

**49**

**STANDING COMMITTEE  
ON FINANCE  
(2006-2007)**

**FOURTEENTH LOK SABHA**

**MINISTRY OF COMPANY AFFAIRS**

**DEMANDS FOR GRANTS  
(2006-07)**

*[Action Taken by the Government on the recommendations contained in the  
Fortieth Report of the Standing Committee on Finance on Demands for  
Grants (2006-07) of the Ministry of Company Affairs]*

**FORTY-NINTH REPORT**



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**LOK SABHA SECRETARIAT  
NEW DELHI**

*December, 2006 / Agrahayana, 1928 (Saka)*

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STANDING COMMITTEE ON FINANCE  
(2006-2007)

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(2006-07)

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*Presented to Lok Sabha on 14.12.2006*

*Laid in Rajya Sabha on 14.12.2006*



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NEW DELHI

*December, 2006/Agrahayana, 1928 (Saka)*

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COMPOSITION OF STANDING COMMITTEE ON  
FINANCE (2006-2007)

Maj. Gen. (Retd.) B.C. Khanduri — *Chairman*

MEMBERS

*Lok Sabha*

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri Shyama Charan Gupta
5. Shri Vijoy Krishna
6. Shri A. Krishnaswamy
7. Dr. Rajesh Kumar Mishra
8. Shri Bhartruhari Mahtab
9. Shri Madhusudan Mistry
10. Shri Rupchand Pal
11. Shri Prakash Paranjpe
- \*12. Shri P.S. Gadhavi
13. Shri R. Prabhu
14. Shri K.S. Rao
15. Shri Magunta Sreenivasulu Reddy
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17. Shri Lakshman Seth
18. Shri A.R. Shaheen
19. Shri G.M. Siddeshwara
20. Shri M.A. Kharabela Swain
21. Shri Bhal Chand Yadav

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\*Nominated to this Committee *w.e.f.* 31.8.2006 *vice* Shri Raosaheb Danve Patil.

*Rajya Sabha*

22. Shri Santosh Bagrodia
23. Shri Raashid Alvi
24. Shri M. Venkaiah Naidu
25. Shri Yashwant Sinha
26. Shri Mahendra Mohan
27. Shri Chittabrata Majumdar
28. Shri S.P.M. Syed Khan
29. Shri Mangani Lal Mandal
30. Shri C. Ramachandraiah
31. Vacant

SECRETARIAT

- |                           |   |                             |
|---------------------------|---|-----------------------------|
| 1. Dr. (Smt.) P.K. Sandhu | — | <i>Additional Secretary</i> |
| 2. Shri A. Mukhopadhyay   | — | <i>Joint Secretary</i>      |
| 3. Shri S.B. Arora        | — | <i>Deputy Secretary</i>     |
| 4. Smt. Anita B. Panda    | — | <i>Under Secretary</i>      |

## INTRODUCTION

I, Chairman of the Standing Committee on Finance (2006-2007) having been authorized by the Committee to submit the Report on their behalf present this Forty-Ninth Report on action taken by Government on the recommendations contained in the Fortieth Report of the Committee (Fourteenth Lok Sabha) on Demands for Grants (2006-2007) of the Ministry of Company Affairs.

2. The Report was presented to Lok Sabha/laid in Rajya Sabha on 22 May, 2006. The Government furnished the written replies indicating action taken on all the recommendations on 29 August, 2006. The draft action taken report was considered and adopted by the Committee at their sitting held on 11 December, 2006.

3. An analysis of action taken by Government on the recommendations contained in the Fourth Report (Fourteenth Lok Sabha) of the Committee is given in the Appendix.

4. For facility of reference observations/recommendations of the Committee have been printed in thick type in the body of the Report.

NEW DELHI;  
11 December, 2006  
20 Agrahayana, 1928 (Saka)

MAJ. GEN. (RETD.) B.C. KHANDURI,  
*Chairman,*  
*Standing Committee on Finance.*

## CHAPTER I

### REPORT

1. This Report of the Standing Committee on Finance deals with action taken by Government on the recommendations contained in their Fortieth Report (Fourteenth Lok Sabha) on Demands for Grants (2006-2007) of the Ministry of Company Affairs, which was presented to Lok Sabha/laid in Rajya Sabha on 22 May 2006.

2. The Report contained fifteen recommendations. Action taken notes have been received from the Government in respect of all the recommendations contained in the Report. These have been analysed and categorized as follows:

- (i) Recommendations/observations that have been accepted by the Government:

Recommendation Sl. Nos. 1 (Para No. 21), 2 (Para No. 22), 3 (Para No. 23), 4 (Para No. 32), 5 (Para No. 33), 6 (Para No. 34), 7 (Para No. 48), 9 (Para No. 50), 11 (Para No. 52), 12 (Para No. 53) and 13 (Para Nos. 65-66)

(Total 11)

(Chapter II)

- (ii) Recommendations/observations which the Committee do not desire to pursue in view of Government's replies:

Recommendation Sl. Nos. 8 (Para No. 49), 14 (Para No. 67)

(Total 2)

(Chapter III)

- (iii) Recommendations/observations in respect of which replies of Government have not been accepted by the Committee:

Recommendation Sl. Nos. 10 (Para No. 51), 15 (Para No. 80)

(Total 2)

(Chapter IV)

- (iv) Recommendations/observations in respect of which final reply of the Government is still awaited:

Nil

(Chapter V)



3. The Committee will now deal with action taken by the Government on some of their recommendations.

#### VANISHING COMPANIES

##### **Recommendation (Sl. No. 10, Para No. 51)**

4. The Committee found that the definition of vanishing companies was ambiguous thereby leaving loopholes in the law. From the information furnished to them, they noted that one of the criteria, which stated that 'no correspondence had been received by the Exchange from the company for a long time', was interpreted by the Task Forces concerned to imply a period between 2 to 3 years of absence of correspondence between the exchange and the company. The Committee felt that any company which had duped its investors, could continue to operate and avoid being classified as 'vanishing' just by sending a piece of correspondence, at intervals of 2-3 years. They, therefore, felt that the criteria for identifying a company as vanished/vanishing needed streamlining and called upon the Government to have a re-look at the definition, so that all such companies, having the slightest intention of duping investors of their hard earned money, could be classified as 'vanishing or potentially vanishing companies'.

5. The Government in their action taken reply have stated as under:

"The issue of a clearer definition of a Vanishing Company and the criteria for identifying a company as vanished/vanishing was placed before the Coordination and Monitoring Committee (CMC) in its meeting held on 26.07.2006. The Committee decided to amend one of the criteria by substituting the words '*for a long time*' with '*a period of two years*' for identifying the company as a vanishing company. This would take care of the said ambiguity.

The criteria for identifying a company as vanished now stands revised as under:

- (i) Companies, which have not complied with listing requirements/filing requirements of Stock Exchange/ROC respectively for a period of 2 years;
- (ii) No correspondence has been received by the Exchange from the company for a period of two years; and
- (iii) No office of the company is located at the mentioned registered office address at the time of Stock Exchange inspection.

All the conditions laid down have to be met for treating a company as vanishing and companies satisfying one or more but not all conditions are not to be considered as vanishing.”

6. The Committee note that their recommendation pointing out the ambiguity in the definition of a vanishing company has been partially considered by the Government and they had in their reply stated that revised criteria under which all the following three conditions are required to be met for treating a company as ‘vanished’:—

- (i) Companies, which have not complied with listing requirements/filing requirements of Stock Exchanges/ROCs respectively for a period of 2 years;
- (ii) No correspondence has been received by the Exchange from the company for a period of two years; and
- (iii) No office of the company is located at the mentioned registered office address at the time of Stock Exchange inspection.

7. However, the Committee regret to point out that their central concern has not yet been addressed adequately. The Committee find no substantial change in the revised criteria except that the words ‘for a long time’ under (ii) above have been substituted with the words for ‘a period of 2 years’. In their view, a company which satisfies the first and the third condition, and is actually vanished, can manage to fool the system and avoid being classified as vanishing, just by sending a piece of correspondence at intervals of two years.

8. The Committee, therefore, feel that if any company fails to satisfy any one of the three conditions, then it should be treated as a ‘vanishing’ company. They recommend that the Government should revise the criteria accordingly for identifying a company as ‘vanished’.

#### LIQUIDATION OF COMPANIES

##### Recommendation (Sl. No. 15, Para No. 80)

9. The Committee noted that the J.J. Irani Committee had already taken up the issue of exit or liquidation of companies in detail in view of the inordinate delays and lengthy procedure for companies to exit. The Committee also noted from the reply of the Government referring to the observation in a World Bank Report that the time

taken for a companies to exit was between 2—3 years in China, Malaysia and Thailand whereas it was about 10 years in India. They further noted that the Government had attributed this delay to the lengthy nature of judicial process. The Committee were of the view that it was essential to provide a sound framework for winding up and liquidation of companies. In this connection, the Committee recommended that in the extant legal provisions, the Government should strive to work in such a time-bound manner that, excluding the time taken for obtaining the approval of the High Court, all other formalities could be completed with a period of 2-3 years. Moreover, the Committee hoped that efforts by the Government to get the NCLT Second Amendment Act, 2002 passed at the earliest in their favour by the Supreme Court, would pave way for its establishment ultimately. This, the Committee hoped would help in reducing time for getting required judicial approval for exit of companies. Overall, the Committee opined that simplifying the existing liquidation process and speeding up the winding up of sick companies having no chance of revival would be steps in the right direction. Besides, the modified framework should seek to preserve the estate and maximize the value of assets of the existing company so that those could be redeployed suitably.

10. The Government in their action taken reply have stated as under:

“With a view to deal with some of the issues arising out of reconstruction/liquidation/winding up, the Companies Act, 1956 was amended through Companies (Amendment) Act, 2002 and the consequential establishment of the National Company Law Tribunal and National Company Law Appellate Tribunal. It was also provided that the functions of rehabilitation of companies (at present done by BIFR and AAIFR) and liquidation/winding up of companies (which is being done by High Courts) would be brought under the purview of the National Company Law Tribunal and National Company Law Appellate Tribunal. Sick Industrial Companies (Special Provisions) Act, 1985 is to be repealed. However, due to legal challenge, which is now with Hon’ble Supreme Court, the National Company Law Tribunal and National Company Law Appellate Tribunal could not be established. The new provisions also could not be notified.

The Ministry of Company Affairs is taking note of the observation of Committee for speedy conduct of winding up process and enabling the maximization of the value of assets under liquidation.

The entire framework relating to rehabilitation/liquidation/winding up is being revised as a part of the exercise of reviewing the Companies Act.

A revised comprehensive Bill which, *inter-alia* will address this problem is under preparation and will be introduced in Parliament after due approval.”

11. The Committee had in their recommendation desired that the Ministry of Company Affairs should in the extant legal provisions, strive to work in such a time bound manner so that, excluding the time taken for obtaining the approval of the High Court, all other formalities in respect of exit or liquidation of companies are completed within a period of 2-3 years. The Committee had also hoped that efforts by Government to get the NCLT Second Amendment Act, 2002 passed, at the earliest, in their favour by the Supreme Court, would pave way for its establishment ultimately.

12. The Committee are however dismayed to note that the Ministry have not given a convincing reply indicating a road-map for completing formalities regarding exit of companies in a time-bound manner. The Government have merely stated that they are taking note of the observation of the Committee for speedy conduct of winding up process and enabling the maximization of the value of assets under liquidation. The Committee also find that the reply is silent on the efforts made by the Government to get the judgment in the court case delivered early with regard to the setting up of NCLT and NCLAT under Companies (Second Amendment) Act, 2002. The Committee, therefore, recommend that the Government should make vigorous efforts to see that the court case in regard to the setting up of NCLT and NCLAT, which is pending before the Hon'ble Supreme Court is decided expeditiously and adequate provisions are made under the relevant provisions of the NCLT Act so that the liquidation of a company is completed within a period of 2-3 years.

## CHAPTER II

### RECOMMENDATIONS/OBSERVATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

#### **Recommendation (Sl. No. 1, Para No. 21)**

It is widely known that the Companies Act, in its present form, is quite unwieldy and complicated. In this connection, reducing the number of sections/provisions alone will not help in simplifying, rationalizing and modernizing the law. What is needed is that the new law must provide a flexible framework for proper growth of companies, have dynamic orientation and take into account the new developments that have taken place in the corporate world. The Committee recall in this regard, their earlier recommendation as contained in the 5th Report on Demands for Grants (2004-05) wherein they have urged the Government to expedite the matter relating the comprehensive Review of the Companies Act, 1956. From the response of the Government, they gather the impression that the Competition Bill amending provisions of Companies Act may be Tabled on the floor of the House shortly. They expect that this long awaited piece of legislation will soon see that light of the day and many provisions of the Companies Act needing reforms, as per the requirements of modern day corporate governance practices as well as investors protection, may be amended suitably. The Committee would also find it equally necessary to ensure the use of simple and understandable language as compared to the existing complicated structure of provisions, explanations and multiple cross references in the Companies Act. Moreover, Company law should not be viewed in isolation and must be in harmony with other economic legislations. In this connection, the Committee note that the Expert Committee to advise the Government of new Company Law, under the Chairmanship of Shri J.J. Irani, have already submitted their Report on 31st May, 2005 and subsequently the Government is in the process of consultation and approval on the recommendations of the same.

#### **Reply of the Government**

A fresh comprehensive draft Companies Bill, 2006 is being drafted. Once the Draft Bill is ready, it would be introduced in the Parliament after obtaining the requisite approvals.

### **Recommendation (Sl. No. 2, Para No. 22)**

In the course of examination of Budget Proposals for the year 2006-07, another issue concerning Independent Directors of Companies came up before the Committee. As the existing Companies Act is silent on this issue, the Committee note that this requirement was prescribed by SEBI (Securities and Exchange Board of India) as one of the listing conditions. The Committee feel that absence of a relevant provision in the Companies Act has contributed in further ambiguity in so far as the responsibilities of Independent Directors are concerned.

### **Reply of the Government**

The matter relating to duties, role and liabilities of Directors (including Independent Director) are being examined as a part of the comprehensive review of the Companies Act, 1956. A comprehensive legislation in this regard is under preparation and shall be brought before the Parliament with due approvals.

### **Recommendation (Sl. No. 3, Para No. 23)**

The Committee further note that the Government have introduced a limited amendment to the Companies Act to enable 'smooth implementation of MCA-21 e-governance project'. This project aims at providing clarity and security and enabling the digitization of support documents submitted by the companies. The Committee also note that once operational at all locations, this system would provide facilities for all services delivered through the offices of Registrars of Companies on-line and facilitate completion of all transactions from the comfort of homes/offices of stakeholders. In this regard, the Committee endorse the view that there is an urgent need for such e-governance project taking into account the internationally accepted best practices in the ever evolving corporate world, and hope that the operationalisation of the project would be done expeditiously. They also desire to be kept apprised of the concrete measures taken in this direction.

### **Reply of the Government**

The MCA-21 e-Governance Project has been rolled out throughout India except in the State of Jammu and Kashmir, where connectivity issue is being sorted out with the help of Ministry of Telecommunication. It is likely to become operational before mid-September, 2006. At present all the RoC office services including Name Availability, Company Registration, Viewing of documents, Filing of event based documents etc. are available on line anywhere anytime in a 24x7 mode.

### **Recommendation (Sl. No. 4, Para No. 32)**

The Committee note that SFIO has been functioning since October, 2003 as a multi disciplinary administrative organization attached to the Ministry of Company Affairs to investigate complex corporate frauds and enable adequate infrastructure and funds to carry out investigation into alleged fraud under the existing legal framework. The Committee note that till now 31 cases have been referred to the SFIO for investigation. Out of these, SFIO has already submitted inspection reports in 11 cases and out of these instructions for prosecutions have already been issued in respect of nine companies. From the replies furnished by the Government, the Committee note that in most of the cases the investigation of SFIO is sub-judice. The Committee are dismayed to learned that despite being in existence for more than two years, certain crucial posts *e.g.* Additional/Joint Director/Deputy Director (Admn.), Sr. ADs/ADs etc. are lying vacant in SFIO. Although the Government is stated to be in the process of filling up the posts, the Committee are not sure as to how much time will it take before these posts are actually filled. The Committee feel that with the passing of time, more and more cases will be referred to the SFIO, with the result that its work will be increased enormously. Keeping this in view, they recommend that apart from filling the vacant posts immediately, additional posts in various categories may be created so that the cases referred to SFIO are disposed of expeditiously and the purpose for which it came into existence is fulfilled. Since SFIO, conceived as a professional units requiring specialized skill and multi disciplinary approach, is attended to investigate corporate frauds, the personnel for the prestigious office may be drawn from finance, income tax, SEBI, CBI etc.

### **Reply of the Government**

Out of 12 posts of additional/Joint directors, sanctioned for head office of SFIO 11 officers are already in position. Applications received for one vacant post have been sent to the UPSC for making the selection.

The post of Additional Director for Mumbai office and Deputy Director (Admn.) at Delhi Office have since been filled up.

Out of 29 posts of Senior Assistant Director/Assistant Directors 25 posts are already filled up. Selection for one more post is under approval of the competent authority. Action for filling up the remaining three posts had been initiated long back. However, due to inadequate

response, the concerned Departments/Organizations have been requested again to sponsor suitable willing officers.

The SFIO at present has officers from the following disciplines:

- (i) Taxation
- (ii) Customs and Central Excise
- (iii) Police
- (iv) Company Law
- (v) Forensic Audit
- (vi) Capital Market (SEBI)
- (vii) Financial Sector (Banking)
- (viii) Audit
- (ix) Criminal Investigation
- (x) Intelligence
- (xi) Information Technology
- (xii) Foreign Exchange Regulation

An Expert Committee was constituted on 23.22.2006 to advise the Government on issues concerning SFIO and a separate legislation for it. Creation of additional posts and strengthening of the organization will be undertaken after the Committee finalizes its report. The Committee is likely to submit its report within next three months.

**Recommendation (Sl. No. 5, Para No. 33)**

The Committee also feel that officers of SFIO should be suitably trained for this purpose. They also recommend that, in this regard, the training and investigation mechanism of SFIO should be of international standard yet keeping in mind the trends and peculiarities of the Indian Corporate World.

**Reply of the Government**

Training to some officers of SFIO on investigation of financial fraud, bank fraud etc. has been imparted in the CBI Academy. One nomination has also been made for overseas training in Stock Market Regulation.

**Recommendation (Sl. No. 6, Para No. 34)**

The Committee further take note of the fact that in pursuance of J.J. Irani Committee recommendation, an expert Committee namely



Vepa Kamesam Committee has been constituted to assess the need for and details of a separate statute to govern the constitution and functioning of the SFIO. In this regard, they feel that there is a need to strengthen SFIO with adequate powers to act as a nodal agency in unveiling intricate and complex corporate frauds, in coordination with other agencies/organizations at the Centre and State levels and, therefore, recommend that a separate Statute to regulate and guide the functioning of SFIO may be framed.

#### **Reply of the Government**

On the basis of experience gained till date, the Ministry is examining measures for strengthening of SFIO. The Expert Committee referred to in para 32 above is also examining the statutory provisions necessary to make SFIO more effective, including through a separate statute to govern the constitution and functioning of SFIO.

#### **Recommendation (Sl. No. 7, Para No. 48)**

The Committee note that the Government have so far traced back about 115 vanishing companies. However, it remains to be seen whether the investors duped by these companies, will ultimately get some relief. The Committee are convinced that the issue of vanishing companies is inextricably linked with the issue of 'Vanishing funds', which first of all implies that the investors who have been lured into investing in a company that has vanished must get back his/her legitimate dues. They, therefore, feel that the matter of vanishing companies does not only rest with just tracing out the vanishing companies and their inspection of books of accounts etc., but equal attention should be paid to the prosecution mechanism so that the investors could get their money back. Equally important is to keep a watch on the vanishing companies so that they do not resurface in a different name to dupe the investors again. The Committee feel that utmost vigilance is required to prevent efforts by a 'vanishing company' or a defaulting company to restart its operations in another name or disguise.

#### **Reply of the Government**

The Ministry has noted the observations and the concerns of the Committee. It is submitted that there is no provision in the Companies Act, 1956 for refunding money collected by the companies through public issue except through the liquidation process. The whole scheme of winding up proceedings is based on the principle that on realization of assets of the company, its debts and liabilities should, subject to preferential payments as per provisions or Sections 529A and 530 of

the Companies Act, 1956, first be paid in full. The shareholders of the company may get their claim out of surplus in pursuant to the Court order. The suggestions received with regard to protecting the interest of the investors are being examined in the Ministry from the point of view of providing a legal framework for safeguarding investors' interests.

It is submitted that some of the companies, which tapped the capital market and collected funds from the public through public issue of shares/debentures defaulted in their commitments made to them while mobilising funds. A Coordination and Monitoring Committee (CMC), Co-chaired by Secretary, Ministry of Company Affairs (MCA) and Chairman, SEBI has been set up to take stringent action against unscrupulous promoters who raised money from investors and misused them. Following steps have been taken/are being taken by the Ministry against the vanishing companies and its promoters/directors under the relevant provisions of the Companies Act, 1956 in order to protect the interest of the investors:—

- Disgorgement proceedings were initiated in two cases, on test check basis, under Sections 397/398/402/408 read with Section 406 of the Companies Act, 1956 before the Hon'ble Company Law Board (CLB) to disgorge the properties/monies fraudulently obtained by promoters/directors of these two vanishing companies. In one case, the Petition filed by the Ministry (Central Government) in respect of M/s. Nuline Glassware (India) Ltd. has been dismissed by the CLB and an appeal has been filed before the Hon'ble High Court, Gujarat against the said dismissal order of the CLB. In another case *i.e.* M/s. AVI Industries Ltd., the final arguments were heard and the judgment is reserved.
- Prosecutions have been filed through the Registrar of Companies (RoC) under Sections 62/63, 68 and 628 of the Companies Act, 1956 against vanishing companies and their promoters/directors for misstatement in prospectus/fraudulently inducing persons to invest money/false statement made in the offer documents etc. The cases are pending in the Courts.
- FIRs have also been filed against such companies and their promoters/directors for the offences punishable under Sections 420, 406, 403, 415, 418 & 424 of the Indian Penal Code (IPC).

- The details of Vanishing Companies and their promoters/directors had been published in the Newspapers to facilitate investors to come forward and lodge their complaints against these companies in order to help the Police authorities in their investigation and prosecution launched against them in the Courts.
- The concerned Task Forces are reviewing the working of Vanishing Companies, which had been deleted from the list, very closely with a view to keep a close watch so that such companies do not indulge in fraudulent activities again.
- The Ministry has also implemented an e-Governance project under which the identity of directors has been built in through the introduction of a Director Identification Number (DIN) to facilitate effective legal action against the directors of such companies under the law, keeping in view the possibility of fraud by companies and the phenomenon of companies that raised funds from the public and vanished thereafter.
- For bringing awareness amongst the investors, details of the Vanishing Companies and their promoters/directors have been placed on the Website of the Ministry ([www.mca.gov.in](http://www.mca.gov.in)). Further, a new Website [www.watchoutinvestors.com](http://www.watchoutinvestors.com) has been created by Prime Investors Protection Association and League, with the financial assistance from the Investor Education and Protection Fund, to help the investors to protect themselves from unscrupulous promoters, companies and entities. This website is a national web-based registry covering entities including companies, intermediaries and, wherever available, persons associated with such entities, who have been indicted for an economic default and/or for non-compliance of laws/guidelines. It enables investors to do a free, fast and user-friendly search on such entities/persons before making any new investments and for continuously reviewing their existing portfolio *vis-a-vis* such entities. This website also marks a step on the part of the Ministry in promoting investor protection through various means including investor awareness and education.

**Recommendation (Sl. No. 9, Para No. 50)**

The Committee feel that the auditors/auditing firms who either fail in their duties to audit the companies/properly or knowingly

shut their eyes to any impending misfortune for the investors should also be held equally responsible. The Committee desire that the Government should, within the extant provisions of the law, try to pinpoint erring auditors and their firms equally responsible, otherwise the very idea of the auditors acting as whistleblowers would be defeated. The Committee find that the Government are toothless in this regard as they gather the impression, from the replies of the Government, that all they can do is to ask CAG to exercise due caution while appointing the 'guilty' firms as statutory auditors for conducting the audit of public sector companies, while they are free to operate in the private sector. The Committee, in this regard, would like to see the 'guilty' auditors/auditing firms to be treated as accomplices in the eyes of the Government.

#### **Reply of the Government**

Action can be taken for professional and other misconduct against an erring Chartered Accountant under the provisions of the Chartered Accountants Act, 1949. The Parliament has passed the Chartered Accountants (Amendment) Act, 2006 in March, 2006 which, *inter-alia*, provides that action for professional misconduct can be taken against those Chartered Accountants who do not exercise due diligence or are grossly negligent in the conduct of their professional duties. Stricter penalties have also been provided through the Amendment Act. In accordance with the revised provisions, a penalty of fine upto Rs. 5.00 lakh can also be imposed in addition to existing penalties of reprimand or removal of name from the register of membership for a specified period or permanently in the case of proved mis-conduct by a member. These measures are expected to ensure higher level of accountability for the Chartered Accountants.

Apart from above, the Ministry is also examining the feasibility of taking appropriate action against the Chartered Accountants (CAs) associated with the public issue of securities made by Vanishing Companies involving larger size issues. Prosecutions have already been launched by the concerned Registrar of Companies against the auditors of M/s. Western India Industries Ltd., M/s. Kiev Finance Ltd., and M/s. Vini Metaspin Steels Ltd. for contravention of provisions of Companies Act, 1956.

#### **Recommendation (Sl. No. 11, Para No. 52)**

In this regard, the Committee also note the recommendations of the Samir Biswas Committee that the coordination mechanism may involve Ministry of Finance (Department of Economic Affairs) in

addition to Ministry of Company Affairs and SEBI. The Committee feel that the present mechanism may be extended to also incorporate representative of Department of Economic Affairs, as they are primarily responsible to oversee the implementation of Government's policies in regard to regulation of Capital Market.

#### **Reply of the Government**

The Coordination and Monitoring Committee (CMC) has taken note of the suggestion for involving a representative of Department of Economic affairs, Ministry of Finance, in addition to the Ministry of Company Affairs and SEBI, and decided in its meeting held on 26.07.2006 to request the Department of Economic Affairs, Ministry of Finance, to depute their representative to be a Member of the CMC.

#### **Recommendation (Sl. No. 12, Para No. 53)**

The Committee note the government's efforts to prepare a database of all Directors of the companies under the system of allotment of DIN (Director Identification Number) under the MCA-21 e-governance project and urge the Government to expedite completion of the same. The Committee also note the Government decision to take up a technical scrutiny of Balance Sheets of all such companies, which come out with IPOs, so as to monitor the utilization of funds raised from the public. The Committee while appreciating the Government's decision, desire that the Government may fix a suitable time limit in this direction so that the investors in the secondary market may also be benefited.

#### **Reply of the Government**

The system of allotment of DIN has already been introduced under the MCA-21 e-Governance project. More than 2.25 lakh Directors have already been allotted the DIN. Rules under the provisions of the amended Act are in the process of being issued. This exercise is expected to be completed nationwide by the end of December, 2006.

The Ministry has taken note of the observation of the Committee on conducting technical scrutiny with the help of the MCA-21 database. The modalities are being worked out on lines of the observation made by the Committee.

#### **Recommendation (Sl. No. 12, Para No. 65, 66)**

The Committee note that the utilization of the proceeds of the funds under IEPF have shown an inconsistent trend. The percentage

of expenditure in 2002-03 was 59.4%, in 2003-04 it was 94.52%. Again in 2004-05 it plunged to 54.46% and in 2005-06 it was 86.72%. While taking note of the Government's efforts for a more effective utilization of the fund available under IEPF, the Committee still feel that such efforts are not adequate enough. The Committee feel that the government have not been able to utilize the amount of fund available to their credit. This calls for restructuring of schemes under IEPF. The Committee also take note of the J.J. Irani Committee's recommendations in this regard and express agreement over their suggestion that the structure and administration of the fund should be revamped and schemes should be made more comprehensive and their scope expanded to enable flow of current information to the investors about their rights.

Besides, in view of the spurt in various scams related to capital market in the last few years, the Committee feel that the time has come to utilize the IEPF on the education of small investors, who are more gullible due to lack of proper information.

#### **Reply of the Government**

The Committee on IEPF has been reconstituted with experts drawn from various fields namely, capital market, economics, finance, banking and media so as to provide a broad based pool of experts on the Committee. It is proposed to engage a professional agency, which will advise the committee and help in preparing a comprehensive Action Plan indicating a complete basket of various activities including a media plan. This would also include plans for spread of financial literacy so as to empower the investor.

Further, in order to protect the interest of the investors, the suggestions given by the Irani Committee are being considered with a view to strengthen the legislative framework. MCA-21 e-Governance initiative has been launched with a view to bring transparency and certainty in the delivery of services to the stakeholders and empower the investors by providing access to the public information about the companies.

### CHAPTER III

#### RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN VIEW OF THE GOVERNMENT'S REPLIES

##### **Recommendation (Sl. No. 8, Para No. 49)**

The Committee also recommend that special care should be taken at the time of registration of a company as this marks its arrival and possibility of raising Capital. Therefore, the Committee recommend that Government should be more alert during the process of registering the companies so as to assess their potential viability to survive in the competitive environment and benefit their investors.

##### **Reply of the Government**

The observations of the Committee have been noted. However, it may be submitted that a company is required to file a prospectus with SEBI before going in for a public issue with the intent of tapping Capital Market. The requisite scrutiny of the antecedents of a company is carried out by SEBI while approving its prospectus. This exercise cannot be taken up at the time of registration of a company. Notwithstanding the above, the Ministry has introduced a concept of a unique Director Identification Number (DIN) under the e-Governance programme. This feature will be helpful in tracking the Directors of the company at all times.

##### **Recommendation (Sl. No. 14, Para No. 67)**

The Committee note that the government do not support the idea of either assigning the funds under IEPF created under the Companies Act, 1956 to SEBI or placing the funds under the Central Monitoring Committee jointly chaired by the Ministry of SEBI on the ground that since IEPF has been created by the government after expropriating the moneys from the budget allocated to it, which belong to investors by exercising its sovereign right through Statute. Moreover, SEBI is already represented in IEPF committees. The Committee are, however, of the view that the broad issues on which complaints from the aggrieved investors are being received relate to refund claims of investors, shares/ debenture certificate, dividend amount, interests etc. which are generally looked after by SEBI. They further feel that since SEBI is the primary

market regulator and cases of unscrupulous persons duping investors is also one of its concerns, it would, perhaps, be appropriate if SEBI is given a bigger role not only in preparation and approval of schemes relating to IEPF but also in the approval for disbursement of funds. The Committee hope that the Government will consider the concern expressed by them and will administer the Investor Education and Protection Fund (IEPF) in coordination with SEBI.

### **Reply of the Government**

The Committee on IEPF takes all the decisions relating to administration of the Fund. Further, financial assistance to various organizations/associations/Institutes etc. are disbursed only after the approval of the Sub-Committee/Committee on IEPF. Executive Director, Securities and Exchange Board of India, is a member of the Committee on IEPF. Thus, SEBI is already associated in the administration of the Investor Education and Protection Fund (IEPF). Moreover, SEBI has its own sources of funds for this purpose.

It is further submitted that the investors concerns are not limited to the listed companies alone which constitute less than 1.5% of the total number of companies registered under the Companies Act, 1956. As regards Ministry's efforts and future plans in this direction, attention is invited to the reply Paras 65 & 66.



## CHAPTER IV

### RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH REPLIES OF THE GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE

#### **Recommendation (Sl. No. 10, Para No. 51)**

The Committee also find that even the definition of vanishing companies is ambiguous thereby leaving loopholes in the law. From the information furnished to them, they note that one of the criteria which states that 'no correspondence has been received by the Exchange from the company for a long time', is interpreted by the Task Forces concerned to imply a period between 2 to 3 years of absence of correspondence between the exchange and the company. The Committee feel that any company which has duped its investors, can continue to operate and avoid being classified as 'vanishing' just by sending a piece of correspondence, at intervals of 2-3 years. They, therefore, felt that the criteria for identifying a company as vanished/vanishing needs streamlining and call upon the Government to have a re-look at the definition, so that all such companies, having the slightest intention of duping investors of their hard earned money, could be classified as 'vanishing or potentially vanishing companies'.

#### **Reply of the Government**

The issue of a clearer definition of a Vanishing Company and the criteria for identifying a company as vanished/vanishing was placed before the Coordination and Monitoring Committee (CMC) in its meeting held on 26.07.2006. The Committee decided to amend one of the criteria by substituting the words '*for a long time*' with '*a period of two years*' for identifying the company as a vanishing company. This would take care of the said ambiguity.

The criteria for identifying a company as vanished now stands revised as under:

- (i) Companies, which have not complied with listing requirements/filing requirements of Stock Exchange/ROC respectively for a period of 2 years;
- (ii) No correspondence has been received by the Exchange from the company for a period of two years; and

- (iii) No office of the company is located at the mentioned registered office address at the time of Stock Exchange inspection.

All the conditions laid down have to be met for treating a company as vanishing and companies satisfying one or more but not all conditions are not to be considered as vanishing.

#### **Recommendation (Sl. No. 15, Para No. 80)**

The Committee note that the J.J Irani Committee have already taken up the issue of exit or liquidation of companies in detail in view of the inordinate delays and lengthy procedure for companies to exit. The Committee also note from the reply of the Government referring to the observation in a World Bank Report that the time taken for a companies to exit is between 2-3 years in China, Malaysia and Thailand whereas it is about 10 years in India. They further note that the Government have attributed this delay to the lengthy nature of judicial process. The Committee are of the view that it is essential to provide a sound framework for winding up and liquidation of companies. In this connection, the Committee recommends that in the extant legal provisions, the Government should strive work in such a time-bound manner that, excluding the time taken for obtaining the approval of the High Court, all other formalities could be completed within a period of 2-3 years. Moreover, the Committee hope that efforts by the Government to get the NCLT second Amendment Act, 2002 passed at the earliest in their favour by the Supreme Court, would pave way for its establishment ultimately. This, the Committee hope will help in reducing time for getting required judicial approval for exit of companies, overall, the Committee opine that simplifying the existing liquidation process and speeding up the winding up of sick companies having no chance of revival would be steps in the right direction. Besides the modified framework should seek to preserve the estate and maximize the value of assets of the existing company so that those could be redeployed suitably.

#### **Reply of the Government**

With a view to deal with some of the issues arising out of reconstruction/liquidation/winding up, the Companies Act, 1956 was amended through Companies (Amendment) Act, 2002 and the consequential establishment of the National Company Law Tribunal and National Company Law Appellate Tribunal. It was also provided that the functions of rehabilitation of companies (at present done by BIFR and AAIFR) and liquidation/winding up of companies (which is

being done by High Courts) would be brought under the purview of the National Company Law Tribunal and National Company Law Appellate Tribunal. Sick Industrial Companies (Special Provisions) Act, 1985 is to be repealed. However, due to legal challenge, which is now with Hon'ble Supreme Court, the National Company Law Tribunal and National Company Law Appellate Tribunal could not be established. The new provisions also could not be notified.

The Ministry of Company Affairs is taking note of the observation of Committee for speedy conduct of winding up process and enabling the maximization of the value of assets under liquidation.

The entire framework relating to rehabilitation/liquidation/winding up is being revised as a part of the exercise of reviewing the Companies Act.

A revised comprehensive Bill which, *inter-alia* will address this problem is under preparation and will be introduced in Parliament after due approval.

**CHAPTER V**

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH  
FINAL REPLIES OF THE GOVERNMENT ARE STILL AWAITED

—NIL—

NEW DELHI;  
12 December, 2006  
21 Agrahayana, 1928 (Saka)

MAJ. GEN. (RETD.) B.C. KHANDURI,  
*Chairman,*  
*Standing Committee on Finance.*

MINUTES OF THE FOURTEENTH SITTING OF THE STANDING  
COMMITTEE ON FINANCE

The Committee sat on Monday, the 11th December, 2006

PRESENT

Maj. Gen. (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

*Lok Sabha*

2. Shri Gurudas Dasgupta
3. Shri A. Krishnaswamy
4. Shri Bhartruhari Mahtab
5. Shri Madhusudan Mistry
6. Shri Rupchand Pal
7. Shri Prakash Paranjpe
8. Shri P.S. Gadhavi
9. Shri M.A. Kharabela Swain

*Rajya Sabha*

10. Shri Mahendra Mohan
11. Shri Chittabarta Majumdar

Secretariat

- |                            |   |                             |
|----------------------------|---|-----------------------------|
| 1. Dr. (Smt.) P.K. Sandhu  | — | <i>Additional Secretary</i> |
| 2. Shri A. Mukhopadhyay    | — | <i>Joint Secretary</i>      |
| 3. Shri S.B. Arora         | — | <i>Deputy Secretary</i>     |
| 4. Shri T.G. Chandrasekhar | — | <i>Under Secretary</i>      |
| 5. Shrimati Anita B. Panda | — | <i>Under Secretary</i>      |

2. At the outset, the Chairman welcomed the Members to the sitting of the Committee.

3. \*\*\*
4. \*\*\*

5. \*\*\*

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6. The Committee, thereafter, considered the draft report on action taken by the Government on the recommendations/observations contained in the 40th Report on Demands for Grants (2006-07) of Ministry of Company Affairs and adopted the same without any modification/amendment.

7. The Committee authorized the Chairman to finalise the Reports in the light of suggestions received from the Members and also make consequential changes arising out of factual verification and present the same to Parliament.

*The Committee then adjourned.*

## APPENDIX

[Vide Para 3 of the Introduction]

ANALYSIS OF THE ACTION TAKEN BY GOVERNMENT ON  
THE RECOMMENDATIONS CONTAINED IN THE FORTIETH  
REPORT OF THE STANDING COMMITTEE ON FINANCE  
(FOURTEENTH LOK SABHA) ON DEMANDS FOR GRANTS  
(2006-2007) OF THE MINISTRY OF COMPANY AFFAIRS

	Total	% of Total
(i) Total number of recommendations	15	
(ii) Recommendations/observations which have been accepted by the Government (Vide Recommendations at Sl. Nos. 1 to 7, 9, 11, 12 & 13)	11	73.33
(iii) Recommendations/observations which the Committee do not desire to pursue in view of the Government's replies (Vide Recommendations at Sl. Nos. 8 & 14)	2	13.33
(iv) Recommendations/observations in respect of which replies of the Government have not been accepted by the Committee (Vide Recommendations at Sl. Nos. 10 & 15)	2	13.34
(v) Recommendations/observations in respect of which final reply of the Government is still awaited  (Nil)	Nil	00.00