companies Act were operating in the country as of 31 March 2005. The maximum concentration of the registered companies is in Maharashtra, Delhi, Tamil Nadu, Andhra Pradesh, West Bengal, Karnataka and Gujarat.

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<sup>1</sup> Public companies 78328, Private companies 6,01,321.



### 3.2 Law and procedure

**3.2.1** Section 166 of the Companies Act, 1956 (hereinafter referred to as the 'Act') provides for holding of Annual General Meeting (AGM) by every company. Defaulting companies are punishable under Section 168 of the Act with a fine.

**3.2.2** Every company is required to file an annual return and its Balance Sheet and Profit & Loss Account under Sections 159, 160 and 220(1) of the Act. Defaulting companies are punishable with a fine under Sections 162 and 220(3).

**3.2.3** Under Section 97 of the Act, if a company increases its share capital beyond the authorised capital, it has to file a notice with RoC in Form 5 of increase of capital. In the case of default, the company and each officer concerned with the default is punishable with fine.

**3.2.4** The fee structure for filing various returns/documents and for incorporation of companies is prescribed in Schedule X, read with Sections 574 and 611 of the Companies Act 1956. Additional fee from one to nine times of the normal fee prescribed under Schedule X of the Act, based on the period of delay is leviable under Section 611(2) for delays in filing returns/documents.

**3.2.5** Section 205C of the Act, 1956 provides for establishment of Investor Education and Protection Fund (IEPF) from 31<sup>st</sup> October 1998. Any unpaid/unclaimed dividend is to be transferred to unpaid dividend account of the company within 30 days from the declaration of the dividend and to the IEPF if it remained unpaid/ unclaimed for a period of seven years from the date of transfer to the unpaid dividend account.

**3.2.6** Under Section 383(A) of the Act, 1956, every company with paid up share capital of Rs.2 crore and above shall have a whole time Company Secretary. The company in default is punishable with fine under section 383A (1A).

**3.2.7** Section 209A(1) of Companies Act, 1956 empowers the RoC to undertake inspections of the books of accounts and other records of the companies.

**3.2.8** Under Section 621 of the Act, 1956 the RoC can prosecute the companies, which violate any provisions of the Act.

### **3.3 Scope of audit**

**3.3.1** Audit test checked the records of the regional directorates and offices of RoC for the years 2002-03 to 2004-05. Statistical data for the years 2000-01 to 2004-05, wherever found necessary, has been included in the report.

### **3.4. Audit objectives**

**3.4.1** The objective of the limited study is to assess whether there were proper systems and adequate mechanisms for:

- ensuring effective discharge of functions by Regional Directors and RoCs under various sections of the Companies Act
- levy and collection of fees and penalties as prescribed under Companies Act and rules framed there under
- invoking penal provisions of the Act against the defaulters
- co-ordination with RBI, SEBI and other authorities for efficient discharge of responsibilities under Companies Act and
- effectiveness of internal controls.

### **3.5. Audit analysis**

**3.5.1** The following analysis was adopted in examining the records and arriving at audit conclusions: -

- extent of application, levy and collection of fees and fines at prescribed rates
- time series analysis of outstanding fees
- progress of investigation and prosecution proceedings in cases of violation of the provisions of the act by defaulting companies
- effectiveness of internal control system
- submission of returns
- defunct companies and demands outstanding
- efficacy of inspections
- extent of reliability of the computer system/data.

### **3.6. Audit Methodology**

#### **3.6.1 Entry conference**

Before taking up the performance audit of the system of levy and collection of fees by the Registrar of Companies, an entry conference was organised with the Joint Secretary, Ministry of Company Affairs. Audit objectives, audit criteria and scope of audit were explained and the suggestions as well as the perceptions of the Ministry relating to the strengths and weaknesses of the system were discussed.

#### **3.6.2 Agencies involved**

- (i) Ministry of Company Affairs, New Delhi.
- (ii) Four Regional Directorates at Mumbai, Kolkata, Chennai and Noida.
- (iii) Registrar of Companies in States and Union Territories of Delhi, Punjab, J&K, Uttar Pradesh, Meghalaya (Shillong), Bihar, Kolkata, Orissa, Goa, Rajasthan, Gujarat, Mumbai, Madhya Pradesh, Karnataka, Andhra Pradesh, Kerala, Tamil Nadu and Pondicherry.
- (iv) Pay & Accounts Offices at Mumbai, Kolkata, Chennai and New Delhi.

#### **3.6.3 Modalities of conducting audit**

There are 22 offices of Registrar of Companies in the states and Union Territories. The audit of fees levied and collected by RoCs was conducted by 17 designated audit offices i.e. State Accountants General and Principal Directors of Audit/ Director General of Audit, Central Revenues. Following modalities were followed to arrive at audit findings.

- (i) Analysis of the computerised data using computer aided audit techniques, interactive data extraction and analysis (IDEA 2001).
- (ii) Verification of document files of companies including banking/non-banking companies.
- (iii) Test check of cash book with reference to challans and daily cash reports.
- (iv) Cross check of challans with bank reconciliation statements.
- (v) Scrutiny of correspondence files.
- (vi) Scrutiny of annual administrative reports and monthly statistical statements.
- (vii) Scrutiny of document files relating to non-functional companies.
- (viii) Verification of records relating to issue of default notices and launching of prosecutions.
- (ix) Scrutiny of fee register relating to inspection of document files/certified copies.

### **3.6.4 Exit conference**

The audit findings were discussed with the Secretary and other senior officers of the Ministry in an exit conference held on the 19 September 2006. The Ministry appreciated the issues raised in the report and felt that these would help them in streamlining the systems especially as the Company Law and various aspects associated with it were currently under review. The Ministry was in broad agreement with the recommendations included in the report. Views of the Ministry as expressed in the meeting and additional replies given after the meeting have been appropriately reflected in the report.

### **3.7 Sampling**

Samples from records covering the period from 1 April 2002 to 31 March 2005 were test checked. The number of companies selected was based on their authorised capital, nature of company such as private, banking, finance, IT companies and other risk prone companies. All companies with authorised share capital of Rs. 500 crore and above have been covered in audit. The sample size of companies having authorized share capital of less than Rs. 500 crore was selected on random basis. Out of 679649 companies registered, as on 31.3.2005, physical files of 9407<sup>2</sup> companies were test checked manually. Statistical information in this report is based on electronic database made available to audit.

### **3.8. Audit findings**

#### **3.8.1 Major Sources of Revenue**

ROC collects fees from companies and public at the rates stipulated in the Companies Act. The main areas of revenue collection are fees and additional fees for

- a) registration of new companies,
- b) increase in authorised capital,
- c) filing/ registration of documents,
- d) inspection of document files by public and supply of certified copies of documents to the public,
- e) amounts credited to Investor Education and Protection Fund (amount of unpaid dividend, application money, matured deposits and debentures lying unclaimed for 7 years) and
- f) fines levied on companies for violation of Companies Act.

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<sup>2</sup> in respect of 16 RoCs

### 3.8.2 Trends of revenue collected

The trend of revenue realised during 2000-01 to 2004-05 is given below:

(Rs. in crore)

Table 1 : Receipts of RoC		
Year	Nature of Receipts from	
	Regulation of Joint Stock Companies	Unclaimed/unpaid dividend and deposits of Companies
2000-01	433.43	0.48
2001-02	304.38	34.67
2002-03	324.08	115.17
2003-04	401.44	106.15
2004-05	473.75	99.53

There is no system of either forecasting the revenue or fixing the target for collection of revenue. The department had also not formulated specific plans for maximising collection of fees from companies. Non-fixing of targets led to the Ministry not being able to assess the performance of the different Registrars of Companies in maximising the collection of revenue.

The Ministry stated (October 2006) that it was not a revenue earning ministry and that it was not possible to forecast the collection of revenue as payment of fee by companies depended upon various events and their business decisions. Ministry agreed to prepare revenue estimates based on past trends.

Even though the major portion of the fee paid by companies arise from incorporation of new companies and increase in authorised share capital, all live and working companies under the jurisdiction of each RoC have to pay fees at the prescribed rates along with their annual returns and balance sheets. The Ministry may consider framing targets for each RoC on the basis of these fees which are definite in nature.

### 3.8.3 System deficiencies in the maintenance of records and database of companies

Data of companies registered with various RoCs is stored by each ROC in a computer system developed by NIC. The data is stored in five directories i.e. Name<sup>3</sup>, Receipt<sup>4</sup>, Diary<sup>5</sup>, Dores<sup>6</sup> and Coins<sup>7</sup>. The software is used for confirming

<sup>3</sup> The said programme facilitates to verify the availability of name.

<sup>4</sup> Fee as per Schedule X of the Companies Act, 1956 is received under this programme.

<sup>5</sup> Every document received by RoCs is given a distinct number under this programme.

<sup>6</sup> Under this programme every document registered is given a ledgerisation number.

<sup>7</sup> This programme maintains master details of every company registered with this office.



the existence of a company in records, collection of fees and also for generating periodic returns and reports. Audit analysis of this data revealed the following deficiencies.

- (i) Information regarding change in share capital from time to time was neither stored nor updated in the database due to which fees recoverable on increase in the authorised share capital were not ascertainable.
- (ii) The database does not indicate the correct authorised share capital of several companies. It was found from the database that some companies had filed Form 5 with the necessary fees but the database had not been updated. Manual receipts issued when computers could not be operated due to power failure and other reasons, were also not found updated in some cases. The software could not generate exception reports of companies that have not filed Form 23 and Form 5 though there was increase in authorised share capital as reflected in the balance sheets and other returns.
- (iii) There were various discrepancies in the data maintained on the basis of actual receipt of revenue/documents and main database of the system.
- (iv) There was lack of inbuilt validation checks to maintain data integrity. This was displayed in some cases in which the information about events such as filing of return etc. was found entered incorrectly (for example year 1999 had been entered as 2999) but the fee and additional fee had been recovered in accordance with rules indicating manual calculations.
- (v) Through the edit facility provided to the computer cash counter the authorised capital of any company could be altered to any extent without generating corresponding cash receipt /or any other kind of receipt.
- (vi) Maintenance of documents and their filing was not systematic as exhibited by the facts that (i) all the documents were not found in the respective files, (ii) documents of certain companies were found filed in document files of other companies etc.

The Ministry while accepting audit observations stated (October 2006) that there were constraints in the computer system developed and supported by NIC and maintenance of records under manual system was extremely difficult on account of increased volume of work during peak filing season as well as general shortage of staff. It further stated that to address these systemic constraints MCA21 e-Governance Project was implemented by it from March 2006.

Since legacy data of the existing system is also intended to be utilised on the MCA 21 e-governance project, Ministry may like to conduct a thorough review of the integrity and reliability of data so as to ensure that the errors in the earlier system do not affect the new project.

### 3.8.4 Constraints in conducting the limited systems appraisal

The Ministry of Company Affairs is implementing an e-governance project known as MCA-21 program. The document files of the companies in almost all the RoCs were at various stages of scanning for being added to the database of this new programme. Consequently, a large number of documents required by audit were not found filed in the relevant document files.

### 3.9 Deficiencies in implementation of Companies Act

#### 3.9.1 Striking defunct companies off the register

Section 560 of the Act, empowers the RoCs to strike the defunct companies off the register in case he has a reasonable cause to believe that these were not carrying on business or were inoperative. If a company has defaulted in filing with the RoC its annual accounts and annual returns for three or more consecutive financial years, the company is to be declared as defunct company. However, test check of the database of RoCs at Orissa, Andhra Pradesh, Delhi, Haryana and West Bengal and the document files of RoC, Shillong revealed that despite non filing of annual returns and balance sheet by 93408 companies for three years or more, only 4098 companies were struck off during the period under coverage. The state wise details are given below:

<b>Table 2 : Companies did not file Annual return</b>			
<b>Sl. No.</b>	<b>Name of RoC</b>	<b>Number of companies which did not file Annual Return/Annual Accounts for 3 or more consecutive financial years</b>	<b>Prosecution launched</b>
1.	Madhya Pradesh	6543	1437
2.	Orissa	1,487	NA
3.	Hyderabad	18,272	NA
4.	West Bengal	26,047	399
5.	Shillong	86*	NA
6.	Kerala	3208	NA
7.	Delhi and Haryana	37765	NA
8.	Gujarat	14938	NA
	<b>Total</b>	<b>108346</b>	

\* Indicates the result of document files test checked manually.

The Ministry replied (October 2006) that striking off names of the companies from the register under Section 560 of the Act had several legal implications and the process took 6-9 months. It further stated that a company could be struck off the Register only if it had no assets and liabilities.

Ministry may vigorously pursue for striking off the name of defunct companies so that they no longer enjoy the benefit of limited liability and owning of assets. Timely action on the part of Ministry would safeguard the interest of stakeholders and avoid further exposure to these companies by the public.

### 3.10 Short/non-recovery of fees and fines

#### 3.10.1 Non-levy of fine due to non-holding/delay in holding of AGM

In terms of Section 166 of the Act, every company is required to hold an Annual General Meeting (AGM). Not more than 15 months shall elapse between the date of one AGM and that of the next, provided that a company may hold its first AGM within a period of not more than eighteen months from the date of its incorporation. Default in holding a meeting, is punishable with a fine under Section 168 which may extend to Rs. 50,000/- in the first case and in case of a continuing default with a further fine which could extend to Rs.2,500/- for every day during which the default continues. No minimum penalty is prescribed under the Act. Further the defaulting companies are to be prosecuted following the procedures as prescribed under Criminal Procedure Code. As per Section 468 of the Criminal Procedure Code, the ROC is required to file prosecution case within 6 months of the due date of failure to hold AGM.

Test check of computerised database and manual checking of document files in 5 RoCs for the period 2000-01 to 2004-05 revealed poor monitoring and control for timely detection of non-compliance with above provisions due to which 2353 companies had either delayed or not held AGMs as indicated below.

(Rs. in lakh)

Name of RoC	No. of cases where AGM not conducted	Number of cases where AGM delayed	Period of delay (yrs)	Fine leviable
Uttar Pradesh	27	--	1	43.50
Madhya Pradesh	165	-	1 to 3	1311.40
Orissa	1960*	18	1 to 9	131837.00
Meghalaya	56	--	1 to 10	4465.80
Delhi and Haryana	125	2	1 to 5	517.82
<b>Total</b>	<b>2333</b>	<b>20</b>	<b>-</b>	<b>138175.52</b>

\*Indicates the result of analysis of the computerised data

Thus, Rs.1381.76 crore was recoverable as fine from 2353 companies under Section 168 due to delay in holding or non-holding of AGMs on the basis of maximum fine of Rs.50,000 in first case and Rs.2500 for every day of default. This was not recovered. Only 58, 189, 98 and 13 prosecution cases were launched in respect of all the 22 RoCs during the years 2000-01, 2002-03, 2003-04 and 2004-05 respectively. In 2001-02 no prosecution was launched against any company for delay/non-holding of AGM.

In RoC, Orissa, test check revealed that despite a large number of companies failing to file “Notes on AGM” in support of holding AGMs, neither were show cause notices issued nor was any prosecution launched. The RoC also did not exercise the power of inspecting the records of these companies. In RoC, Delhi, there were 35001, 38743, 41666, 46689 and 57533 companies which had not filed annual returns and balance sheet during 2000-01 to 2004-05 respectively. It can be presumed that these companies had also not held their AGMs. The RoC did not furnish any data or notices issued by it to the defaulting companies during 2000-01 to 2004-05. No prosecution was either launched by it during this period. Besides the fee outstanding against these companies, fine at maximum prescribed rate mentioned above amounting to Rs. 287.66 crore is also leviable. Due to non-prosecution of defaulting companies within six months, the recovery has become time barred resulting in loss of Government revenue.

The Ministry stated (October 2006) that the loss of Rs. 1669.42 crore as computed by audit was based on the maximum fine leviable under law which might not have been levied by the courts. It also stated that RoCs did not have any power to levy any fine or impose penalty and recourse to filing prosecution was not found to be an effective remedy as besides the long time taken in disposal of cases, the fines imposed by the courts were far below the litigation costs. The Ministry added that the Vaish Committee constituted for looking into this aspect had observed that courts were not in a position to handle such a large number of cases and in a very large number of cases even first summons had not been issued by courts for years. The Ministry stated that these systemic problems would be addressed in the new law as Companies Act 1956 is under comprehensive revision.

Audit has pointed out several cases in which even show cause notices as prescribed under the Act have not been issued by the RoCs. Further, calculation of the loss on the basis of maximum prescribed penalty has been made in the absence of any minimum penalty in the Act and to highlight the impact on revenues. Ministry may take expeditious action to correct the systemic issues including carrying out revisions as required to the Companies Act and fixing appropriate minimum penalties to act as an effective deterrent to non complying companies.

### **3.10.2 Non-realisation of fees due to non-filing of Annual Returns**

As per Sections 159 and 160 of the Act, 1956 every company shall, within sixty days from the day on which Annual General Meeting (AGM) is held, prepare and file with RoC annual return in the prescribed format along with filing fee. Default to comply with these provisions, attract payment of additional fee @ one to nine times of normal filing fee and fine under Section 162 which may extend to five hundred rupees for every day during which default continues.

Test check of the computerised and manual records of 15 RoCs revealed that during 2000-01 to 2004-05, annual returns were not filed in 904709 cases which resulted in non collection of fee of Rs. 25.42 crore and additional fee of Rs.207.21 crore. Besides, fine upto Rs.500 per day of default was also leviable.

(Rs. in lakh)

<b>Table 4 : Non –realisation of fees</b>				
<b>Name of RoC</b>	<b>No. of cases in which annual return was not filed</b>	<b>Normal fee not collected</b>	<b>Additional fee leviable @ nine times of normal fee for average delay of 2 years</b>	<b>Number of prosecution cases filed for default</b>
Andhra Pradesh	18272	60.42	543.85	741
Bihar	21692	65.08**	585.72	688
Delhi & Haryana	220701	641.81	4105.28	583
Goa	3055	9.17**	82.53	1125
Gujarat	93134	279.40**	2514.60	NA
Kerala	24830	74.49**	670.41	6289
Madhya Pradesh	232*	0.35	2.30	NA
Maharashtra	195691	587.07**	5283.65	777
Meghalaya	534*	2.24	18.74	N.A
Orissa	7563	22.44	179.15	N.A
Punjab	47,939	143.82**	1261.85	N.A
Rajasthan	17640	33.54	254.63	N.A
Tamil Nadu	19280	57.84**	520.56	N.A
Uttar Pradesh	14*	0.04**	0.38	N.A
West Bengal	234132	564.64	4697.48	607
<b>Total</b>	<b>904709</b>	<b>2542.35</b>	<b>20721.13</b>	<b>10810</b>

\* Indicates result of cases test checked manually

\*\* As authorized capital of the company was not available, average normal filing fee of Rs.300/- was adopted for calculation.

Initiation of prosecution against defaulting companies in West Bengal, Maharashtra, Andhra Pradesh, Goa, Delhi and Haryana for which information was available, was very poor. As per records of the Ministry, prosecution launched by all the RoCs was 4170, 3460, 3657, 2626 and 3395 cases during the years 2000-01, 2001-02, 2002-03, 2003-04 and 2004-05 respectively which constituted about one per cent of the defaulting companies. Thus, the Ministry failed to perform its function of administering the Companies Act with consequent non realisation of revenue of Rs.232.63 crore.

The Ministry stated (October 2006) that filing fee and additional fees would be recovered as and when the companies in default come forward to file any document with the RoCs. Ministry should put in place a mechanism to ensure that notices are served in time on defaulting companies for recovery of revenue due to the Government. Ministry could also consider taking action to correct the systemic issues including carrying out revisions as required to the Companies Act.

### 3.10.3 Companies which availed of Company Law Settlement Scheme 2000 (CLSS) but failed to file annual returns later

Government of India launched a one time amnesty scheme namely CLSS in May 2000 for granting immunity to companies from prosecution for non filing of documents under the Act. Test check of the records of RoC, Orissa, Hyderabad and Tamil Nadu revealed that even after availing of this scheme, 3477 companies continued to default in filing their annual returns and balance sheets. Thus, lack of monitoring resulted in non-achievement of the objective of the Government to mainstream these companies despite foregoing substantial revenue of which, details relating to Rs.1.27 crore was only available (Table 5).

(Rs. in lakh)

<b>Table 5 : Revenue foregone</b>		
<b>RoC</b>	<b>No. of defaulting companies</b>	<b>Revenue foregone*</b>
Goa	24	0.89
Hyderabad	57	NA
Kerala	676	NA
Orissa	399	125.80
Punjab	2321	NA
<b>Total</b>	<b>3477</b>	<b>126.69</b>

\* The fee forgone has been calculated as the difference between the amounts of additional fee recoverable had the scheme not been introduced and additional fee actually recovered.

The Ministry replied (October 2006) that steps for identification of such companies had been initiated and it would now be possible to monitor such companies with the implementation of MCA 21 e-Governance project. Ministry may review the functioning of amnesty schemes in the light of experience gained so that the objective of providing amnesty to defaulting companies is achieved.

### 3.10.4 Non realisation of fee from foreign companies

RoC, Delhi is the registering office for foreign companies. Every foreign company is required to submit every year Form 52 indicating its place of business in India and file three copies of the balance sheet within 9 months from the close of financial year to RoC, Delhi under Sections 593 and 594 of the Act, 1956. Section 601 of the act prescribes fee of Rs.5000/- for registration of each document. In case of violation of the aforesaid provisions, a fine of Rs.10,000/- and in case of continuing offence additional fine of Rs.1000/- for every day during which the default continues, is leviable.

Analysis of the computerised database of RoC, Delhi revealed that out of 1840 foreign companies, 1400 companies had not filed their balance sheet and Form 52 for which minimum fee of Rs. 1.40 crore and additional fee of Rs.5.60 crore was recoverable. Test check of files of 121 foreign companies examined manually in audit revealed that balance sheets and form 52 were not filed in 401 cases resulting in non recovery of fee and additional fee of Rs.1.83 crore. The

department had issued default notices to only 10 companies' under section 594 till 31.3.2005. Prosecutions were launched during 2000-01 to 2004-05 against 3 defaulting companies. Further, no technical scrutiny under section 234 of the Act and inspection under section 209A of the Act had ever been conducted.

The Ministry stated (October 2006) that the fee and additional fee would be recovered from the defaulting companies as and when they come forward for filing documents. It further stated that a large number of foreign companies had closed their branch offices in India without informing RoC and identification of these companies was being taken up on priority. Under the circumstances, Ministry should consider instituting a suitable control mechanism to monitor discharge of dues by foreign companies.

### 3.10.5 Non realisation of fees due to non-filing of Balance Sheet and Profit & Loss Account

Test check of the records including computerised database of various RoCs revealed that a large number of companies had not filed annual returns and balance sheets during 2000-01 to 2004-05 as required under section 220(1) of the Act which resulted in non collection of fee of Rs.25.87 crore and additional fee of Rs.211.18 crore as detailed below. Besides, maximum fine @ Rs. 500/- per day was also recoverable from the defaulting companies.

(Rs. in lakh)

<b>Table 6 : Non realisation of fees</b>				
<b>Name of RoC</b>	<b>No. of cases where balance sheet and profit &amp; loss a/c were not filed</b>	<b>Fees (Normal)</b>	<b>Outstanding maximum additional fee leviable for average delay of 2 years</b>	<b>No. of cases where prosecution was launched</b>
Andhra Pradesh	18272	60.42	543.85	741
Bihar	22039	66.12#	595.08	688
Delhi and Haryana	220154	641.76	4098.75	566
Goa	3055	9.17#	82.53	1125
Gujarat	106821	320.46#	2884.14	NA
Kerala	23688	71.06#	639.54	6051
Madhya Pradesh	232*	0.35	2.30	NA
Maharashtra	196367	589.10#	5301.90	777
Meghalaya	570*	2.42	21.03	NA
Orissa	7256	21.52	171.63	NA
Punjab	47939	143.82#	1261.85	NA
Rajasthan	17640	33.55	254.69	NA
Tamil Nadu	19280	57.84#	520.56	NA
Uttar Pradesh	30*	0.09	0.81	NA
West Bengal	236234	569.70#	4739.65	607
<b>Total</b>	<b>919577</b>	<b>2587.38</b>	<b>21118.31</b>	<b>10555</b>

\* Indicates result of cases test checked manually.

# As authorized capital of company was not known, average normal filing fee has been taken @ Rs. 300/- per balance sheet

In RoC, Delhi and Haryana, Punjab and J&K manual scrutiny of 101, 147 and 73 document files revealed that fee and additional fee of Rs.32.51 lakh were not recovered in 321 cases of non filing of balance sheet. As per the records of the Ministry, prosecution for default was launched against 4218, 3552, 3709, 2531 and 3529 companies only during the years 2000-01, 2001-02, 2002-03, 2003-04 and 2004-05 respectively which constituted only 2 per cent of the total defaulting companies.

The Ministry stated that the filing fee and additional fees would be recovered as and when the companies came forward to file any document. Ministry may take proactive measures to recover the fee payable apart from invoking penal provisions of the Act.

### 3.10.6 Non recovery of fee of Rs. 17.85 crore payable on increase in authorized share capital

Under Sections 97, 192 and 611 of the Act, a company has to file with the RoC, a notice of increase in its share capital in Form 5 and for registration of special resolutions authorising increase in share capital in Form 23 alongwith fee/ additional fee at rates varying between Rs.100 to Rs.500 depending upon the authorised share capital of the company. The registrar based on Form 23 and Form 5, is required to make necessary alterations in the company's Memorandum or Articles or both. As per Section 97(3), for default in complying with this section, every company and its officer who is in default is punishable with fine, which may extend to Rs. 500 per day during which the default continues.

Test check of the records of RoC Andhra Pradesh, Shillong, Tamil Nadu, Rajasthan, Delhi and Haryana, Maharashtra, West Bengal and Bihar revealed that despite increase in share capital as reflected in the annual returns and balance sheets of various companies, no fees were collected till the date of audit as these companies did not file Form 5 or Form 23. Details are given below.

(Rs. in lakh)

<b>Table 7 : Non-recovery of fees</b>			
<b>ROC</b>	<b>No. of companies which did not file Form 5</b>	<b>No. of companies which filed only Form 5 and not Form 23</b>	<b>Amount of fee/ additional fee leviable</b>
Andhra Pradesh	14	7	111.48
Bihar	11	8	227.93
Delhi and Haryana	21	28	496.11
Kerala	7	7	36.90
Maharashtra	52	246**	317.04*
Madhya Pradesh	2	-	144.16
Meghalaya	5	-	77.17
Rajasthan	10	-	15.14
Tamil Nadu	3	-	85.47
West Bengal	43	-	62.50
<b>Total</b>	<b>168</b>	<b>296</b>	<b>1573.90</b>

\* the fee/additional fee is calculated on the basis of average filing fee @ Rs.300 and additional fee @ Rs.1200/-.

\*\* indicates result of analysis of records in computer system.



Thus, filing fee/additional fee amounting to Rs.15.74 crore was not realised by the RoCs for non-filing of Form 5 and 23. Besides, a fine of Rs. 500 per day of default for non-filing of Form 5 was also not levied in these cases.

Further, Section 611(2) of the Act provides for payment of additional fee for delayed filing of Form 5. The rates of additional fee prescribed for belated filing of Form 5 is 2 per cent and 2.5 per cent per month of the fees payable for delay upto one year or exceeding one year respectively.

Analysis of the computerised data base and records maintained in the office of RoC, Orissa, Tamil Nadu, Andhra Pradesh, Rajasthan, Gujarat, Karnataka and West Bengal for the period 2000-01 to 2004-05 revealed short recovery of additional fee of Rs.1.07 crore involving 2771 cases of belated submission of Form 5 for increase in authorised share capital as per details given below.

(Rs. in lakh)

<b>Table 8 : Short recovery of additional fees</b>			
<b>Sl. No.</b>	<b>Name of RoC</b>	<b>Number of cases of late submission of Form 5</b>	<b>Amount of additional fee short recovered</b>
1	Andhra Pradesh	868	12.43
2	Gujarat	22	0.38
3	Karnataka	205	5.00
4	Rajasthan	469	3.32
5	Tamil Nadu	273	23.76
6	Orissa	27	0.96
7	West Bengal	907	61.15
	<b>Total</b>	<b>2771</b>	<b>107.00</b>

Besides cases of short recovery mentioned above, in RoC Tamil Nadu, fee/additional fee amounting to Rs. 10.70 lakh was not collected in 35 cases for belated filing of Form 5.

The short recovery for belated filing of form 5 was due to deficiency in software developed by NIC. According to the rule provision, delay upto 12 months is chargeable with 2 per cent additional fee and once it exceeds 12 months, it should be at 2.5 per cent for all the months including the first 12 months. But the software developed by NIC calculates additional fee as 2 per cent per month for the first year and 2.5 per cent per month for the remaining period of delay in case of delayed submission of more than one year. The adoption of incorrect interpretation of government orders has led to an error in application software developed by NIC.

Following interesting cases were noticed in the States:

- M/s AP State Minorities Finance Corporation received the share application money of Rs. 32.8 crore from Government of Andhra Pradesh in 1999-2000 over and above its authorised share capital of Rs. 5 crore. The corporation continued to receive the share application money subsequently every year up to 2003. Total share application money of Rs. 67.45 crore was received by the company upto 2003 as reflected in the balance sheets. However, no resolution for increase of authorised share capital was passed and the prescribed fee paid. Failure of ROC to conduct proper technical scrutiny of the balance sheets resulted in non collection of Rs. 39.43 lakh as fee and additional fee.
- M/s Eldeco Housing and Industries Limited (Uttar Pradesh) increased its authorised share capital from Rs. 1 crore to Rs. 2 crore and paid registration fee amounting to Rs. 51,000. However, as per the schedule enclosed with the balance sheet as on 31 March 1995, the authorised share capital of the company was Rs. 7.50 crore which was again increased to Rs. 10 crore as reflected in Form 29 and Form 30 filed on 8 October 1997. Despite increase in share capital and non-filing of Form 5 and non-payment of fee, no action was taken by RoC under Section 97 of the Act. This resulted in short recovery of fee of Rs. 19.73 lakh apart from fine.
- M/s Sujana Industries Ltd (Andhra Pradesh) increased its authorised share capital from Rs.10 crore to Rs.50 crore during the year 1995-96 which was reduced to Rs.25 crore on 31.12.98. There was no recorded evidence in the docket files for payment of fee of Rs.15 lakh for the increase in authorised share capital from Rs.10 crore to Rs.50 crore in 1995-96.
- The authorised share capital of M/s Charminar Granites Exports Limited (Andhra Pradesh) was Rs. 13 crore in March 1992. Form 23 and 5 filed by the Company on 12 April 1999 indicate that the authorised share capital of the company was reduced from Rs. 20 crore to Rs. 13 crore as per resolution passed in the AGM held on 26 March 1999. However, no records reflecting increase of the authorised share capital from Rs. 13 crore to Rs. 20 crore in the period 1992 to 1999 was available in docket files and no fee has been received as verified from the records. Failure of RoC to monitor the increase in share capital of the company resulted in non-recovery of filing and additional fee amounting to Rs. 11.46 lakh for the period April 1998 to October 2005.
- M/s Stiles India Limited (Andhra Pradesh) with a share capital of Rs.15 crore increased its authorised share capital to Rs.25 crore on 27.09.1996. Though Form 23 containing special resolution was filed with RoC, Form 5 was not filed and no fee was paid. The authorised share capital of the company was further raised to Rs.35 crore on 31.01.2001. While fees at the prescribed rates on increase of share capital in January 2001 was paid, additional fee payable amounting to Rs.6.88 lakh for delay from September 1996 to September 2005 was not recovered.

- M/s Deewan Tyres Limited (Uttar Pradesh) initially registered with authorised share capital of Rs.1.5 crore, increased this to Rs.2 crore in February 1985, Rs.2.5 crore in March 1987, Rs.5 crore in July 1989, Rs.8 crore in July 1993 and Rs.60 crore in March 1994. The company had not filed Form 5 in respect of increase in share capital from Rs.5 crore to Rs.8 crore and no action had been taken by RoC. There was also delay of more than one year (16.03.94 to 31.05.96) in filing of Form 5 in respect of increase in authorised capital from Rs.8 crore to Rs.60 crore for which additional fee should have been charged at the rate of 2.5 per cent of the enhanced fee instead of 2 per cent as calculated by RoC which resulted in short recovery of additional fee of Rs. 1.22 lakh.

The non/short realisation of fees and additional fees as discussed above was facilitated due to the failure of RoCs to scrutinise various documents filed i.e. the annual return, balance sheet, form 23 etc.

The Ministry stated (October 2006) that it was aware of the problem and had put in place the necessary system of linking Form 5 and Form 23 in MCA database and generation of exception statements would identify the defaulting companies. It further stated that the RoCs were being directed to examine the cases pointed by audit and take appropriate action for recovery of the short recovered fee. Cases pointed out by audit are only indicative and Ministry should review other cases also where share capital has been increased to verify if the corresponding fees have been collected as specified under the Act.

Ministry may also examine the controls provided in the new system so that the shortfalls and risks associated with earlier software do not recur in the new system.

### **3.10.7 Short collection of additional fees for belated submission of documents**

Section 611(2) of the Act provides for payment of additional fee for delayed filing of documents other than Form 5. Additional fee at the rate of one to nine times of normal fee depending upon the period of delay in filing of documents is recoverable for delay in filing other documents viz. resolutions, annual returns and balance sheet, Form 18, 23 etc.

Analysis of the computerised database and records maintained in the office of RoC, Orissa, Tamil Nadu, Andhra Pradesh, Kerala and West Bengal for the period 2000-01 to 2004-05 revealed that due to incorrect application of rates of additional fees, there was short recovery of additional fee of Rs.127.91 lakh involving 18080 cases of belated submission of documents other than Form 5 (Table 9).

(Rs. in lakh)

Sl. No	Name of RoC	No. of cases of late submission	Amount of additional fee short recovered
1	Andhra Pradesh	7146	42.71
2	Kerala	1570	18.83
3	Tamil Nadu	5033	47.32
4	Orissa	247	1.89
5	West Bengal	4084	17.16
	<b>Total</b>	<b>18080</b>	<b>127.91</b>

The Ministry stated (October 2006) that RoCs had been directed to re-examine the cases specifically pointed out by audit.

### 3.10.8 Non levy of fees and fines for non-appointment of whole time company secretary and non-submission of compliance certificate

Section 383(A) of the Companies Act, 1956, provides for appointment of a whole-time Company Secretary by every company with paid up share capital of Rs.2 crore and above. Companies not required to employ a whole-time secretary are required to file a compliance certificate from a Secretary in whole-time practice certifying that company has complied with all the provisions of the Act. Under Section 383A(IA) of the Act every company in default is liable to fine which could extend to Rs. 500 for every day during which default continues.

Test check of the computerised and manual records of RoCs, West Bengal, Rajasthan, Delhi, Haryana and Orissa for the period 2000-01 to 2003-04 revealed non levy of fee and additional fee amounting to Rs. 2.03 crore and fine of Rs. 2.28 crore under Section 383A (1A) of the Act as indicated below:

(Rs. in lakh)

RoC	Number of companies which did not		Fine leviable for non-appointment of company secretary	Fees and additional fees leviable for not filing of compliance certificate
	appoint company secretary	file compliance certificate		
Bihar	5**	2**	27.38	0.30
Delhi and Haryana	18**	--	152.32	--
Madhya Pradesh	--	16	--	5.16
Orissa	8**	6**	48.20	0.35
Rajasthan	--	807*	--	89.31
West Bengal*	--	5120*	--	107.52
Total	31	5951	227.90	202.64

\* indicates result of the analysis of data available in computer system

\*\* indicates result of documents test checked manually

RoC, Orissa and Bihar had failed to monitor violations under Section 383(A) as data base of 3733 out of the total of 7105 companies as on 31.03.05 was incomplete. The database did not have any information regarding paid up capital of these companies. In respect of another 150 companies with paid up capital of Rs. 2 crore or above, information on appointment of a full time Secretary was not available in the database. RoCs, Delhi and Punjab stated that their system did not identify the companies having paid up capital of Rs. 2 crore and above nor was it possible to ascertain if a qualified company secretary was appointed or not. In the absence of such a mechanism, the department could not levy any fine against the defaulting companies as prescribed in the Act.

The Ministry replied (October 2006) that there had been problems in maintaining and updating correct database regarding paid up capital due to which the provisions of Section 238 of the Act could not be applied. The Ministry added that a revised form had been introduced and all the related information would be available in the database by March 2007 and once this database became available, this aspect can be monitored effectively.

Appointment of a company secretary is a requirement of the Act with a view to strengthening corporate governance and protecting the interests of stake holders. As this is a crucial control mechanism, Ministry needs to take urgent steps to ensure adequate monitoring.

### **3.10.9 Non recovery of fee and fine due to non-enhancement of paid up capital**

According to Sections 3(3) and 3(4) of the Companies Act, 1956, every private and public company existing on the date of commencement of the Companies (Amendment) Act, 2000, with a paid-up capital of less than one lakh rupees and less than five lakh rupees shall within a period of two years from such commencement, enhance its paid up capital to one lakh rupees and five lakh rupees respectively. The amendment came into force from 13.12.2000 and companies were to enhance their paid up capital before January 2003. Ministry in its circular No. 4/2002 dated 11.12.2002 had instructed the RoCs to prosecute companies which failed to comply with the provisions of the Act.

Test check of the computerised and manual records of RoCs, Delhi, and Orissa revealed that 934 companies had not complied with the above provisions.

<b>Table 11 : Non-recovery of fees</b>		
<b>Registrar of companies</b>	<b>Number of public companies with paid up capital of less than Rs. 5 lakh as on 31.3.2005</b>	<b>Number of private companies with paid up capital of less than Rs. 1 lakh as on 31.3.2005</b>
Delhi and Haryana	870	781
Orissa	64	71
<b>Total</b>	<b>934</b>	<b>852</b>

Thus, there was a potential loss of revenue due to non-filing of Form 5 by these companies. The amount of fee recoverable in these cases could not be assessed due to non-availability of information (in the database) regarding the authorised and paid up share capital of these companies. Besides, one time fine of Rs. 5000/- and further fine of Rs.500/- per day after the first day of default was also leviable under section 629A of the Act against the defaulter companies. No prosecution was launched against any of these companies by the RoCs during 2000-05.

The Ministry stated (October 2006) that most of the companies that had been test-checked were defunct companies which were not interested in continuing their business and those RoCs had been advised to take suo moto action against defaulting companies.

### **3.10.10 Cancellation of receipts – suspected fraud**

The Receipt and Payment Rules stipulate that all the cancelled receipts are to be authenticated by the head of office. Further, all the cancelled receipts alongwith the counterfoils/office copy should be kept in the office records in original. However, in the RoC, Maharashtra, cancelled receipts had not been preserved. The reasons for cancellation were not properly recorded in the RoCs, Maharashtra, and Delhi. RoC, Mumbai stated that proper records of cancelled receipts would be maintained in future. Due to non-preservation of cancelled receipts, it could not be verified in audit whether the revised entries in the records which were initially made such as increase of authorised capital etc. were subsequently reversed or cancelled. In RoC, Kolkata 52 cash receipts for levy of registration fee of Rs. 52.36 lakh and additional fee of Rs. 46.62 lakh towards increase in authorised capital were cancelled. In all these cases the increased authorised capital was not revised to its earlier limit after cancellation of cash receipts. Thus, the records of RoC indicated increased authorised share capital even though corresponding registration and fee payable on additional share capital had not been recovered. The failure of the RoC to revise the authorised share capital to earlier limit even though cash receipts of Rs. 98.98 lakh were cancelled is fraught with the risk of misappropriation of government revenues.

The Ministry stated (October 2006) that it had taken note of the seriousness of the issue and the risk involved in such cancellations as pointed out by audit. RoCs had been instructed to examine each case of cancellation of receipts in the old system. Ministry also informed that Cash Assistant in Kolkata who was involved in fraudulent cancellation of receipts had been given major penalty.

### **3.10.11 Non recovery of fees due to non-adherence to ceiling of minimum capital**

The guidelines issued by the Department of Company Affairs in March 1989 prescribe a ceiling of minimum capital for such companies which use key words

like 'Corporation', 'International', 'Globe', 'Asia' and 'Hindustan' etc. as part of their names. Analysis of the database revealed that 375 companies which were incorporated subsequent to the date of issue of the guidelines with these key words as part of their names had been registered by RoC, Kolkata with authorised capital less than the prescribed limit due to which the companies paid less registration fee. The registration fee recoverable as on April 2006 from these 375 companies on increase in capital to the required limit worked out to Rs. 271.38 lakh. Manual verification of 15 case files also revealed that in all 15 cases the authorised capital was less than the ceiling amount resulting in short payment of registration fee of Rs. 10.04 lakh.

The Ministry admitted (October 2006) the variations in adherence to its guidelines and different interpretations by various RoCs. It stated that the fee logic in the system would be suitably built in so as to give alerts at the time of incorporation of companies in such cases. It further stated that cases relating to RoC Kolkata would be investigated for appropriate action. Ministry may review all cases to ensure that revenues accruing to the government on this count are realised early.

### **3.10.12 Non transfer of liquidation amount to General Revenue Account**

According to Section 555(8) of the Companies Act, 1956, any money paid into the companies liquidation account and remaining unclaimed thereafter for a period of 15 years is to be transferred to the General Revenue Account of the Union Government. Test check of the records of RoCs, Orissa, Punjab and West Bengal revealed that unpaid amount of Rs. 36.49 lakh had not been credited to Government accounts even after the stipulated period of 15 years.

The Ministry stated that necessary action for transferring the unpaid amount in liquidation account to general revenue account was being initiated.

### **3.10.13 Compounding of fines**

According to Section 621A of the Companies Act, the Company Law Board is empowered to compound offences involving fines exceeding Rs. 50,000 per case. The compounding of offences involving fine of less than Rs. 50,000 per case is within the power of the Regional Director. Test check of 131 compounding cases considered by Company Law Board and 11 cases considered by Regional Director of Eastern Region, Kolkata for the years 2001-2002 to 2004-2005 revealed that in 80 per cent cases, fine imposed ranged between 0.01 to 14 per cent approximately of the maximum fines leviable under rules. In 88 out of 131 cases the fine imposed was below 1 per cent. It was also noticed that Regional Director Kolkata, adjudicated a case in November 2002 involving a maximum fine of Rs. 15.61 lakh which was not within his delegated powers.

The Ministry accepted (October 2006) that there was no provision for minimum penalty and fine under the Act and this shortcoming had been recognised and

addressing this weakness in the new Companies Bill was under its consideration. It further added that since the respective authorities decide the cases of compounding in their capacity as quasi judicial entities, the amount of fine levied by them could not be questioned. The Ministry further intimated that the case of acting beyond jurisdiction by the Regional Director Kolkata was being examined.

### **3.10.14 Functioning of NBFCs in violation of stipulated requirements**

Under sub-section (1) of Section 45-1A of the RBI Act, 1934 a Non-Banking Financial Company (NBFC) can carry on the business of a non-banking financial institution only after obtaining a certificate of registration from RBI and must have a minimum net owned fund (NOF)<sup>8</sup> of twenty five lakh rupees.

Test check of records of RoC Orissa, Meghalaya, Madhya Pradesh and Rajasthan revealed that 303 non banking financial companies were functioning without certificates of registration from RBI. No action was taken by RoC for bringing these to the notice of RBI for prosecution/winding up of these companies under Section 45 MC of RBI Act and imposition of penalties.

Further, Section 58A(2) (b) of Companies Act, 1956, provides that no company shall invite any deposit unless an advertisement including therein a statement showing the financial position of the company has been issued by the company. Copy of the said advertisement or statement in lieu thereof is also to be filed with the Registrar under Section 70 of Companies Act, 1956. Default in refund of deposits of investors is to be treated as cognisable offence under Section 58AAA of the Act. All these non-banking finance companies are to be registered with RBI after which they are to submit regular return and accounts to the RBI.

Test check of records of the RoC, Orissa revealed that three companies had accepted public deposits without complying with the provisions of Companies Act, 1956, and non-banking companies (RBI) directives, 1987. In case of one company despite the fact of accepting deposits being qualified by the Auditor of company in its Report attached to the balance sheet filed with the RoC, penal provisions under the Act were not invoked by the RoC by way of issuing show-cause notice under Section 234 and filing prosecution cases so as to prevent that NBFC from collecting public deposits in violation of the provisions of Companies Act/RBI directions. Consequently, after collecting deposits of Rs. 6.45 crore from public and after showing continuous losses, these companies stopped filing returns with the RoC after the year 1999-2000. The RoC neither issued any show-cause notice for violation of Sections 159, 166, 220 and 58A(2)(b) of the Act nor were proceedings for prosecution launched.

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<sup>8</sup> Net Owned Funds (NOFs) of NBFCs is the aggregate of paid up capital and fee reserves, noted by (i) the amount of accumulated balance of loss (ii) deferred revenue expenditure and other intangible assets, if any, and further reduced by investments in share of (a) subsidiaries, (b) companies in the same group and (c) other NBFCs and loans and advances to (a) subsidiaries and (b) companies in the same group in excess of 10 per cent of owned fund.



The Ministry stated (October 2006) that the RoCs had been submitting a list of companies registered with them to RBI on monthly basis along with industry code as derived from their primary objects and that it was for the RBI to check if such companies had registered themselves with the latter. However, Ministry agreed to work on the development of an appropriate system in consultation with RBI. In view of the seriousness of the matter wherein audit has pointed out the case of a company accepting deposits in violation of RBI directions, Ministry should urgently put in place a system to safeguard stake holder's interests.

### **3.10.15 Non initiation of prosecution against the companies which filed their documents late by paying additional fees**

According to the instructions issued by the Ministry of Company Affairs vide circular No. 31/19/69; the payment of additional fee for delay in filing of documents did not exonerate the companies from the offence of not filing the documents within the stipulated time as specified in the Companies Act, 1956. None of the RoCs had, however, initiated prosecution against the defaulting companies.

The Ministry in its reply stated (October 2006) that keeping in view the large increase in the number of companies it was not feasible to follow the instructions to prosecute the defaulter companies. It added that it took considerable time and efforts of a resource starved ROC office to initiate prosecution. On the other hand the fines imposed by the courts were far less than the costs involved in prosecution proceedings. Therefore, the RoCs had not been initiating prosecution cases in the cases where statutory documents had been filed by the companies along with the additional fees.

Ministry may consider this aspect and put in place a suitable deterrent mechanism for non compliance if necessary by appropriately revising the Act.

### **3.11 Investor Education and Protection Fund (IEPF)**

As per Section 205C introduced as an amendment to the Companies Act, 1956 effective from October 1998, Investor Education and Protection Fund were to be set up for promotion of investor awareness and protecting the interest of small investors. Dividend, share application money, matured deposits etc. lying unclaimed/unpaid for 7 years with the companies were to be credited to this fund. Rules governing IEPF were issued vide Ministry of Law Justice & Company Affairs notification in October 2001. According to these rules, the unclaimed/unpaid amounts received were to be accounted initially under the Major Head-0075-Miscellaneous Services and thereafter transferred to the fund. All expenditure for the purpose of carrying out the objectives for which the fund was established was to be incurred under the functional expenditure head of the department and equivalent amount was to be shown as deduct entry by transfer of amount from the fund. Against total credit of Rs. 320.85 crore afforded under the

Major Head - 0075- Miscellaneous during the years 2002-03 to 2004-05 on account of unpaid dividend etc, Rs. 6.38 crore was spent by the Ministry for the education and protection of small investors during this period.

Test check of the records of the Ministry and RoCs revealed that no separate fund had been created as envisaged. The unclaimed amounts were being credited to the Consolidated Fund of India under the major head 0075 and the expenditure incurred on the objective of the funds was being met through normal budgetary procedures i.e. through demand for grants.

The Ministry replied (October 2006) that the current accounting procedure had been approved by the CGA and the Ministry of Finance. It added that the matter of reflecting the credit to the fund under Public Account as an interest bearing deposit was being taken up with the Ministry of Finance.

Further, as per the IEPF rules, all companies were required to furnish to RoCs annually a statement of amounts credited to the IEPF in Form 1 certified by a chartered accountant or the company secretary. It was seen in audit that Form 1 prescribed under the rules did not have provision for supply of information regarding the dates on which the unclaimed amounts fell due for transfer to the government account. In the absence of this information the RoCs were not in a position to assess or determine the delays made by the companies in the transfer of these funds. It was also seen that there was no system or mechanism in place in the RoCs for identifying such companies which did not either file Form 1 or transfer the unclaimed/unpaid dividend amounts etc. to unpaid dividend account and government account after the expiry of 30 days and 7 years respectively. Due to this, the RoCs did not have any control over the remittances of unclaimed amounts to the Government revenues by the companies. The possibility of these amounts having been retained by some companies can not, therefore, be ruled out. It was noticed in RoCs Delhi and Mumbai that an amount of Rs. 15.13 crore involving 460 cases was credited to government account during April 2004 to December 2005 after delays of 2 months to 388 months from the date they became due for payment. There is no provision under Section 205C of the Companies Act, 1956, for levy of penalty when delayed credit is made to IEPF. This section is required to be amended to incorporate provisions for charging of interest and penalty for delayed credit of specified amounts to government account.

The Ministry further stated that adequate measures such as certificate of CA/CS in Form I and inclusion of Balance Sheet item under the head 'liability' had been put in place as a safeguard against the possibility of retaining unpaid dividend amount. However, in Form 1 the CAs/CS are required to certify only the sums being transferred into the unpaid dividend account / IEPF. As this does not indicate whether all sums transferable have been credited into the relevant account, Ministry may put in place a mechanism to ensure the correctness and

completeness of transfers into the unpaid dividend account / IEPF apart from strengthening the deterrent provisions to safeguard against the delays in transfers.

### **3.11.1 Non/short credit of unpaid dividend etc.**

Under Section 205 A of the Companies Act, 1956, read with Rule 3 of IEPF Rules, any unpaid/unclaimed dividend is to be transferred to a special account called “unpaid dividend account” by the company within 30 days from the declaration of the dividend. The amount in the unpaid dividend account of the company and unpaid matured deposits, share application money received by the company and lying unclaimed/unpaid for 7 years from the date of their becoming due for refund along with interest accrued thereon were to be transferred to the Fund within 30 days of their becoming due for transfer to IEPF. In case of default, the company was to pay interest @ 12% p.a. and fine upto Rs. 5000/- for every day during which the default continued. Test check of records of various RoCs revealed following interesting points:

- In Madhya Pradesh, 100 companies had not opened unpaid dividend account in the designated scheduled bank. The companies deposited the unpaid dividend of Rs. 6.07 crore lying unclaimed for more than seven years direct to the government account for which they were liable to pay interest of Rs. 4.65 crore and penalty of Rs. 14.15 crore.
- In RoCs, Delhi, Rajasthan and Orissa, Rs. 58.35 lakh lying unpaid for 7 years had not been credited to the government account by the defaulter companies for which interest of Rs. 39.98 lakh and fine of Rs. 1.60 crore were recoverable.
- Scrutiny of records of RoCs, Delhi and Mumbai revealed that Rs. 28.43 crore in 819 cases pertaining to the period April 2004 to December 2004 was kept under a non interest bearing account with the bank. Had this amount been retained under interest bearing head with a bank, a minimum amount of Rs.11.94 crore could have been earned by way of interest at the rate of six per cent approximately.

The Ministry stated (October 2006) that RoCs were being advised to look into the delays in depositing the unpaid amounts to the fund and recover the interest wherever payable. The Ministry added that specific cases mentioned by audit would be taken up for examination and appropriate action.

### **3.11.2 Reconciliation of receipts**

The credits relating to unpaid dividends etc. were to be reconciled at two levels i.e. at the level of ROC who was to reconcile the figures of remittances with the concerned Pay & Accounts Office (PAO) on monthly basis and furnish an

abstract of such receipts received during the month to the Ministry. The latter was to prepare a consolidated abstract of receipts and reconcile the credits on quarterly basis with the figures of the Principal Pay & Accounts Office. Test check of records of RoCs, Delhi, Punjab, Orissa, Uttar Pradesh, West Bengal and Andhra Pradesh revealed that reconciliation was not conducted at any stage by the RoCs. The Ministry had also failed to conduct the reconciliation despite the variation of Rs.16.12 crore during the years 2002-03 to 2004-05 between the figures of credits as per the Ministry's records and the records of the Principal PAO. Ministry had also not maintained the consolidated abstract of receipts required to be prepared on quarterly basis. In absence of such reconciliation, the amounts purportedly deposited by companies in the government account could not be verified.

The Ministry agreed to take up reconciliation of these accounts with PAOs and Chief Controller of Accounts (October 2006).

### 3.12 Internal controls

In the background of very large number of companies being handled by the RoCs and the complexities of company law in respect of the need for filing of various forms and returns and levy of penalties for non-compliance with the provisions of Companies Act, a sound system of internal control including prescribing and preparation of various MIS reports for monitoring and review of records of each company was necessary. Some of the weaknesses and inadequacies of internal control are discussed in the following paragraphs.

#### 3.12.1 Inspection

In order to ensure compliance of the registered companies with the provisions of Companies Act, 1956, Section 209A (1) of this Act provides for the inspection of books of accounts and other papers of the companies by the Registrar of Companies or any officer of Government on its behalf and the person making an inspection has been vested with the power of a civil court. The year wise position of inspections carried out during 2000-01 to 2004-05 is given below.

<b>Year</b>	<b>No. of functioning companies</b>	<b>No. of companies actually inspected</b>	<b>Percentage</b>
2000-01	569100	221	0.04
2001-02	589246	244	0.04
2002-03	612155	150	0.02
2003-04	641512	109	0.02
2004-05	679649	181	0.03

The percentage of inspections actually carried out was thus insignificant which resulted in non-identification of various defaulter companies.

The Ministry stated (October 2006) that inspection under Section 209A could not and should not be taken up as a matter of routine. It added that very high number of inspections could also become counter-productive in the growth of corporate sector. The inspections were done by the Inspection Wing attached to the office of the Regional Directorate and thus due to the paucity of the staff, the Ministry was able to carry out only a limited number of inspections in a year.

Ministry, however stated that it would strengthen the inspection wing in each of the Regional Directorate. Ministry could also consider developing and adopting a scientific methodology for identifying companies for inspection based on an analysis of risk prone sectors.

### 3.12.2 Technical scrutiny

Every ROC is required to conduct technical scrutiny of annual return and balance sheet and other documents filed by the companies for ensuring that the companies complied with the provisions of the Companies Act, 1956. In case of any violation noticed, the ROC is required to issue show-cause notice and take penal action against defaulter companies.

Test check of records for the years 2002-03 to 2004-05 of ROC West Bengal, Goa, Andhra Pradesh and Delhi revealed that against 392066 annual accounts received, technical scrutiny was done in 4369 cases only which constituted barely one per cent of the number of annual accounts received as indicated below :

<b>Sl. No.</b>	<b>RoC</b>	<b>No. of annual accounts received</b>	<b>Technical scrutiny conducted</b>	<b>Percentage coverage</b>
1.	Andhra Pradesh	44485	160	0.36
2.	Delhi and Haryana	207648	207	0.10
3.	Goa	6085	120	2.36
4.	West Bengal	133848	3882	2.90
	<b>Total</b>	<b>392066</b>	<b>4369</b>	<b>1.12</b>

Ministry stated (October 2006) that the technical scrutiny of the desired number of companies had not been taken up due to fact that the registry function in the RoC offices took most of the time of the limited number of officers. Ministry had started the MCA 21 project and electronic filing of documents and registration for stronger enforcement mechanism.

### **3.12.3 Non-correlation and co-ordination of activities**

A joint mechanism between SEBI and Ministry of Company Affairs was envisaged in the Finance Minister's Budget speech on 27 February 1999 for taking stringent action against unscrupulous promoters who raised money from investors and misused them. Accordingly, a Central Co-ordination and Monitoring Committee (CMC) co-chaired by Secretary, Ministry of Company Affairs and Chairman, SEBI was set up. The CMC is assisted by four task forces, one each corresponding to a region falling under the jurisdiction of the Regional Director of the Ministry of Company Affairs. The main responsibility of these task forces was to identify the companies which have disappeared; or which have misutilised funds mobilised from investors and suggest appropriate action in terms of Companies or SEBI Act. It was noticed that only 16 meetings of CMC were held till 05.01.2006 in which 114 vanishing companies, had been identified.

It was further seen in audit that no institutional mechanism for correlation/coordination of activities, information and data with statutory bodies such as SEBI, RBI etc. was in place in RoCs, Orissa, Goa, Hyderabad and Maharashtra. 303 companies were found working as NBFC in RoCs, Shillong, Orissa and Rajasthan without registration with RBI. RoCs did not have separate database, based on principal business of companies such as NBFCs, banks, insurance etc. As per the computerised data provided by ROC Delhi, 1274 non-banking companies were registered with it as on January 2006 whereas data provided by RBI indicated that 2438 non-banking financial companies were at work. Thus, the ROC had failed to identify the companies which were working as NBFCs without registration with RBI and the foreign companies though registered with RBI were not registered with RoC, Delhi.

Ministry stated that it has been decided to make it mandatory for RoCs to scrutinize 100 percent of the balance sheets of companies that have gone into public issues to monitor the end-use of funds and deployment thereof. Ministry further stated that there was proper coordination between various agencies. However, mismatches between the figures provided by RBI vis-à-vis that provided by RoCs indicates the need for improved co-ordination.

### **3.12.4 Non reconciliation of receipts with Pay & Accounts Office**

RoCs received fees in cash and by demand draft or cheque over the counters which were deposited in the designated branches of Punjab National Bank. As per the provisions of the General Financial Rules, reconciliation of receipts remitted to banks was to be carried out at the end of every month and differences, if any, between figures remitted and actual credit to government account was to be reconciled with the bank as well as with PAO.

It was noticed in audit that despite variation between the amount deposited by RoCs and amount credited to Government account as per the records of PAO,

reconciliation had not been conducted by RoCs at Delhi and Haryana, West Bengal, Maharashtra, Uttar Pradesh, Andhra Pradesh, Goa and Punjab. RoC, Mumbai had also not reconciled the variation of Rs. 4.69 crore for the years 2000-01 to 2004-05 between its records and the accounts of PAO. Reconciliation was also not done by the Ministry despite variation of Rs.73.87 crore during 2002-03 to 2004-05 between the figures of receipts of fee as per Ministry's records and records of Principal Pay and Accounts office. The absence of such reconciliation is fraught with the risk of the revenues received by RoCs not being properly accounted. There is also the risk of misappropriation of public funds.

The Ministry has stated (October 2006) that necessary steps would be taken to reconcile the receipts with respective PAOs.

### **3.12.5 Internal audit**

The internal audit of the RoCs is conducted by Principal Pay & Accounts Office of the Ministry of Company Affairs. It was seen that in internal audit of 15 units which include the offices of two Regional Directors and 13 RoCs, 386 paras were raised, which have been pending for 4 years.

The Ministry replied (October 2006) that the field offices had been directed to get the audit paras settled expeditiously

### **3.13 Conclusion**

The Ministry had failed to perform its primary function of administering the Companies Act, 1956, especially in the area of identification of defaulting companies and launching prosecutions against them. Despite large number of defaulting companies, inspection under Section 209A was conducted by RoCs in only 0.03 per cent cases. This resulted in non identification of defaulter companies and non levy of fees amounting to Rs.517.96 crore. Reconciliation of fees recovered and credited to government accounts as per the records of RoCs was not conducted. The database of Registrar of Companies was not reliable as it had not been updated. Planning of maximising the revenue was found deficient as out of 391066 annual accounts received in four RoCs during 2002-03, 2003-04 and 2004-05, only 4369 accounts were subjected to technical scrutiny due to which the defaulter companies were not identified. There was very little co-ordination between the Ministry and statutory bodies such as SEBI, stock exchange and RBI.

The Ministry in its reply stated (October 2006) that there have been deficiencies, largely systemic, which had been duly recognised and addressed by launching the MCA 21 e-governance project and considering revision of Company Law.

## Recommendations

- Data base of all the companies should be complete and reliable. It should match with the receipt data base.
- The department should evolve proper system for identification of defaulter companies, monitoring the recovery of outstanding fees and additional fees from defaulting companies to maximise the realisation of revenue.
- More attention should be given to the technical scrutiny of all the documents and returns filed by the companies. It will facilitate early recovery of fees from defaulter companies.
- The percentage of regular inspection of companies should be increased to ensure effective compliance of the Act by companies.
- The limitations faced by the Department in pursuing prosecution cases in the courts of law should be suitably addressed in the Companies Act which is under revision.
- Special emphasis should be given to strengthen the mechanism of prosecution which include issuing of show cause notices to the defaulting companies and pursuing prosecution cases.
- Immediate attention should be given to reconciliation of figures of revenue collected depicted in the books of the banks and PAOs.
- Minimum limit of penalty leviable per day for continued default under Sections 162, 168, 220(3) and 383(A) of the Act may be prescribed.
- Presently, additional fee for delay over two years is fixed at nine times of the normal fee irrespective of the years of default. Additional fee in proportion to the delays involved beyond two years should be prescribed for discouraging wilful default by companies.
- To protect the interest of investors, coordination between ROC, Ministry and statutory bodies such as SEBI, RBI and Stock Exchange may be strengthened.
- Internal control systems and internal audit need to be strengthened.