
STUDY MATERIAL

PROFESSIONAL PROGRAMME

**SECRETARIAL AUDIT
COMPLIANCE MANAGEMENT
AND DUE DILIGENCE**

MODULE 1

PAPER 2



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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PROFESSIONAL PROGRAMME

SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

Due diligence is an investigative process for providing the desired comfort level about the potential investment and to minimize the risks such as hidden uncovered liabilities, poor growth prospects, price claimed for proposed investment being on higher side etc., In general due diligence process is transaction based.

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due process. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Compliance management is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution.

Secretarial Audit and Compliance management are the routine tools for effective governance. Compliance management is to be built into the corporate system to avoid non compliances and the Secretarial audit is carried out on periodical basis by an independent professional. Due diligence is a pre-emptive tool to assess a business transaction.

Due diligence process includes examining all aspects of a company including manufacturing, financial, legal, tax, IT systems, labour issues, checking for regulatory issues as well as understanding issues related to IPR, the environment and other matters such as contractual documentation, litigation, ownership of movable, fixed and intangible assets.

Further Adoption of secretarial standards issued by the Institute of Company Secretaries of India(ICSI) help the corporates in better compliance management and is indeed an effective governance tool.

The paper on Secretarial Audit, Compliance Management and Due Diligence has been introduced to enable the students to understand the concepts and technicalities of due diligence whether transaction based or pertaining to issue of financial instruments etc. the importance of Secretarial Audit and Secretarial Standards. This study would also throw light on secretarial standards, checklists under secretarial audit, compliance management systems etc.

This paper warrants continuous updation in terms of legislative changes made to laws from time to time. Students are advised to keep themselves abreast of latest developments by regularly resorting to reading of various regulatory websites/economic dailies and additional source materials concerning corporate world. Students are also advised to read regularly the 'Student Company Secretary'/ 'Chartered Secretary' wherein all important regulatory amendments are reported regularly.

In the event of any doubt, students may write to the Directorate of Academics and perspective planning of the institute for clarification at sacmdd@icsi.edu and sudhir.dixit@icsi.edu.

Although care has been taken in publishing this study material, yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf. In the event of any doubt, students may write to the Directorate of Academics in the Institute for clarification.

Should there be any discrepancy, error or omission noted in the study material, the institute shall be obliged if the same is brought to its notice.

PROFESSIONAL PROGRAMME

**SYLLABUS
FOR**

**MODULE 1 - PAPER 1: SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT
AND DUE DILIGENCE (100 MARKS)**

Level of Knowledge: Expert Knowledge

Objective:

- (i) *To acquire thorough understanding of Secretarial Audit and Corporate Compliance Management.*
- (ii) *To acquire understanding of the due diligence of various business transactions.*

Detailed Contents:

PART A: Secretarial Audit (25 Marks)

1. Secretarial Standards

- *Concept, Scope and Advantages*
- *Secretarial Standards issued by the ICSI*
- *Compliance of Secretarial Standards for Good Governance*
- *Relevance of Guidance Note(s)*

2. Secretarial Audit

- *Need, Objective and Scope*
- *Periodicity and Format for Secretarial Audit Report*
- *Benefits of Secretarial Audit*
- *Professional Responsibilities and Penalties*

3. Checklist for Secretarial Audit

Part B: Due Diligence and Compliance Management (75 Marks)

4. Due Diligence - An Overview

- *Introduction, Nature, Need and its Significance*
- *Objectives, Scope and Types of Due Diligence*
- *Process of Due Diligence*
- *Concept of Data Room in Due Diligence*
- *Due Diligence vs. Audit*

5. Issue of Securities

- *Introduction and Regulatory Framework*
- *Pre and Post Issue Due Diligence - IPO/FPO*
- *Due Diligence - Preferential Issues of Listed and Unlisted Companies*
- *Employee Stock Option, Bonus Issue, Rights Issue, Debt Issues*

(v)

- *Issue of Securities by SMEs*
- *Role of Company Secretary in Issue of Securities*

6. Depository Receipts Due Diligence

- *Introduction; Broad Regulatory Framework; Parties, Approvals,*
- *Documentation and Process*
- *Issue of ADRs, GDRs, IDRs and FCCBs*

7. Merger & Acquisition (M&A) Due Diligence

- *Introduction*
- *Stages of M&A Due Diligence*
- *Data Room Management*
- *Business, Financial, Legal and Corporate Governance Due*
- *Diligence*
- *HR and Cultural Due Diligence*
- *Impact of Due Diligence on Valuation*
- *Takeovers and Acquisitions Due Diligence*

8. Competition Law Due Diligence

- *Introduction*
- *Need for Competition Compliance Programme*
- *Mergers & Acquisitions and Competition Law Aspects*
- *Reasons for Due Diligence of Competition Law Aspects*
- *Process of Due Diligence of Competition Law Aspects*
- *Due Diligence of Various Agreements*
- *Some Common Anti Competitive Practices*
- *Due Diligence on Abuse of Dominance*
- *Due Diligence Checklist for Compliance with Competition Act, 2002*
- *Checklist for Anti Competitive Agreements/Abuse of Dominant Position/Regulation of Combinations*

9. Legal Due Diligence

- *Introduction*
- *Objectives, Scope, Need and Process*
- *General Documents/Aspects to be covered*
- *Possible Hurdles in Carrying out a Legal Due Diligence and Remedial Actions*

10. Due Diligence for Banks

- *Introduction*
- *Need for Due Diligence for Banks*
- *Process of Due Diligence for Banks*
- *Due Diligence Report to Banks*

11. Environmental Due Diligence

- *Introduction*
- *Need for Environmental Due Diligence*
- *Process involved in Environmental Due Diligence*
- *Regulatory Framework relating to Environment*
- *Check List on Major Regulatory Compliances*
- *Environmental Guidelines for Industries by Ministry of Environment*
- *Environmental Impact Assessment*
- *Environmental Management Plan*
- *Preparation of Risk Analysis Matrix*
- *Identification of Potential Issues*
- *Impact Analysis*
- *Suggestions and Mitigation Measures*

12. Search and Status Reports

- *Importance and Scope*
- *Verification of Documents relating to Charges*
- *Requirements of Financial Institutions and Corporate Lenders*
- *Preparation of Report*

13. Compliance Management

- *Concept and Significance*
- *Establishment of Compliance Management System*
- *Absolute, Apparent and Adequate Compliance*

LIST OF RECOMMENDED BOOKS

MODULE I

PAPER 2 : SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

Recommended Readings and References:

1. Taxmann : SEBI Manual
2. Mamta Bhargava : Compliances and Procedures under SEBI Law, Shreeji Publishers, 8/294, Sunder Vihar, New Delhi – 110087
3. ICSI : Handbook on Mergers Amalgamations and takeovers.
4. Snow white : Mergers/Amalgamations, takeovers, Joint Ventures, LLPs and Corporate Restructure by K R Sampath
5. Butterworths : Mergers et al by S Ramanujam
6. The Art of M&A Due Diligence : Alexandra Reed Lajoux & Charles M. Elson
7. Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc from time to time.
8. Bare Acts
9. Listing agreement for Equity, debts, Indian Depository Receipts etc.
10. Guidance Note on Diligence Report for Banks (ICSI Publication)
11. Referencer on Secretarial Audit (ICSI Publication)
12. Important Websites
 - (a) www.sebi.gov.in
 - (b) www.rbi.org.in
 - (c) www.finmin.nic.in
 - (d) www.dipp.nic.in
 - (e) www.mca.gov.in

Journals:

1. Chartered Secretary : ICSI, New Delhi
2. Student Company Secretary : ICSI, New Delhi
3. Corporate Law Adviser : Vishaman Publisher (P) Ltd.
4. SEBI and Corporate Laws : Taxmann

Note:

- (i) Students are advised to read the relevant Bare Acts, Regulations/circulars/rules issued by various regulatory authorities like SEBI, RBI, MCA etc from time to time in addition to reading of journals like Student Company Secretary, Chartered Secretary etc.
- (ii) The reference to websites of different regulatory authorities is essential.

ARRANGEMENT OF STUDY LESSONS

**PAPER 1: SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND
DUE DILIGENCE (100 Marks)**

Lesson No.

Subject

PART A

- 1 Secretarial Audit – An Overview
2. Check Lists for Secretarial Audit
3. Secretarial Standards

PART B

4. Due Diligence – An Overview
5. Issue of Securities
6. Depository Receipts Due Diligence
7. Due Diligence – Mergers & Amalgamations
8. Competition Law Due Diligence
9. Legal Due Diligence
10. Due Diligence for Banks
11. Environmental Due Diligence
12. Search & Status Report
13. Compliance Management

PROFESSIONAL PROGRAMME

SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

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Lesson 1

SECRETARIAL AUDIT – AN OVERVIEW

LESSON OUTLINE

- Secretarial Audit – Concept
- objective, scope of secretarial audit
- Benefits and Beneficiaries
- Secretarial Audit process
- Professional Responsibilities and Penalties
- Secretarial Audit Report - Format

LEARNING OBJECTIVES

Timely examination of compliance reduces risks as well as potential cost of non-compliance and also builds better corporate image. Secretarial Audit establishes better compliance platform by checking the compliances with the provisions of various statutes, laws, rules & regulations, procedures by a Practicing Company Secretary to make necessary recommendations/ remedies. The primary objective of the Compliance Management backed Secretarial Audit is to safeguard the interest of the Directors & officers of the companies, shareholders, creditors, employees, customers etc. With the introduction of concept of 'Secretarial Audit' in Voluntary Corporate Governance Guidelines (CGV) 2009 and the 'Companies Bill 2012', it has gained immense importance. After reading this lesson the students would be able to understand the need, objectives, scope, benefits of secretarial audit, professional responsibilities and penalties etc.

“Since the Board has the overarching responsibility of ensuring transparent, ethical and responsible governance of the company, it is important that the Board processes and compliance mechanisms of the company are robust. To ensure this, the companies may get the Secretarial Audit conducted by a competent professional. The Board should give its comments on the Secretarial Audit in its report to the shareholders.”

MCA CORPORATE GOVERNANCE VOLUNTARY GUIDELINES 2009

INTRODUCTION

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed due processes. It is essentially a mechanism to monitor compliance with the requirements of stated laws and processes.

The Ministry of Corporate Affairs, Government of India released CORPORATE GOVERNANCE VOLUNTARY GUIDELINES 2009 on December 21, 2009. The preamble to Guidelines states that “These guidelines provide for a set of good practices which may be voluntarily adopted by the Public companies. Private companies, particularly the bigger ones, may also like to adopt these guidelines.”

The Guidelines, amongst other things, recommend the introduction of Secretarial Audit. Companies, which do not adopt these guidelines, either fully or partially, are expected to inform their shareholders about the reasons for not adopting these Guidelines. This is in consonance with the popular doctrine of “Comply or Explain”. The Board should give its comments on the Secretarial Audit in Directors’ Report as provided in Para V of the Guidelines.

Further Companies Bill 2012, states that every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board’s report a Secretarial Audit Report, given by a Company Secretary in Practice, in such form as may be prescribed. It shall be the duty of the company to give all assistance and facilities to the Company Secretary in Practice, for auditing the secretarial and related records of the company. The Board of Directors, in their report shall explain in full any qualification or observation or other remarks made by the Company Secretary in Practice in his report. If a company or any officer of the company or the Company Secretary in Practice, contravenes the provisions of this section, the company, every officer of the company or the Company Secretary in Practice, who is in default, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

The Objectives of Secretarial Audit

The objectives of Secretarial Audit may be briefed as under.

- To check & Report on Compliances
- To Point out Non-Compliances and Inadequate Compliances
- To Protect the interest of the Customers, employees, society etc.
- To avoid any unwarranted legal actions by law enforcing agencies and other persons as well.

Scope of Secretarial Audit

The scope of Secretarial Audit comprises verification of the compliances under the following enactments, rules, regulations and guidelines:

- (i) The Companies Act, 1956 and the Rules made there under;
- (ii) The Securities Contracts (Regulation) Act, 1956 (‘SCRA’) and the Rules made there under;
- (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed there under;
- (iv) Foreign Exchange Management Act, 1999 and the rules & regulations made there under;

- (v) The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act') which *inter alia* includes;
 - (a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
 - (b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
 - (c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
 - (e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
 - (f) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
 - (g) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;
- (vi) The Listing Agreement(s) entered into by the Company with Stock Exchange (s).
- (vii) Secretarial Standards issued by The Institute of Company Secretaries of India.
- (viii) Corporate Governance Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs, Government of India;
- (ix) Corporate Social Responsibility Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs, Government of India;
- (x) Guidelines on Corporate Governance for Central Public Sector Enterprises, 2010;
- (xi) Corporate Governance Guidelines for Insurance Companies, issued by IRDA in case of companies regulated by IRDA; and
- (xii) Other corporate laws as may be applicable specifically to the auditee company.

Contents:

Secretarial Audit report should be addressed to the members and form part of the Annual Report.

It should, among other things, contain Secretarial Auditor's comments and observations on:

1. Compliance or non-compliance during the defined audit period, in relation to the statutes, rules, regulations, etc. applicable to the company;
2. Significant litigation(s) within the scope of audit;
3. Board Processes followed by the Company which *inter alia* would cover:
 - a. Board structure which consists of –
 - (i) Composition of the Board
 - (ii) Suitability of directors
 - (iii) Succession planning

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- b. Board Systems and Processes consisting of-
 - (i) Convening the meeting.
 - (ii) Content of agenda (whether the agenda has been made available to the Board along with supporting papers/presentations in advance)
 - (iii) Conducting the meetings (frequency and length)
 - (iv) Adequacy of minutes
 - (v) Board Committees
4. The existence of adequate internal control systems, procedures and safeguards for ensuring compliance with laws applicable to the company, commensurate with the size of the company and the nature of its business.
5. Such other matters that may be required to be audited/reviewed from a compliance and governance perspective.
6. Any material event(s) happening after the financial year but before the date of the report having substantial impact on any of the above reported items.

NEED FOR SECRETARIAL AUDIT

Secretarial Audit is the process of independent verification, examination of level of compliance of applicable Corporate Laws to a company. The audit process if properly devised ensures timely compliance and eliminates any un-intended non compliance of various applicable rules and regulations. An action plan of the Corporate Secretarial Department is to be designed so as to ensure that all event based and time based compliances are considered and acted upon. Secretarial Audit is to be on the principle of “Prevention is better than cure” rather than post mortem exercise and to find faults. Broadly, the need for Secretarial Audit is:

- Effective mechanism to ensure that the legal and procedural requirements are duly complied with.
- Provides a level of confidence to the directors, officers in default, Key Managerial Personnel etc.
- Directors can concentrate on important business matters as Secretarial Audit ensures legal and procedural requirements.
- Strengthen the image and goodwill of a company in the minds of regulators and stakeholders
- Secretarial Audit is an effective compliance risk management tool.
- It helps the investor in analyzing the compliance level of companies, thereby increases the reputation.
- Secretarial Audit is an effective governance tool.

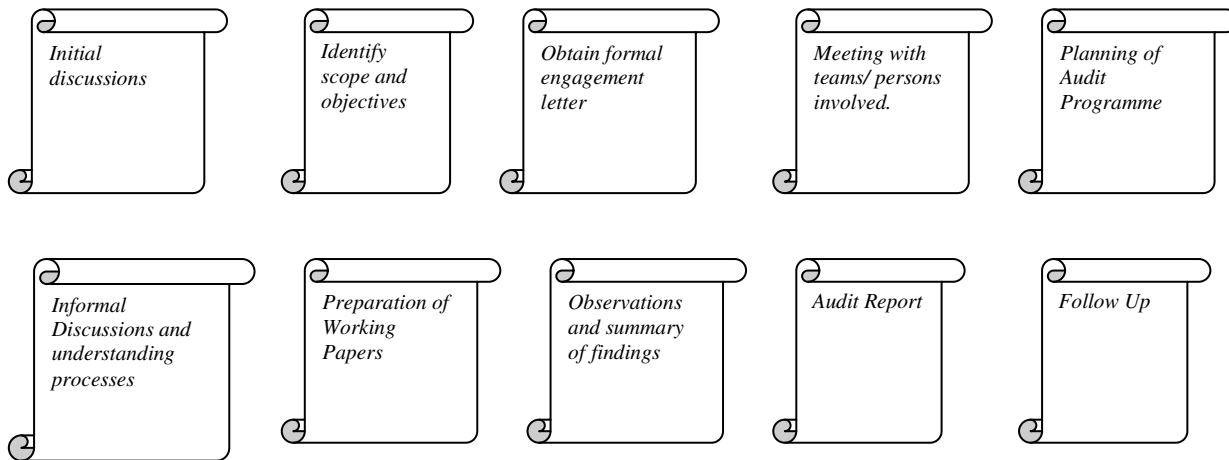
Secretarial Audit & Company Secretary in Practice (PCS)

A significant area of competence of PCS include “Corporate, Business, Economic and other laws” (comprising statutes, rules, regulations, notifications, circulars and clarifications, forms, guidelines and bye-laws) owing to intensive and rigorous coaching, examinations, training and continuing education programs. PCS is a highly specialized professional in matters of statutory, procedural and practical aspects involved in

proper compliances under corporate laws. Strong knowledge base makes PCS a competent professional to conduct Secretarial Audit.

A Company Secretary in Practice has been assigned the role of Secretarial Auditor in section 2(2)(c)(v) of the Company Secretaries Act, 1980.

Secretarial Audit – The process



Initial discussions

In this phase the auditor gathers relevant information about the Company in order to obtain a general overview of operations. The auditor talks to key personnel and reviews reports, files, and other sources of information.

Identifying scope and objectives

During this stage the Secretarial Auditor discusses the scope and objectives of the examination, in a formal meeting with the management and gathers information on important processes, evaluates existing controls, and plans the audit steps.

Obtaining of formal engagement letter

A formal engagement letter from the Management shall be issued to the Auditor. This letter communicates the scope and objectives of the audit. PCS shall then forward a preliminary checklist to the Company that will help the auditor learn more about the company under audit.

Meeting with teams/persons involved

The opening meeting should include senior management and any administrative staff who may be involved in the audit. The Company should feel free to ask the PCS to review areas that are concerned about. The time frame of the audit will be determined.

Planning of Audit programme

This program outlines the fieldwork necessary to achieve the audit objectives. The PCS shall use a variety of tools and techniques to gather and analyze information about the Company's operations. The review of controls helps the auditor determine the areas of highest risk and design tests to be performed in the fieldwork section.

Informal interactions and understanding of business

The fieldwork concentrates on informal communications. It is during this phase that the PCS determines whether the controls identified during the preliminary review are operating properly and in the manner described by the Company. Fieldwork typically consists of talking to staff, reviewing procedure manuals, learning about processes, testing for compliance with applicable policies and procedures and laws and regulations, and assessing the adequacy of controls. The fieldwork stage concludes with a list of significant findings from which the auditor will prepare a draft of the audit report.

Preparation of Working Papers

Working papers are a vital tool of the audit profession. They are the support of the audit opinion. They connect the management's records and financials to the auditor's opinion. They are comprehensive and serve many functions.

Observations/Discussions

The detailed commentary describing the findings and recommended solutions shall be summarised and presented for initial discussions with the management for its insights.

Summary of Audit findings and subsequent discussions

Upon completion of the fieldwork, the auditor to summarize the audit findings, conclusions, and recommendations necessary in the form of the audit report.

Audit Report

The auditor shall prepare the final report based on the field work and working papers to present the audit findings and discuss recommendations for improvements, if any. The Final report shall contain the opinion on the statutory compliances examined by the auditor and shall state whether in his opinion the Company is carrying out/not carrying out due compliances of the applicable provisions of the Various corporate laws. The final report shall be provided with or without qualifications.

Follow up

Finally, as part of Secretarial Audit's self-evaluation program, the PCS may request the Company to list the actions taken by the Company to resolve the audit report findings. Unresolved findings will also appear in the follow-up report and will include a brief description of the finding, the original audit recommendation, the client response and the current condition.

Benefits and Beneficiaries of Secretarial Audit

The Benefits

The benefits of secretarial audit includes the following:

- (a) It can be an effective due diligence exercise for the prospective acquirer of a company or controlling interest or a joint venture partner.
- (b) It assures the owners that management and affairs of the company are being conducted in accordance with requirements of laws, and that the owners stake is not being exposed to undue risk.
- (c) It ensures the Management of a company that those who are charged with the duty and responsibility of compliance with the requirements of law are performing their duties competently, effectively and efficiently.

- (d) It ensures the Management that the company has complied with the laws and, therefore, they are not likely to be exposed to penal or other liability or to action by law enforcement agencies for non-compliance by the company.
- (e) Secretarial Audit being proactive measure for compliance with a plethora of laws, it will have a salutary effect of substantially lessening the burden of the law-enforcement authorities.
- (f) Instilling professional discipline and self-regulations.
- (g) Reduces the work load of the regulators due to better and timely compliances.

The beneficiaries

The major beneficiaries of Secretarial Audit include:

(a) Promoters

Secretarial Audit will assure the Promoters of a company that those in-charge of its management are conducting its affairs in accordance with requirements of laws.

(b) Management

Secretarial Audit will assure the Management of a company that those who are entrusted with the duty and responsibility of compliance are performing their role effectively and efficiently. This also helps the management to establish benchmarks for the compliance mechanism, review and improve the compliances on a continuing basis.

(c) Non-executive directors

Secretarial Audit will provide comfort to the Non-executive Directors that appropriate mechanisms and processes are in place to ensure compliance with laws applicable to the company, thus mitigating any risk from a regulatory or governance perspective; so that the Directors not in-charge of the day-to-day management of the company are not likely to be exposed to penal or other liability on account of non-compliance with law.

(d) Government authorities/regulators

Being a pro-active measure, Secretarial Audit facilitates reducing the burden of the law-enforcement authorities and promotes governance and the level of compliance.

(e) Investors

Secretarial Audit will inform the investors whether the company is conducting its affairs within the applicable legal framework.

(f) Other Stakeholders

Financial Institutions, Banks, Creditors and Consumers are enabled to measure the law abiding nature of Company management.

Secretarial Audit-Periodicity

Secretarial Audit on a continuous basis would help the company in initiating corrective measures and strengthening its compliance mechanism and processes. It is recommended that the Secretarial Audit be carried out periodically (quarterly/half yearly) and adverse findings if any, be communicated to the Board for corrective action.

Reporting with Qualification

The qualification, reservation or adverse remarks, if any, should be stated by the PCS at the relevant places in his report. The qualifications, reservations or adverse remarks of Secretarial Auditor, if any, should be mentioned in bold type or in italics in the Secretarial Audit Report.

If the PCS is unable to form an opinion on any matter, he should mention that he is unable to form an opinion on that matter and the reasons therefor. If the scope of work required to be performed, is restricted on account of limitations imposed by the company or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the Report should indicate such limitations. If such limitations are so material as to render the PCS incapable of expressing any opinion, the PCS should state that:

“In the absence of necessary information and records, we are unable to report compliance(s) by the Company”.

Professional Responsibility and Penalty for Incorrect Audit Report

While the Voluntary Guidelines on Corporate Governance have opened up a significant area of practice for Company Secretaries, it casts immense responsibility on Company Secretaries, and poses a great challenge to justify fully, the faith and confidence reposed in them. Company Secretaries must take adequate care while conducting Secretarial Audit.

Any failure or lapse on the part of PCS in issuing a Secretarial Audit Report may attract penalty for incorrect report and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980. It, therefore, becomes imperative for the PCS that he exercises great care and caution while issuing the Secretarial Audit report and also adheres to the highest standards of professional ethics and excellence in providing his services.

Specimen SECRETARIAL AUDIT REPORT FOR THE FINANCIAL YEAR ENDED

To

The Board of Directors

_____ Limited

We have examined statutory and other records, documents maintained by (“the Company”) for the financial year ended on __, _____ according to the provisions of:

- (i) The Companies Act, 1956 and the Rules made thereunder ;
- (ii) The Securities Contracts (Regulation) Act, 1956 (‘SCRA’) and the Rules made there under;
- (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed there under;
- (iv) Foreign Exchange Management Act, 1999 and the applicable rules and regulations made thereunder;
- (v) The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 (‘SEBI Act’);
 - (a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

- (b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
- (c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- (d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
- (e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
- (f) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
- (g) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;
- (vi)(Mention the other laws as may be applicable specifically to the auditee company)
- (vii) The Listing Agreements entered into by the Company with.....Stock Exchange(s).

I have also examined compliance with the applicable clauses of the following:

- (i) Secretarial Standards issued by The Institute of Company Secretaries of India.
- (ii) Corporate Governance Voluntary Guidelines- 2009 issued by the Ministry of Corporate Affairs, Government of India;
- (iii) Corporate Social Responsibility Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs, Government of India;

Based on my examination and verification of the books, papers, minute books, forms and returns filed and other records produced to me and according to information and explanations given to me by the Company, I report that the Company has in my opinion, complied with the provisions of the Companies Act, 1956 (Act) and the Rules made thereunder, the Memorandum and Articles of Association of the Company and also applicable provisions of the aforesaid laws, standards, guidelines, agreements, etc.

I report that, during the year under review:

1. The status of the Company during the financial year has been that of a Private Company/Unlisted Public Company/Listed Public Company.
2. The Company has/has not been a holding or subsidiary of another company. The company has/has not been a Government/non Government Company or a financial/non financial company.
3. The Board of Directors of the Company is duly constituted with proper balance of Executive Directors, Non-Executive Directors and Independent Directors. The changes in the composition of the Board of Directors that took place during the period under review were carried out in compliance with the provisions of the Companies Act, 1956.

Adequate notice is given to all directors to schedule the Board Meetings, agenda and detailed notes on agenda are sent atleast seven days in advance, a system exists for seeking and obtaining further information and clarifications on the agenda items before the meeting and for meaningful participation at the meeting.

Majority decision is carried through while the dissenting members' views are captured and recorded as part of the minutes.

4. The Company has complied with the provisions of the Act and Rules made under that Act in carrying out the following changes:

- (a) Name of the Company
- (b) Registered Office
- (c) Principal business in conformity with the Objects
- (d) Particulars of holding and subsidiary companies
- (e) Promoters
- (f) Auditors
- (g) Directors
- (h) Managerial Remuneration
- (i) Officers in default
- (j) Share Capital (authorized, issued, subscribed, paid-up, conversion/redemption, reclassification, sweat).
- (k) The changes in the provisions of:
 - (i) The Memorandum of Association.
 - (ii) The Articles of Association.

5. The Directors have complied with the disclosure requirements in respect of their eligibility of appointment, their being independent and compliance with the code of Business Conduct & Ethics for Directors and Management Personnel.

6. The Directors have complied with the requirements as to disclosure of interests and concerns in contracts and arrangements, shareholdings/debenture holdings and directorships in other companies and interests in other entities.

7. The company has advanced loans, given guarantees and provided securities amounting to ₹..... to directors and/or persons or firms or companies in which directors were interested, and has complied with the provisions of the Companies Act, 1956.

8. The Company has made loans and investments; or given guarantees or provided securities to other business entities and has complied with the provisions of the Companies Act, 1956 and any other statutes as may be applicable.

9. The amount borrowed by the Company from its directors, members, bank(s)/ financial institution(s) and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws.

10. The Company has not defaulted in the repayment of public deposits, unsecured loans and debentures, facilities granted by bank(s)/financial institution(s) and non-banking financial companies.

11. The Company has created, modified or satisfied charges on the assets of the company and complied with the applicable laws.

12. All registrations under the various state and local laws as applicable to the company are valid as on the date of report.

13. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within the stipulated time in compliance with the provisions of the Companies Act, 1956 and other relevant statutes.

14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956 and other relevant statutes.

15. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends, repayment of principal and interest on debentures, repayment of principal and interest on fixed deposits as required to be so credited to the Fund.

16. The Company has paid all its Statutory dues and satisfactory arrangements have been made for arrears of any such dues.

17. The Company (being a listed entity) has complied with the provisions of the Listing Agreement.

18. The Company has provided a list of statutes in addition to the laws as mentioned above and it has been observed that there are proper systems in place to ensure compliance of all laws applicable to the company.

19. The MCA, SEBI, (any other regulatory authority) carried out inspection of the company during the year and there are no major findings/and the major findings are given below:

20. During the year the company has become a sick company or otherwise (amalgamated) etc.

I further report that:

- (a) the Company has complied with the provisions of Corporate Governance Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs, Government of India;
- (b) the Company has complied with the provisions of Corporate Social Responsibility Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs, Government of India;
- (c) the Company has followed the Secretarial Standards on,, issued by the Institute of Company Secretaries of India;
- (d) the Company has complied with the provisions of Equity listing Agreements entered into with _____ Stock Exchange(s), Simplified Debt listing Agreements entered into with _____ Stock Exchange(s) and provisions of Listing Agreements the company entered into with (Stock Exchanges);
- (e) the Company has complied with the provisions of The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 including the provisions with regard to disclosures and maintenance of records required under the Regulations;
- (f) the Company has complied with the provisions of The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 including the provisions with regard to disclosures and maintenance of records required under the Regulations;
- (g) the Company has complied with the provisions of The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 with regard to _____ ;
- (h) the Company has complied with the provisions of The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 with regard to grant of Stock Options and implementation of the Schemes;
- (i) the Company has complied with the provisions of The Securities and Exchange Board of India

(Issue and Listing of Debt Securities) Regulations, 2008 with regard to..... ;

- (j) the Company has complied with the provisions of the Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;
- (k) the Company has complied with the provisions of The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009 with regard to delisting of Equity shares from the _____ Exchange(s);
- (l) the Company has complied with the provisions of the Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998 with regard to buy back of Equity shares.
- (m) the Company has complied with the Guidelines on Corporate Governance for Central Public Sector Enterprises, 2010.
- (n) the Company has complied with Corporate Governance guidelines for Insurance Companies, issued by IRDA in case of companies regulated by IRDA.

I further report that:

There are adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines.

Place: Signature

Date: Name of Company Secretary/Firm:

ACS/FCS No.

C P No.:

Note: (a) The qualification, reservation or adverse remarks, if any, should be explicitly stated at the relevant paragraphs above.

(b) Parawise details of the Audit findings, if necessary, may be placed as annexure to the report.

(c) The items listed above are inclusive and the list varies from company to company.

LESSON ROUND UP

- Secretarial Audit is the process of verification of compliance with rules, procedures, maintenance of books, records etc. by an independent professional to monitor compliance with various legal requirements.
- Secretarial Audit not only ensures that the company has complied with the provisions of various laws but also extends professional help to the company in carrying out effective compliances and establishment of proper systems with appropriate checks and balances.
- Secretarial Audit can prove to be an effective and multipurpose mode to assure the regulator, generate and repose confidence amongst the shareholders, creditors and other stakeholders in companies, assure Financial Institutions, including state level Financial Institutions etc. and instill self regulation and professional discipline in companies.
- Secretarial Audit is of immense benefit even to larger companies which otherwise have a whole-time Company Secretary in its employment.
- Secretarial Audit is an area of practice for company secretaries which demands the expertise and

specialised and comprehensive knowledge of Companies Act, 1956 and laws relating to Competition Act, SEBI, regulations relating to capital issue, takeover code, insider trading, mutual funds, depositories and participants regulations, Foreign exchange/collaborations etc.

- Secretarial Audit is recognized as a good governance tool by corporates.
- Secretarial Audit is recognized in MCA voluntary Guidelines on Corporate Governance and emerging laws like Companies Bill 2012.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Secretarial Audit is essential for developing better reputation of the company. Comment.
2. Discuss the process involved in secretarial Audit.
3. What should be the scope of secretarial Audit?
4. Who are the beneficiaries of Secretarial Audit?

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Lesson 2

CHECKLIST FOR SECRETARIAL AUDIT

LESSON OUTLINE

- Introduction
- Coverage of the Secretarial Audit
- Sample Register and Returns
- The Companies Act, 1956 and the rules made thereunder
- The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder
- The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder
- The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations
- Foreign Exchange Management Act, 1999 and the Rules and Regulations made thereunder.

LEARNING OBJECTIVES

Secretarial Audit is a proactive governance measure that will have a positive effect on corporate entity. Secretarial Audit (SA) is all encompassing and highly relevant. It is a form of Compliance Auditing System that is used in carrying out total auditing of compliances with all codes and regulatory requirements. It looks into all the books used for a period to check whether they really comply with the various applicable laws and standards.

The objective of the study lesson is to familiarize the students with the various aspects of legal compliance requirements stipulated under the Secretarial Audit, covering the Provision of Companies Act, FEMA Regulations, SEBI Regulations etc. It may be noted that Secretarial Audit checklist requirements are inclusive and differs from company to company. This lesson attempts to give general idea about compliances under different legislations.

INTRODUCTION

Today adoption of good governance practices has emerged as an integral element for doing business. It is not only a prerequisite to face intense competition for sustainable growth in the emerging global market scenario but is also an embodiment of the parameters of fairness, accountability, disclosures and transparency to maximize value of the stakeholders.

Businesses have realized that long term growth and stability can be achieved only by strengthening the foundation. Compliances are being regarded as value addition measures rather than cost centers. To achieve this level of investor confidence, the corporate leaders need set of tools that provide greater visibility to their organizations and strengthen governance, compliance and corporate performance management. One such effective and efficient tool is 'Secretarial Audit'.

Compliances with regulations has always been a reality of business. Continuing line of corporate scandals, compliance more than ever connects directly to the market performance. And Regulations have seemed to multiply over time. The regulations becoming more complex, regardless of the industry, any failure to comply now bears more serious penalties than ever, including the loss of management integrity and shareholder confidence.

Secretarial Audit understands the complexities of the compliance needs - which is vast, interconnected and vital to the success of any organisation. For this reason Secretarial Audit provides as a regulatory tool which pulls together compliance data from multiple systems and then analyses it, reports on it and delivers the required information to the management and administrators concerned.

Secretarial Audit thus entails auditing of relevant documents to conclude as to whether a company has complied with corporate governance requirements. Organizations are advised to be mindful of their obligations to remain committed to safeguarding the existence of their business through transparent best practices fashioned along local and international standards. Secretarial Audit will look into the statutory/operational books of organizations including the reports of all other investigators to check whether they comply with Compliance requirements.

In the Indian situation, unless issues relating to weaknesses prevailing in corporate governance are well addressed, it would be futile to expect good standards of governance. Further, with a view to promote the best corporate governance practices, secretarial audit should be made mandatory for all the institutions. This casts immense responsibility on Practising Company Secretary and poses a great challenge to justify fully, the faith and confidence reposed. PCS should therefore take adequate care while conducting the 'Secretarial Audit' and also adhere to the highest standards of professional ethics and excellence in providing services.

Coverage of the Secretarial Audit

- The Companies Act, 1956 and the rules made thereunder;
- The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder;
- The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder;
- Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder;
- The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992:

- ✓ The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
- ✓ The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
- ✓ The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- ✓ The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
- ✓ The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
- ✓ The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
- ✓ The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;

Major Areas of Compliances under the Companies Act, 1956

The purpose of a company, formed as a commercial enterprise, is mainly to make profits by carrying on its business and maximize its wealth. While doing so, a company is directed by the Board of Directors, which is assisted by officers and professionals. In its pursuit for achieving its objectives and making profits the most important for requirement of a company is to adhere to the legislative environment in relation to such objectives and pursuits and strive, at all times, to deliver whatever has been promised, whether it is to shareholders or stakeholders or customers or vendors or service providers or suppliers or regulators, whether such promises are made in any contract or agreement, or demanded by a provision of law, or merely due to moral covenants only. In other words the company is expected to aim always to deliver whatever has been promised to different sections of the society including its stakeholders and regulators. A company would have failed in its commitment to be a responsible corporate citizen, if it doesn't comply with the provisions of law. This proposition is based on the premise that every provision of law the statute book is only in the interests of the public.

General Compliance Requirements

General compliance requirements includes

1. "Whether the company has kept and maintained all the statutory registers, filed all forms, returns and notices to the prescribed authorities as per the provisions of the Companies Act, 1956."
2. "Whether the company has followed all the requirements of the Act and Memorandum and Articles of Association in respect of notices, proxies, quorum and minutes of all general meetings (including annual general meeting and requisitioned extra-ordinary general meeting) and board and committee meetings."

An analysis of the Companies Act brings out the following:

- The Act has 658 sections, though there are many sections which have become inapplicable or which have been omitted altogether.
- The Act has been divided into XIII parts. For the time being, Part VIA brought into the Act by the Companies (Second Amendment) Act, 2002 has not yet come into force.
- Part I and Part IA to Part IC of the Act relate to certain preliminary matters including provisions for the establishment and empowerment of National Company Law Tribunal and Appellate Tribunal.

For the time being, it is necessary to note that the provisions of the Act with regard to administration of justice through Company Law Board in certain matters continue and the National Company Law Tribunal has not yet been constituted.

Sample List of Documents to be verified

Registers and Records

- Register of investments
- Register of deposits
- Register of charges /Copies of instruments creating charges
- Register & Index of members
- Register & Index of debenture holders
- Foreign registers of members of debenture holders
- Registers and returns
- Minutes book of meetings
- Minutes book of class meeting/creditors meeting
- Books of accounts & cost records
- Register of contracts
- Register of directors, MD, manager & secretary
- Register of directors' shareholding
- Register of investments of loans made, guarantee given or security provided
- Register of renewed & duplicate certificates
- Register of destruction of records/documents
- Register of directors' attendance
- Register of shareholders' attendance
- Register of proxies
- Register of Transfer
- Register of fixed assets
- Register of documents sealed
- Register of debenture holders

Periodical Returns

- Annual Returns
- Annual Accounts/Reports

Other Important Returns

- Return of allotment
- Notice of redemption of preference shares, consolidation, division, increase in share capital, cancellation of shares and increase in number of member
- Notice of situation/change in situation of registered office
- Court/CLB orders

- Registration of resolution & agreements
- Return of appointment of managing director/whole-time director/manager
- Particulars of appointment of directors, managing director, manager or secretary & changes made
- Return of deposits
- Particulars of beneficial interest in shares
- Registration of creation/modification/satisfaction of charge

Meeting Board/Committees/General Meetings and Minutes

- Meetings of directors/Committee Members
- Minutes book of meetings of directors/committee members
- AGM/EGM/deemed Meeting minutes
- Proof of despatch of notices to members

Share Certificates, Transfer/Transmission of Shares, Dividend, Board's Report

- Copies of Endorsed shares certificates and other securities
- Transfer Deeds and transmission request letters etc.
- Declaration, payment and transfer of dividend
- Board's report
- Transfer of unpaid amounts to the IEPF

Contracts

- Details of related parties
- Copies of Disclosure forms under section 299(3)(b)
- Details of transactions/contracts entered into
- Entries made in Register of contracts

Notices

Copies of Show cause notices/default notices etc. received by the company if any.

Compliances with SEBI/Stock Exchanges

- Correspondences exchanged with stock exchanges for complying with listing agreement clauses.
- Returns and intimations submitted with exchanges
- Shareholding Pattern

ANALYSIS OF THE COMPANIES ACT

Contents of Memorandum

As per Section 13, the memorandum of a limited company must state the following:

- (1) (a) the name of company with "Limited" as its last word in the case of a public company; and "Private Limited" as its last word in the case of a private company;
- (b) the state in which the registered office of the company is to be situated;

- (c) in the case of a company in existence immediately before the commencement of the Companies (Amendment) Act, 1965, the objects of the company;
 - (d) in the case of a company formed after such commencement:
 - (i) the main objects of the company to be pursued by the company on its incorporation; and objects incidental or ancillary to the attainment of the main objects;
 - (ii) other objects of the company not included in sub-clause (i); and
 - (e) in the case of companies (other than trading corporations) with objects not confined to one State, the States to whose territories the objects extend;
- (2) The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited.
- (3) The memorandum of a company limited by guarantee shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case may be, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves; such amount as may be required not exceeding a specified amount.
- (4) In the case of a company having a share capital—
- (a) unless the company is an unlimited company, the memorandum shall also state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount;
 - (b) no subscriber of the memorandum shall take less than one share; and
 - (c) each subscriber of the memorandum shall write opposite to his name the number of shares he takes.

The above clauses are compulsory and are designated as “conditions” prescribed by the Act, on the basis of which a company is incorporated.

Alteration of Memorandum of Association

Of all the sections that pertain to alteration of memorandum, the most important seems to be Section 16, where it is clearly provided that alteration of conditions of memorandum shall not be carried out except in the cases, in the manner and to the extent specifically provided in the Act. As per Section 16 of the Act it will be very interesting to see that the name clause, situation clause, objects clause, liability clause, capital clause are the main clauses that could be deemed to be conditions contained in a memorandum of association. The basic point should be what is stated in Section 16 of the Act. Section 16 of the Act provides that the conditions contained in the memorandum of association are those conditions that are governed by Section 13 of the Act. And such conditions have to be altered only in the manner and to the extent expressly provided in the Act.

However, where the share capital of the company has to be altered for earmarking a portion of the capital for issue of preference shares without any increase in capital, it could be seen that no specific provision touching upon this issue is contained in the Act. But share capital is a condition contained in Section 13 of the Act and therefore, it should be scrupulously ensured that the alteration of any condition contained in the memorandum should be done only to the extent and in the manner expressly provided in the Act.

Therefore all the questions relating to alteration of conditions contained in the memorandum could be clubbed into one question whether the company has complied with Section 16 of the Act. This would cover alterations of not only the conditions contained in a memorandum falling under sub-sections (1) and (2) but also other provisions contained in the memorandum falling under sub-sections (3) and (4) of Section 16 of the Act.

The reclassification of share capital could be considered as a matter falling under sub-section (3) and (4) of Section 16 of the Act, particularly in view of the following facts:

- That the term “shares” include both preference and equity shares.
- That the company can issue preference shares if so authorised by articles of association;
- That Section 13, in sub-section (4) requires the mentioning of only the amount of share capital and the division thereof into shares of fixed amount.
- It does not state the kind of share composition and the nature of share capital.
- Thus classification of shares into its kinds cannot constitute a condition governing the memorandum.

A company with unlimited liability may like to alter its liability clause. In such a situation, Section 32 of the Act will come into play. As per Section 32 of the Act, a company registered as unlimited may re-register under this Section as a limited company and a company already registered as a limited company may re-register under this Act. Obviously, the section does not provide for registration of a limited company into an unlimited company. Altering the liability clause of the memorandum for converting the limited liability into unlimited liability would appear to be void as there is no express provision provided in the Act. However for alteration of the liability clause from limited liability to unlimited liability, it is necessary to keep in mind that under Section 38 of the Act, it has been clearly provided that if the alteration in any way increases the liability of a member, it shall not be binding upon the members unless the member agrees in writing before or after the particular alteration is made. Thus, a reading of Section 38 of the Act would make it clear that increasing the liability of members is not, per se, void. Only thing it requires the consent of all the members in writing. This also makes it clear that such an alteration cannot be considered an alteration falling under sub-section (3) and (4) of Section 16 of the Act. Thus practically, all the members of the company have to agree in writing for undertaking unlimited liability. It is in this context, one has to look at Section 32(1)(b) of the Act and understand that if a company with limited liability were to apply for re-registration, with unlimited liability, the Registrar cannot do so unless he is convinced that all the members have agreed in writing for undertaking unlimited liability.

Thus the question whether the company has complied with Section 16 of the Act assumes greater significance and this will be a crucial question in Part II of the Act. This question will also include within its ambit the position that may arise out of any failure to register an alteration to the situation clause. As per Section 19 of the Act, an alteration referred to in Section 17 (i.e. Special Resolution relating to shifting of Registered Office from one state to another state, with respect to allocation of objects of the company, upon conditions specified under Section 17), should be registered within 1 month or 3 months, as the case may be, from the date of the order of the Company Law Board. If the alteration is not so registered, all proceedings connected therewith including the order will become void and inoperative on the expiry of the period of 3 months or the extended period.

ARTICLES OF ASSOCIATION

According to Section 2(2) of the Companies Act, 1956, ‘articles’ means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of

this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.

As per Section 26 of the Act, there may in the case of a public company limited by shares, and there shall in the case of an unlimited company or a company limited by guarantee or a private company limited by shares, be registered with the memorandum, articles of association signed by the subscribers of the memorandum, prescribing regulations for the company.

The articles of association of a company are its by-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company *inter se*. They are subordinate to and are controlled by the memorandum of association.

Alteration of Articles of Association (Section 31)

Though there is a requirement for registration of the Alteration of Articles of Association. Where a public company chooses to alter its Articles of Association to change its status to that of a private company, such alteration would require not only the approval of the Central Government (delegated to Registrar of Companies) but also the filing of a copy of the altered Articles of Association within one month from the date of receipt of order of approval.

In the case of a Listed company, such an alteration would also require the passing of the special resolution by postal ballot as per the Companies (Passing of Resolution by Postal Ballot) Rules, 2001. Section 192 of the Act deals with registration of resolutions and as per the said section all special resolutions have to be filed at the office of the Registrar of Companies and the title of the said section is “Registration of Certain Resolutions and Agreements”.

Copy of Memorandum and Articles to be given to the Members (Section 39)

Section 39 of the Act confers upon every member a statutory right to obtain from the company an upto date copy each of following documents:

- The memorandum,
- The articles,
- Every agreement, and every resolution referred to in Section 192, if and in so far as they have not been embodied in the Memorandum and Articles.

Noting of alteration to Memorandum or Articles in every copy (Section 40)

The provisions contained in Section 40 of the Act are very important and companies generally do not keep their memorandum and articles duly updated. It becomes the first duty of every person dealing with the company, auditing/inspecting the records of the company to go through the memorandum and articles without fail. As per Section 40 where an alteration is made in a memorandum or articles or any resolution referred to in Section 192 of the Act is passed, every copy of the memorandum or articles or agreement or resolution shall be in accordance with the alteration. This section also provides a specific penalty for non-compliances of this section. As per the doctrine of constructive notice, a third party is deemed to have notice of the contents of memorandum and articles. If the memorandum and articles does not reflect the alteration made, then it defeats the very purpose of Section 40 of the Act.

ASSOCIATION NOT FOR PROFIT (Section 25)

Section 25 permits the registration, under a licence granted by the Central Government, of associations not

for profit with limited liability without being required to use the word “Limited” or the words “Private Limited” after their names. This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility.

The Central Government may grant such a licence if :

- (i) it is intended to form a company for promoting commerce, art, science, religion, charity or any other useful object; and
- (ii) the company prohibits payment of any dividend to its members but intends to apply its profits or other income in promotion of its objects.

A Company, which has been granted licence under Section 25 cannot alter the provisions of its Memorandum with respect to its objects except with the previous approval of the Central Government in writing. The provisions contained in Section 25 of the Act are intended to serve a laudable objective. In order to enable companies formed under Section 25 to carry on their objectives without much hassles, the Companies Act has thought it fit to relieve such companies from various provisions of the Act.

Reduction of number of Members (Section 45)

Where the number of members falls below the statutory minimum, whether the company is a private company or public company, the members become severally liable as per Section 45 of the Act, if the company carries on business for 6 months while the number is so reduced.

Investments of Company to be held in its Own Name (section 49)

Under certain circumstances a company is entitled to hold investments which may not be registered in its own name. Subsections (2), (3), (4) and (5) of Section 49 of the Act describe such situations. It is to be noted that these situations are exceptional in nature and they have to be scrupulously followed with the framework of Section 49 of the Act. And where a company has investments which are not held by it in its own name, sub-section 7 of Section 49 of the Act requires a company to maintain a register of investments which is open for inspection as provided in sub-section (8) of Section 49 of the Act. Any default is liable to be punished in accordance with sub-section (9) of Section 49 of the Act.

Acceptance of Public Deposits and provisions relating to Small Depositors (Section 58A and Section 58AA)

In complying the provisions of Section 58A and 58AA of the Act and also the Companies (Acceptance of Deposits) Rules, 1975, under Companies (Auditors’ Report) Order 2003, the statutory auditor of the company has to report in the case of a company which has accepted deposits from public whether the provisions of Section 58A, 58AA of the Act and the relevant rules have been complied with.

Under CARO, 2003, the auditor is supposed to state positively whether the public company (the scope is restricted to public deposits) has complied the provisions of Section 58A and 58AA of the Act and give his opinion whether the company has violated those provisions. The auditor should also state whether the company has complied with orders of Company Law Board or Court or Tribunal, if any under Section 58AA of the Act. The most important aspect of Section 58A or Section 58AA of the Act is whether the deposit has been repaid on time with interest due thereon as per the terms of acceptance.

In determining the extent of compliance of the provisions of the Act under Section 58A, 58AA and 58B following are important:

- Under Section 58AA of the Act, sub-section (7) provides that if a company had accepted deposits from small depositors and subsequent to such acceptance obtains working capital loans, it should

first use the funds for repayment of such deposits.

- Under Section 372A of the Act, if the company had defaulted in complying with Section 58A, the company cannot invest or lend or provide guarantee or security as long as the deposit is subsisting.
- As per Section 77B of the Act, the company is prohibited from buying back, if any default committed by the company in repayment of deposit or interest payable thereon.
- There are also other provisions that protect the interests of depositors.
- Under Section 274 (1) (g) of the Act, if the default continues for one year or more, the directors of the company incur the inevitable disqualification.
- Under Section 58AAA, the default in repayment of deposits has been made a cognizable offence.

In the case of Non-Banking Financial Companies, they have to comply with the directions of the Reserve Bank of India also.

Offering Shares or Debentures to the Public (Section 67)

Section 67 of the Act contained a very clear expression of what amounts to an issue of shares to public as distinguished from a private placement. Section 67 makes it clear that the offer or invitation to subscribe for shares/debentures shall be treated as an offer to the public, if the offer or invitation is made to 50 persons or more.

Every listed Public Company, making initial Public offer of securities for a sum of rupees ten crores or more, shall issue the same only in dematerialized form by complying with the requisites provisions of the Depositories Act, 1996 (Section 68B)

Minimum Subscription (Section 69)

The law is clear that there should be a minimum subscription and this applies for rights issues also under the SEBI (ICDR) Regulation. All these are very important requirements and have been in place for protecting the investors. Where the minimum subscription has not been received, Section 69 demands returning of the moneys to the investors.

Statement in lieu of Prospectus (Section 70)

Section 70 of the Act contains an important provision. Whenever a company wants to issue shares, without issuing a prospectus, it is mandatory to deliver to the Registrar a statement in lieu of prospectus atleast 3 days before allotment of shares/ debentures.

Listing Permission (Section 73)

Companies issuing securities to public have to necessarily get permission from Stock Exchanges for listing the securities. Hence it is necessary to take care of that while complying Section 73 of the Act .

Buyback of Securities (Section 77A, 77AA, 77B)

The requirements to be complied with by listed companies under the above sections read with relevant regulations of SEBI which covers all matters that apply to listed companies/companies purporting to be listed.

Even in respect of unlisted companies, it is necessary to note that under Section 77A read with Section 77AA and Section 77B, there are certain specific compliance requirements, restrictions and prohibitions. Besides these substantive provisions of law contained in the above sections, the company that intends to make a

buyback should comply with the Private Limited Company and Unlisted Public Limited Company (Buyback of Securities) Rules, 1999. In order to appreciate the depth of the subject, it becomes necessary to go through the important requirements, restrictions and prohibitions.

Under Section 77A, the following are the major requirements:

- The buyback should be from out of specified sources of funds such as the free reserves, the securities premium account or the proceeds of issue of shares or other specified securities.
- The buyback requires an enabling clause in the articles of association.
- The buyback requires a specific board resolution or a special resolution with an explanatory statement containing specified particulars. The buyback should be equal to or less than 25% of the total paid-up capital of the company and its free reserves.
- There should be a specified debt equity ratio.
- The shares or other securities, which are proposed to be bought back, have to be fully paid up.
- The buyback must be in any one of the modes prescribed under the said rules.
- The company should file with the Registrar of Companies, the draft letter of offer containing the particulars specified in the said rules before the buyback.
- The Company should file the declaration of solvency with the Registrar of Companies.
- The company should follow the prescribed procedure for making the offer and the payments.
- The company should obtain a certificate from a Company Secretary in Whole time Practice with regard to compliance of the entire rules.
- The company should also maintain a record of the destroyed share certificates.
- The company should extinguish the certificates or other securities bought back.
- As per the rules, the company should obtain a certificate from a Company Secretary in Whole time Practice with regard to extinguishment and physical share certificates.
- The company is required to maintain a register containing the prescribed particulars.
- The company should file a return in the prescribed form with the Registrar of Companies.
- The company is prohibited from making any further issue of the same kind of shares or other securities for a period of 6 months.
- As per Section 77AA of the Act, it is necessary to create Capital Redemption Reserve Account for a sum equal to the nominal value of the shares purchased.
- As per Section 77B of the Act, a company is prohibited from buying back its own shares or other specified securities if it has not complied with Section 159, 207 and 211 of the Act.
- As per Section 77B of the Act, the company is prohibited from buying back through any subsidiary or any investment company or group of investment companies.
- As per Section 77B of the Act, the company is prohibited from buying back, if any default committed by the company in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting.

It is necessary to look at the important prohibitions contained in Section 77B of the Act. There should not be a buy back through any back door arrangement. This calls for a detailed look at the people who agree to the offer made by the company for buyback. There should not have been certain subsisting defaults when the proposal for buyback is under consideration. There should not be a default in compliance of Sections 159, 207 and 211 of the Act. A perusal of Section 207 would reveal that it is basically a section levying a fine or penalty upon companies that have defaulted in payment of declared dividend except in certain exceptional circumstances. Sub-section (2) of Section 77B should be understood to mean whether the company has defaulted to comply with any order of any court awarding punishment as per Section 207 of the Act.

Whether the company had defaulted the provisions of Section 211 of the Act would require close monitoring. Most of the requirements such as the following pertain to accounts and financial statements of the company:

- Whether the financial statements show a true and fair view
- Whether the company has complied with the accounting standards
- Whether the company has drawn up its financial statements in accordance with Schedule VI of the Act.

While complying one has to ascertain whether the private/unlisted public company has complied with the provisions of the Sections 77A, 77AA and 77B of the Act and the Rules thereunder with regard to buyback of shares and other specified securities. Therefore, one has to ensure that –

- (a) the company has ensured buyback within the ceiling in relation to percentage of paid up capital and free reserves
- (b) the company has followed the prescribed offer procedure and has paid all the persons for the bought back shares or other specified securities
- (c) the company has filed with the Registrar of Companies the letter offer declaration of solvency, certificate from a company secretary in practice of compliance of the Rules including extinguishment and destroying of certificates of shares or other specified securities bought back, the return of buyback
- (d) the company has maintained the register of buyback and Register of securities destroyed/cancelled
- (e) the company has complied with the provisions of Section 77AA of the Act with regard to creation of Capital Redemption Reserve Fund .

Further issue of Shares (Section 81)

Section 81 mainly deals with three requirements:

- Issue of shares on rights basis.
- Further issue of shares to persons who may or may not include existing members.
- Conversion of loans into equity.

All the above things may apply to an unlisted company or a listed company, though the provisions of this Section will not apply to private companies. Taking up one by one, it will be possible to analyse the important requirements of this section. With regard to issue of shares on rights basis, several questions normally arise. They are explained below:

In exercise of the powers conferred by sub-section (1A) of section 81 of the Companies Act, 1956 read with section 642 of the said Act, the Central Government hereby makes the rules, namely Unlisted Public Companies (Preferential Allotment) Amendment Rules 2011.

These rules applicable to all unlisted public companies in respect of preferential issue of equity shares, fully convertible debentures, partly convertible debentures or any other financial instruments, which would be convertible into or exchanged with equity shares at a later date.

The term 'Preferential means allotment of shares or any other instrument convertible into shares including hybrid instruments convertible into shares on preferential basis made pursuant to the provisions of subsection (1A) of section 81 of the Companies Act, 1956; Provided that the name, father's name, address and occupation of persons to whom such allotment is proposed to be made shall be mentioned in the resolution passed by the members under that sub-section: Provided further that persons to whom such offer is proposed, shall not be more than forty-nine as per the first proviso to sub-section (3) of section 67 of the Companies Act, 1956

No issue of Shares or any other instruments convertible into shares including hybrids convertible into shares on a preferential basis can be made by a company unless authorised by its articles of association and unless a special resolution passed by the member in a general meeting authorising the Board of Directors to make such issue. The special resolution shall be acted upon within a period of twelve months.

Where warrants are issued on a preferential basis with an option to apply for and get the shares allotted, the issuing company shall determine before hand the price of the resultant shares.

Disclosures required under Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011

The explanatory statement to the notice for the general meeting as required by section 173 of the Companies Act, 1956 shall contain the following particulars:

- (a) the price or price band at which the allotment is proposed;
- (b) the relevant date on the basis of which price has been arrived at;
- (c) the object/s of the issue through preferential offer;
- (d) the class or classes of persons to whom the allotment is proposed to be made;
- (e) intention of promoters/directors/key management persons to subscribe to the offer;
- (f) shareholding pattern of promoters and others classes of shares before and after the offer;
- (g) proposed time within which the allotment shall be completed;
- (h) whether a change in control is intended or expected.

Issue of Duplicate Share Certificates (Section 84)

The company has to comply with the provisions of the Companies (Issue of Share Certificates) Rules, 1960 with regard to issue of duplicate/fresh share certificates.

Issue of Shares with Differential Rights (Section 86)

Under this section, it is necessary to comply with the Companies (Issue of Shares with Differential Voting Rights) Rules, 2001. In respect of listed companies, the Rules require the passing of necessary resolution through a postal ballot. In respect of all companies, the Rules also require a detailed explanatory statement containing certain specific disclosures.

Alteration of Certain matters relating to Share Capital (Section 94)

Section 94 of the Act requires the passing an ordinary resolution in general meeting for altering the conditions contained in its memorandum in relation to the share capital of a company. This Section rightly

applies only to limited companies with share capital. Section 16 of the Act provides that a company cannot alter the conditions contained in its memorandum except in the cases, in the mode, and to the extent, for which express provision has been made in the Act. Section 94 of the Act is an illustration with regard to alteration of the capital clause of a limited company in relation to the following:

- Increase the share capital.
- Consolidate and divide all or any of its share capital into shares of larger amount than its existing shares.
- Convert all or any of its fully paid shares into stock, and reconvert that stock into fully paid up shares of any denomination.
- Sub-division of shares.
- Cancellation of unissued shares.

Reduction of Share Capital (Sections 100 to 105)

Under these sections, the prerequisites, procedures and penalties in relation to reduction of share capital have been provided. Interestingly any action under this section is verified by the court before which the application for reduction of share capital has been made. However in view of the significance of the subject matter, it is necessary to be careful about reduction of capital and necessarily the procedural aspects thereof. In this context, it is necessary to ensure that the following requirements have been complied with.

Variation of Shareholders Rights (Sections 106 and 107)

The company has varied the rights of holders of special classes of shares and the variation of rights has taken place in accordance with the provisions of the Act.

Appointment of Nominees by Shareholders and Debenture holders (section 109A)

A company has to record particulars of appointment/revocation of appointment of nominees of its shareholders/debenture holders.

Special provisions relating to Debentures (Section 117 to 122)

Section 117A

- The debenture trust deed should be in the prescribed form and it should be executed within the prescribed time.
- The copy of the trust deed should be made available for inspection for debenture holder and he shall also be entitled to have a copy thereof.
- Failure to permit inspection or give copy, invites the penal clause contained in sub-section (3) of Section 117A of the Act.

The mischief addressed by this section is applicable only when the company had issued debentures and if it had refused an inspection of the debenture trust deed or to give a copy of the same.

Section 117B

- The provisions of this section apply when the company issues debentures to public.
- Unless, the company appoints one or more persons who are eligible to be appointed as debenture trustees after obtaining the consent of such persons, it is not possible to issue a prospectus or letter

of offer to the public for subscription of its debentures.

- The debenture trustee has certain functions to be carried out as stated in sub-section 3 of Section 117B of the Act.
- The debenture trustee may file a petition before the Company Law Board at any time when the assets are insufficient or likely to become insufficient to discharge the principal amount as and when becomes due.

Section 117C

- It is necessary to create a debenture redemption reserve out of the profits every year until debentures are redeemed.
- The amounts credited to debenture redemption reserve (DRR) except for the purpose of redemption of debentures.
- Quantum of reserve created should be adequate to meet the amount required for redemption including the interest payable thereon.
- Section 117C of the Act will apply to debentures issued and pending to be redeemed.
- Section 117C of the Act will apply to non-convertible portion of debentures issued.
- Where the company fails to redeem the debentures, the debenture holders may seek necessary directions from Company Law Board and any default in complying with the order of the Company Law Board would be a punishable offence.

Section 118

- Under this section it is necessary to forward a copy of any trust deed to any debenture holder or member within 7 days of receipt of a request together with payment of prescribed fee.
- Where a company refuses to forward a copy of the debenture trust deed as requested, the default is a punishable offence and the aggrieved debenture holder or member may approach Company Law Board for necessary directions.
- The debenture trust deed is open for inspection in the same manner as if it were the register of members.

From the above position of law, it is possible to come to the conclusion that the legislature would take a serious view of any default in delivery of copy of debenture trust deed.

REGISTRATION OF CHARGES

Part V of the Act contains Sections 124 to 145 and this part deals extensively with the issue of registration of charges. In the matter of filing of particulars of charges, there have been many cases of failure to file particulars of charges and resultant hardship to creditors who are mostly banks and financial institutions. The laudable objective with which the legislature has made it mandatory to register particulars of charges should be taken into account in order to understand the importance of this part of the Act. A charge becomes void if its particulars are not filed against the liquidator and other creditors is another important factor which reveals the position of law concerning charges. Banks and financial institutions raise their money from public and the entire Part V has been designed to protect public interest.

The objective of any legislation has been to protect the interest of public. The objective of this analysis is to explore the possibility of enhancing the effectiveness of the provisions of law in protecting public interest.

The concept of Corporate Social Responsibility underlines the need for devising ways and means to strengthen the hands of the regulators so that there is effective enforcement of the provisions of law without much intervention into the day-to-day affairs of the company. When the legislature declares a charge as void under certain circumstances, there should be valid reason for the same and every attempt should be made to ensure that the unwary creditor does not lose his capacity to enforce the charge merely because he did not ensure the filing of the same or the proper filing of the same.

Section 127 requires companies to file particulars of properties acquired subject to charge. Section 143 requires companies to maintain a register of charges, while filing of forms under Sections 125, 127, 128, 129, 135 and 138. Maintenance of register of charges under Section 143 of the Act would be covered by a general question with regard to filing of forms and returns and maintenance of registers. Section 136 of the Act requires the company to maintain a copy of every instrument creating/modifying charges.

Registered Office of Company (Section 146)

Registered office of a company is one of the most important provisions from the regulators point of view and public interest point of view. In these days of virtual offices, naturally there will be question whether it is necessary to have a particular place as the registered office of a company. A perusal of the provisions of the Act and other legislations will show the importance accorded to the registered office by the legislature. There are three most important matters, viz., (i) service of notice upon the company, (ii) jurisdiction of courts, Registrar of Companies, Regional Director, Company Law Board and officers of other regulators and (iii) place of keeping books of account, statutory registers, returns and other documents and common seal. Further even in respect of other legislations, registered office of a company determines various things. It is therefore necessary to view with seriousness any omission to notify any change in the registered office of a company.

Restrictions on Commencement of Business (Section 149)

Under Section 149 of the Act, there are two important aspects. A company is neither entitled to exercise its borrowing powers nor entitled to commence its business unless it has obtained a certificate from the Registrar of Companies that the company is entitled to commence business. Section 149 contemplates a passing of a special resolution, if a company were to commence a new business not germane to its existing business. Section 149(2B) of the Act empowers the Board of Directors to seek approval of Central Government where the Board was able to obtain the approval of the members by an ordinary resolution only instead of a special resolution as required by Section 149(2A) of the Act.

Power to Close Register of Members or Debenture holders (Section 154)

For listed companies the listing agreement operates in addition to the requirements of Section 154 of the Act. Unlisted companies, where they close their books, there is compliance of this section.

Foreign Registers (Section 157 & 158)

If the company maintains a foreign register in any state or country outside India it has to comply with the provisions relating to maintaining a copy of the same in accordance with Section 158 of the Act.

Place of keeping and inspection of Registers and Returns (Section 163)

Section 164 of the Act the evidentiary value of the statutory registers and the right of members and others to inspect the registers and take extracts thereof are enshrined in Section 163 of the Act. It is a very important section and it speaks sufficiently about the intention of the legislature in this regard. The legislature had rightly created machinery for remedying any mischief arising out of refusal of the company to permit

inspection of registers or giving extracts thereof. Any refusal by the company to permit taking extracts of the Register of Members or giving a copy of the same would show the extent of transparency and disclosure policy of the company, whatsoever be the motive of the person requiring the extract or copy.

Annual General Meeting and requisitioned Extra Ordinary General Meetings (sections 166 to 169)

Sections 166 to 169 portray a very important statutory right conferred upon the shareholders of a company. If a company fails to conduct its annual general meeting, the Company Law Board, on the application of any member of the company direct the company to call annual general meeting. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a quorum of the meeting. Similarly under Section 169 of the Act, the shareholders enjoy the right to request the Board of Directors to convene an extra-ordinary general meeting and the Board is liable to proceed to call a meeting within the prescribed time, failing which the requisitionists may themselves proceed to conduct the meeting.

All procedural matters regarding general meetings are covered under sections 170 to 186.

Explanatory Statement (Section 173)

Section 173(2) of the Act contains a very laudable provision for explaining the members in respect of specified business before the general meeting, a brief account of the nature of business, the reasons therefor together with a memorandum of interest or concern of directors. While explaining the nature of interest or concern, the interest of persons holding controlling interest in the company are not revealed if such persons do not hold directorships in the company. Barring this lacuna Section 173(2) of the Act is an exceptional provision of law taking care of the interest of the members advising them duly to exercise their voting rights after understanding the real reason behind a particular motion. In addition to the requirements of Section 173(2) of the Act there are various rules that require explanations to be furnished with regard to certain specific matters. To illustrate, one may look at the provisions of the following Rules:

- The Private Limited Company and Unlisted Public Limited Company (Buyback of Securities) Rules, 1999. [Rule (4) read with Schedule I]
- Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. [Rule 3(9)]
- Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003. [Rule 4]
- Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011.

Filing of Resolutions and Agreements (Section 192)

Section 192 of the Act is a special provision requiring the filing of Form No.23 duly accompanied by resolutions, agreements and explanatory statements. It is necessary to emphasize that there has to be a specific Application of mind with regard to compliance of Section 192 of the Act.

In order to appreciate the significance of Section 192 of the Act, the following ingredients of the same should be noted:

Sub-section (2) provides that every resolution or agreement which has the effect of altering the Articles of Association shall be embodied in or annexed to every copy of the Articles of Association issued after such alteration. Sub-section (2) applies to cases where the Articles of Association of the company has been registered.

Sub-section (3) provides that every resolution or agreement which has the effect of altering the Articles of Association shall be sent to any member at his request.

Sub-section (3) applies to cases where the Articles of Association of the company has not been registered.

Sub-section (5) and (6) deal with cases of default in compliance of provisions of sub-section (1), (2) and (3).

Sub-section (7) of Section 192 of the Act, specifically states that the liquidator of the company should be deemed to be an officer of a company.

Appointment of Managerial Persons (Sections 198, 269, 309, 316, 317, 386, 387, 388 and Schedule XIII)

Section 198 provides that the total managerial remuneration shall not exceed 11% of the net profits of the company. Sub-section (3) of Section 198 of the Act states that within the said ceiling, a company may pay a monthly remuneration to its managing or whole-time directors as per Section 309 of the Act or to its manager as per Section 387 of the Act. Sub-section (4) of Section 198 underlines the need for government approval, if the remuneration were to be not in accordance with Schedule XIII, if a company has no profits or when its profits are inadequate.

Section 309 of the Act provides that the total remuneration payable to a director who is in the whole-time employment in the company or a managing director shall not exceed 5% where there is one such director or 10% if there is more than one such director for all of them together.

Section 269 of the Act provides that the appointment of managerial person is compulsory and if the appointment is made in accordance with Schedule XIII, approval of Central Government is not required.

Schedule XIII to the Act contains two parts. Part I contains ceiling on remuneration where the profits are adequate. Part II contains ceiling on remuneration if profits are not adequate or there is no profit.

Section 316 of the Act provides the ceiling on number of companies of which one person may be appointed managing director and ceiling on tenure of office of managing director. Similarly, Section 386 of the Act provides the ceiling on number of companies of which one person may be appointed manager.

In the light of what has been above, the following questions have to be addressed:

1. Procedural aspects relating to appointment of managing director or whole-time director or manager including the filing of the necessary return and approval requirements if necessary.
2. Total remuneration payable to directors/whole-time directors/managing directors/managers.

In the process the company has to ensure that the provisions of Sections 198, 269, 309, 316, 317, 386, 387, 388 and Schedule XIII to the Act in the appointment of/ remuneration to its managing director/whole-time director/manager have been complied with.

Provisions relating to declaration and payment of Dividend (sections 205, 205A, 205B, 205C, 206, 206A and 207 of the Act)

Briefly stated, Section 205 of the Act provides as follows:

- Dividend shall be declared out of profits, after providing for depreciation and losses, if any, to the extent necessary.
- Board may declare interim dividend.
- Within 5 days of declaration of dividend, amount should be transferred to a separate bank account.
- Companies (Transfer of Profits to Reserves) Rules, 1975 should be complied with.

- If a company has failed to redeem preference shares, it should not declare dividend on equity shares.

Section 205A of the Act provides as follows:

- Where any dividend declared by the company remains unpaid or unclaimed, the total amount which remains unpaid or unclaimed, should be transferred, within 7 days from the expiry of 30 days, to a special account called 'Unpaid Dividend Account' of the company in any scheduled bank.
- If a company proposes to declare dividend out of accumulated profits, even when in a particular financial year, there is inadequacy or absence of profits, the company has to comply with the provisions of the Companies (Declaration of Dividend out of Reserves) Rules, 1975. Where such declaration is not in accordance with the said Rules, it requires previous approval of Central Government.

Section 205C of the Act provides for transfer to Investor Education and Protection Fund (IEPF) certain moneys remaining unpaid/unclaimed with the company after certain period of time. The transfer of moneys falling under this section should be carried out in accordance with the Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001. As far as dividend is concerned, the Rules requires the transfer of all unpaid and unclaimed dividend within thirty days after the expiry of seven years from the due date within which the company should have paid the dividend.

Section 206 of the Act provides that the dividend shall be paid only to registered shareholders or to their order or to their bankers.

Section 206A of the Act requires keeping in abeyance of dividends, rights shares and bonus shares pending registration of transfer of shares. However it should be noted that though it is a statutory requirement to keep these benefits in abeyance, such occasions do not arise frequently and with dematerialisation of shares, the opportunities for keeping in abeyance have got further reduced.

Section 207 of the Act provide for certain penalties and payment of interest in the event of any failure on the part of the company to pay declared dividend.

Thus under compliance process, the following questions may be incorporated:

- (a) Where a company has declared any dividend or interim dividend, whether the company has complied with the provisions of Section 205 and 205A of the Act with regard to payment of dividend within the prescribed 30 days as required under Section 205A (1) of the Act
- (b) Whether the company has complied with the Companies (Transfer of Profits to Reserves) Rules, 1975 and Companies (Declaration of Dividend Out of Reserves) Rules, 1975, if applicable
- (c) Whether the company has complied with the provisions of Section 205C of the Act read with the Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001.

Books of Account (Section 209)

The major requirements of this section are keeping proper books of account and keeping them at the registered office of the company . If the company does not keep proper books of account, in such a case there is supposed to be a show cause notice served upon the company and its directors from the Registrar.

Inspection of Books of Account (Section 209A)

Section 209A of the Act provides for inspection of books of account by the Registrar of Companies, other authorised officers of the Central Government or the SEBI. If an inspection were to be ordered, it is the duty of every director, officer, other employees of the company to provide all the books of account and such other

explanations and assistance as may be necessary. If the books of account are not produced or if the officers of the company do not cooperate, the inspecting officer has been empowered to inform the Ministry of Corporate Affairs, which is empowered to take such action as may be necessary. Similarly, if the books of account reveal contraventions of provisions of law, commissions and omissions, it is again for the inspecting officials to take appropriate action against the company, directors and other officers who are liable for the same.

Financial Year (Section 210)

The major requirement under Section 210 of the Act relates to the period of financial year. This section also provides for an approval by the Registrar of Companies, if the accounting period should be extended beyond the prescribed maximum period.

True and Fair View and Disclosure of Particulars (section 211)

The major requirements under this section are compliance of accounting standards, disclosure of particulars in accordance with the requirements of Schedule VI, the need to obtain specific exemption from Central Government for abstaining from disclosure of quantitative particulars, the need to ensure a true and fair view in so far as it pertains to the balance sheet and profit and loss account of the company. The entire requirements are supposed to be an audit questions from the point of view of audit of accounts to be carried out by a chartered accountant in pursuance of the audit related provisions of the Act.

Furnishing of particulars of Subsidiary Companies (Section 212 read with Section 213)

Under these sections, it is necessary to attach with the balance sheet of the holding-company, the balance sheet, profit and loss account, the directors' report, auditor's report and certain other statements and reports of subsidiary company. The holding company may obtain exemption from complying with the provisions of this section, by making an application to the Central Government. The statutory right of the representatives and members of the holding company to inspect the books of account of its subsidiaries as enshrined in Section 214 of the Act, is basically an important provision contained in the Act aimed at disclosing to the shareholders of the holding company certain basic details in relation to its subsidiaries.

Board's Report (Section 217)

Directors' Report acts as the communication bridge between the directors and the members of a company. With the requirement relating to specific disclosures, with the need for necessary explanation to qualifications of statutory auditors, with the introduction of directors' responsibility statement, the report serves a very important purpose. Section 621 of the Act enables every member to file a complaint against a company and its directors for any offence under the Act. If a member feels aggrieved due to failure of the Board of Directors to disclose in Board's report any material information, the member may choose to file a complaint directly. In addition to the requirements contained in Section 217 of the Act, there are other Rules and Regulations such as the ESOP Guidelines of SEBI, Directions of RBI concerning non-banking financial companies, Schedule XIII to the Act also requires the board to make certain disclosures in the Board's report.

There is another important aspect of the disclosure requirements in the Directors' Report. While there are various agencies for scrutinising the prospectus thoroughly, there is no agency for verifying the implementation of the project as stated in the offer document. It is necessary "to check-the utilisation of proceeds and report whether there are any serious deviation or irregularities. Such a disclosure should be defined as a material information falling within the purview of Section 217 of the Act.

Though Section 217 of the Act requires the Board of Directors of a company to report all material information to the shareholders and more particularly all matters having financial implication and those that would cast an impact on the profits of the company, there is hardly any compliance in letter and spirit.

Therefore it is necessary to include the following questions within the scope of the compliance:

- (a) Whether the Board has disclosed in its report all material particulars in compliance of Section 217 and other provisions of the Act and the Rules and Regulations thereunder and the SEBI Regulations and the directions of Reserve Bank of India, as the case may be.
- (b) Whether the company has utilized the proceeds received from the issue for the purposes and in the manner stated in the offer document and where there has been deviation, has the management explained the reasons thereof in the Directors Report

Right of Member to receive Copies of Balance Sheet, etc. (Section 219)

This is a very important statutory right conferred upon every member to get from the company a copy of duly approved/authenticated balance sheet, profit and loss account, the report of the directors and auditors in respect of every accounting year. The company should also send all the above to every trustee of debenture holders and all other persons who are entitled to receive notices of general meetings of companies.

One has to ensure that the company has despatched, to every member, debenture trustee and every other person who is entitled to receive notices of general meeting, a copy of balance sheet, profit and loss account, auditors report and all other documents that are required to be annexed/attached to every balance sheet in accordance with Section 219 of the Act.

Filing of Balance Sheets with Registrar (Section 220)

The following are the two important provisions of this section:

- Filing of 3 copies of the balance sheet, etc. whether or not they have been laid/adopted at the annual general meeting or not.
- Filing a statement to the Registrar of Companies containing the reasons if the balance sheet has not been adopted or if the annual general meeting has not been held.

However the Companies (Amendment) Act, 2006 has made significant change in the process by introducing e-filing mechanism. Further, new standards of financial reporting like Extensible Business Reporting Language (XBRL) from 2011.

Provisions relating to Appointment of Director (Sections 252 to 266)

The following are the major requirements of these provisions:

- Minimum and maximum number of directors of a company and the requirement for approval of Central Government for increasing the maximum number of directors (Sections 252 and 259)
- Determination of office of directors by retirement by rotation (Sections 255 and 256).
- Automatic appointment of directors who are liable to retire by rotation in certain cases (Section 256).
- Eligibility to stand as a candidate for election to the office of a director (Section 257).
- Power to increase or reduce the number of directors (Section 258).
- Appointment of additional director (Section 260).
- Filling up of casual vacancies (Section 262).
- Appointment of directors to be voted individually (Section 263).
- Consent to act as directors (Section 264).
- Proportional representation for the appointment of directors (Section 265).

- Restrictions with regard to appointment/advertisement of director in any prospectus/statement in lieu of prospectus (Section 266).
- Obtaining of Director Identification Number
- Disqualification of Directors (Section 274).
- Maximum number of Directorship (Section 275).
- Automatic vacation of office (Section 283).
- Removal of directors (Section 284).

Passing of Resolutions by Circulation (Section 289)

- Circulation of the draft resolution together with necessary papers to all the directors or to all the members of the committee, then in India.
- It is necessary to ensure that the number of persons in India to whom the resolutions and the papers have been circulated is not less than the quorum fixed for a meeting of the Board or committee as the case may be.
- The resolution and the necessary papers should also be circulated to all other directors or members of committee at their usual address in India.
- The resolution should have been approved by the directors as are then in India or by a majority of them who are entitled to vote on the resolution.
- By necessary implication, it should be understood that an interested director who cannot be counted for quorum purposes in a physical meeting, cannot vote when a draft resolution is circulated.

Again by implication, it should be understood that atleast a majority of directors who are then in India and who are entitled to vote should have voted in favour. It means a director may be a person resident outside India. But if he was in India at the time of circulation of resolution, the draft resolution and other papers should be sent to him and his presence would be counted for the purpose of quorum and also for the purpose of determining the passing of the resolution. It is needless to say that the resolution can be deemed to have been passed only after it receives the consent of a majority of the directors who are then in India and who are entitled to vote.

Considering the fact that the law contained in Section 289 of the Act requires a thorough compliance so that no defect is noticed in any resolution that is passed by circulation.

Powers of Board of Directors (Sections 291, 292 and 293)

The Board derives general powers under Section 291 of the Act. Section 292 of the Act requires certain powers to be exercised only by means of resolutions passed at meetings of Board. Section 293 of the Act places certain restrictions on the powers of Board. Under Section 293 of the Act in order to exercise certain powers, the Board of a public company would require the consent of the company in general meeting. While it is possible to look at compliance of these provisions on a stand alone basis in respect of select transactions, it is advisable to ensure the compliance of Section 292 and Section 293 of the Act thoroughly so that the legislative intention is taken care with a focus towards it. There are many occasions when non-compliance of these sections has been pressed into service in order to question the validity of a transaction. While the doctrine of indoor management would protect third parties from such threats, it can always cause a lot of nuisance and thereby result in loss of valuable time, energy and money.

Audit Committee (Section 292A)

This section offers a corporate governance tool and provides the need for constitution of audit committees for

unlisted companies also. In respect of listed companies, the clauses of the listing agreement are also to be complied with.

Sole Selling Agents (Section 294 & 294AA)

The following question would be adequate to capture the important compliances of the above sections.

Whether the company has obtained the approval of its members and if necessary, also the approval of Central Government as per Sections 294 and 294AA of the Act in respect of sole selling agents, if any, appointed during the year.

Loans to Directors (Section 295)

Section 295 of the Act creates a very important requirement. Prior approval of Central Government should be obtained before a public company lends or gives guarantee or provides security to or for the benefit of any specified person or firm or company. Sub-section (1) of Section 295 of the Act contains 5 clauses and each clause contains a description of a specified person or firm or company. If a company intends to give any loan or provide any security or give any guarantee as security for the repayment of any loan given by any person to any person or firm or company specified in the said clauses, prior approval is necessary. If a company contravenes the requirements of Section 295, the directors responsible for the contravention are not only liable to be punished for such contravention but also they might fall prey to the operation of law relating to automatic vacation of office contained in Section 283 of the Act.

Contracts requiring certain Approvals (Section 297)

Under this section, if a contract or arrangement involves sale/purchase or supply of any goods, materials or services or for providing underwriting services (specified transactions) were to be entered into by a company with a specified person, firm or company, the contract or arrangement requires the approval of the Board of Directors. The following parties require such approvals for entering into any contract or arrangement with a company for specified transactions.

- Director of the company.
- Any relative of the Director of the company.
- A firm in which such a director or relative is a partner.
- Any other partner in such a firm.
- A private company of which the director is a member or director.

Thus, in respect of specified transactions when specified parties propose to enter into any contract or arrangement with a company, the company should have the approval of the Board of Directors and, wherever necessary, approval of Central Government also.

Disclosure of interests by Directors (Section 299)

As a stand-alone section, Section 299 is only a procedural formality. Read with Section 300, 287, 299, 295 and such other similar sections, the disclosure ought to be made by directors as a general requirement under Section 299 of the Act is very useful. Sub-section (6) of Section 299 of the Act states that if the interest of a director of one company in another company arises solely for the reason that he holds less than 2% of the paid up capital of other company, he need not be considered as interested in the other company. However if the director of a company is also a director of another company or if any one of his relative is a director of another company, irrespective of whether such director holds any share in the other company or not, he should be deemed to be interested in the other company. Any failure to disclose interest results in automatic

vacation of office under Section 283 of the Act. Therefore the Act envisages this provision as an important provision and in the era of Corporate Governance, these objectives are laudable. Under Section 305, every director is required to disclose particulars of other offices held/relinquished/vacated by him in other companies within 21 days of appointment/relinquishments.

Holding of Office or Place of Profit by Directors and/or their Relatives (Section 314)

Section 314 of the Act read with, the Director's Relatives (Office or Place of Profit) Rules, 2003, contains two major requirements with respect to appointment of director or any relative of a director to an office or place of profit or a relative of a director who is holding an office or place of profit in a company. The twin requirements of this section are the special resolution and the approval of Central Governments provided the remuneration is beyond a certain ceiling as per the section and/or the said Rules. This section ensures that the directors of companies do not take undue advantage of the position held by them by taking up offices or places of profits in the company, or by appointing their relatives to any office or place of profit in the company.

It is to be checked, whether the company has complied with Section 314 of the Act and The Director's Relatives (Office or Place of Profit) Rules, 2003 in relation to appointment of a director or any relative of a director to any office or place of profit or appointment of any relative of a director who is already holding an office or place of profit to any office or place of profit.

Inter-Corporate Loans and Investments (Section 372A)

Section 372A requires companies having proposals for inter-corporate loans, investments, guarantees, securities to limit the total inter corporate exposure, whether by way of loans or investments or securities or guarantees to certain level. The following compliance requirements are noteworthy:

- As per Section 372A the total inter-corporate exposure should not exceed 60% of the aggregate of the paid up capital and free reserves or 100% percentage of the free reserves.
- The proviso under sub-section (1) states that with a special resolution passed in a general meeting the said ceiling can be exceeded.
- Sub-section (8) contains certain cases of loans, investments, guarantees and securities in respect of which the entire Section 372A will not apply.
- Sub-section (3) provides a ceiling on the interest rate applicable for loans.
- Sub-section (2) provides that the resolution sanctioning inter corporate loans/ investments/ guarantees/securities should be passed at a meeting of a board with the consent of all the directors present at the meeting.
- Sub-section (2) also requires prior approval of public financial institution referred to under Section 4A of the Act if any term loan is subsisting.
- Sub-section (4) provides that if a company has defaulted under Section 58A, it cannot make any inter corporate loans/investments/guarantees/securities.
- Sub-section (5) and (6) provide for the need to keep and maintain a register of investments and at the registered office of the company and states that the said register can be permitted for inspection in the same manner as if it were the register of members.
- Under sub-section (7) the Central Government is empowered to issue necessary guidelines.

As seen above, Section 372A is one of the most important sections of the Companies Act and therefore, it is essential that compliance of Section 372A needs close monitoring.

Appointment of Company Secretary and issue of Compliance Certificate (Section 383A)

As per Section 383 A(1) every company having such paid-up share capital as may be prescribed shall have a whole time secretary, and where the Board of directors of any such company comprises only two directors, neither of them shall be the secretary of the company.

It may be noted that every company not required to employ a whole time secretary under sub-section (1) and having a paid-up share capital of ten lakhs rupees or more shall file with the Registrar a certificate from a secretary in wholetime practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all provisions of this Act and a copy of such certificate shall be attached with Board's report referred to in section 217.

In exercise of the powers conferred by sub-section (1) of section 642 read with proviso to sub-section (1) of section 383A of the Companies Act, 1956, the Central Government notified the Companies (Compliance Certificate) Rules, 2001.

Compounding of Offences (Section 621A)

This is an important provision which relieves the company and its directors from prosecutions and this section is very frequently utilised. But there is no requirement relating to reporting to the shareholders and stakeholders about the compounding fee paid, though there must be a provision for such a disclosure. The compounding fee paid by the company and its directors is not considered as a fine or penalty and the proceedings before the compounding authority are not criminal proceedings.

SECURITIES CONTRACTS (REGULATION) ACT, 1956

The Securities Contracts (Regulation) Act, 1956 enacted to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith. The Act defines various terms in relation to securities and provides the detailed procedure for the stock exchanges to get recognition from Government/SEBI, procedure for listing of securities of companies and operations of the brokers in relation to purchase and sale of securities on behalf of investors. Central Government in exercise of the powers conferred by Section 30 of the Securities Contracts (Regulation) Act, 1956 notified the Securities Contracts (Regulation) Rules, 1957. It provides for the complete procedure Requirements of listing of securities with recognized stock exchanges.

Listing of Securities may either be:

- (i) Initial listing;
- (ii) Listing of Public Issues;
- (iii) Listing of Rights Issues;
- (iv) Listing of Bonus Issues;
- (v) Listing of debentures and bonds;
- (vi) Listing of Preferential Issues.

Compliance:

- (1) Check whether the company's securities are already listed on a Stock Exchange;
- (2) Check whether the company has issued shares/debentures/bonds to the public. If yes, whether:
 - (a) An application for this purpose to the stock exchange has been made along with the documents and

particulars mentioned in Rule 19(1) of the Securities Contracts (Regulation) Rules, 1957;

- (b) Has the listing agreement been finalised and approved by the company's Board and executed with the stock exchange concerned. In case any conditions have been imposed by the stock exchange, have those restrictions/conditions been incorporated in the agreement.
- (c) Whether listing was done within the statutory time limit
- (d) Where permission for listing has been refused by the Stock Exchange:
 - Whether appeal was filed
 - What is the outcome of the appeal
- (e) Whether all terms and conditions of the listing agreement have been complied with.

Compliance with the terms and conditions of the listing agreement:

Check whether the company has complied with the terms and conditions of the listing agreement. In particular, whether compliance relating to the following points have been carried out.

- (i) share transfers have been effected within the stipulated time period;
- (ii) the requirements of book closure have been complied with;
- (iii) the requirements of informing the Stock Exchange(s) regarding bonus or rights issues/dividend proposals complied with;
- (iv) Payment of dividend on shares, interest on debentures/bonds, redemption amount of redeemable shares or debentures/bonds;
- (v) the requirements of informing the Stock Exchange(s) regarding change in the composition of the Board of directors/managing director complied with;
- (vi) Further issue of Securities;
- (vii) Cash Flow Statement in the Annual Report, Consolidated Financial Statement and related party disclosures;
- (viii) Shareholding pattern containing details of promoters holding and non-promoters holding;
- (ix) Decision regarding issue of shares, forfeiture of shares, alteration of shares, cancellation of declared dividend, merger, amalgamation, de-merger, hiving off, voluntary delisting and other material decisions;
- (x) The Distribution Schedule has been filed with the Exchange(s);
- (xi) Quarterly unaudited financial results have been published in newspapers and a copy of these results is sent to the stock exchange;
- (xii) In any proposal to purchase shares of any other company, the requirements of clause 40A/40B of the listing agreement have been complied with;
- (xiii) Half-yearly results and Limited review Report by auditors;
- (xiv) Quarterly reporting of Segment wise Revenue, results and Capital Employed;
- (xv) Consolidated Quarterly Financial results of holding company;
- (xvi) the copies of annual accounts and notices of general meeting are regularly sent to the exchange;
- (xvii) Change of name due to new activity;
- (xviii) Explanation regarding variations in utilisation of funds and profitability;

- (xix) Registration of share Transfer;
- (xx) Loss of share certificate and issue of duplicate Certificate;
- (xxi) Amendments to Memorandum and Articles of Association are sent to the exchange(s);
- (xxii) The exchange is informed of important events like, strike, lockout or amalgamation;
- (xxiii) Clause 49 relating to Corporate Governance has been complied with;
- (xxiv) Clause 50 relating to Accounting Standards.

Penalties under the Securities Contracts (Regulation) Act, 1956

The Act prescribes various penalties against persons who might be found guilty of offences under the Act. These offences are listed below—

Any person who—

- (a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or
- (b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or
- (c) contravenes the provisions contained in section 17 or section 17A or section 19; or
- (d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30; or
- (e) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or
- (f) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or
- (g) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 willfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or
- (h) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other person for any business connected with contracts in contravention of any of the provisions of this Act; or
- (i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognised stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act,

shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees or with both.

Any person who enters into any contract in contravention of the provisions contained in section 15 or who

fails to comply with the provisions of section 21 or section 21A or with the orders of or the Central Government under section 22 or with the Orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty five crore rupees, or with both.

Penalties under Securities Legislations

All the three pieces of securities legislation namely, the SCRA, the SEBI Act and the Depositories Act provide for imposition of various civil penalties. It was doubtful for a while if imposition of monetary penalty under the securities laws required evidence of *mens rea*. It is now conclusively settled with a ruling from the Highest Court that the adjudication proceedings are not criminal or quasi-criminal proceedings. These deal with failures to comply with the statutory civil obligations. Penalty is attracted as soon as the non-compliance with the statutory obligation is established even if there is no *mens rea*. While upholding imposition of monetary penalty in *SEBI v. Shriram Mutual Fund (2006) 68 SCL 216 (SC)*, the Supreme Court held that "In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such contravention becomes wholly irrelevant..." And, when the state of mind is relevant, what is material is what one does or omits to do and not what he says. In the matter of *Sahara India Real Estate Corporation Limited and Ors. v. SEBI (CA No. 2011)*, the Supreme Court observed that a person's inner intentions are to be read and understood from his acts and omissions.

DEPOSITORIES ACT, 1996

Depositories Act, 1996 enacted to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto. SEBI notified Regulations in order to provide the regulatory framework for the depositories. Depositories gave a new dimension and a new scope for conducting transactions in capital market-primary as well as secondary, in a more efficient and effective manner, in a paperless form on an electronic book entry basis. It provided electronic solution to the aforementioned problems of bad deliveries and long settlement cycles.

A Depository is an organisation like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. To utilise the services offered by a Depository, the investor has to open an account with the Depository through a Depository Participant.

Power of Board to give Directions

Section 19 provides that SEBI after making an enquiry or inspection and if satisfied may issue appropriate directions:

- (a) to any depository or participant or any person associated with the securities market; or
- (b) to any issuer;

in the interest of investors or the securities market or to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or the securities market.

Penalty for failure to furnish information/return etc

Section 19A provides that any person, who is required under Depositories Act or any rules or regulations or bye-laws made there under—

- (a) to furnish any information, document, books, returns or report to the Board, fails to furnish the same

within the time specified there for;

- (b) to file any return or furnish any information, books or other documents within the time specified there for in the regulations or bye-laws, fails to file return or furnish the same within the time specified there for;
- (c) to maintain books of account or records, fails to maintain the same;

he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to enter into agreement

Section 19B provides that if a depository or participant or any issuer or its agent or any person, who is a registered intermediary and is required under this Act or any rules or regulations made there under, to enter into an agreement, fails to enter into such agreement, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.

Penalty for failure to redress investors' grievances

Section 19C provides that if any depository or participant or any issuer or its agent or any person, who is registered as a registered intermediary, after having been called upon by the SEBI in writing, to redress the grievances of the investors, fails to redress such grievances within the time specified, such depository or participant or issuer or its agents or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for delay in dematerialization or issue of certificate of securities

Section 19D provides that if any issuer or its agent or any person, who is a registered intermediary, fails to dematerialize or issue the certificate of securities on opting out of a depository by the investors, within the time specified under this Act or regulations or bye-laws made there under or abets in delaying the process of dematerialization or issue the certificate of securities on opting out of a depository of securities, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to comply with directions issued by Board under section 19 of the Act

Section 19F requires that if any person fails to comply with the directions issued by SEBI under section 19, within the time specified by it, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Offences

Section 20 provides that without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or byelaws made there under, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both. If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

Offences by companies

Section 21 provides that where an offence under this Act has been committed by a company, every person

who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. The proviso to the section also provides that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Further Sub-section (2) of the section provides that notwithstanding anything contained in Sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Composition of certain offences

Section 22A provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Appeal to Securities Appellate Tribunal

Section 23A provides that, any person aggrieved by an order of SEBI made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the regulations made there under or by an order made by an adjudicating officer under this Act may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter. However, no appeal shall lie to the Securities Appellate Tribunal from an order made by SEBI with the consent of the parties. Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by SEBI is received by the person referred to in sub-section (1) and it shall be in such form and be accompanied by such fee as may be prescribed :

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

Sub-section (4) provides that on receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

Sub-section (5) provides that the Securities Appellate Tribunal shall send a copy of every order made by it to the Board and parties to the appeal.

Sub-section (6) further provides that the appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Appeal to Supreme Court

Section 23F provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Right to Legal Representation

Section 23C provides that the appellant may either appear in person or authorise one or more Chartered Accountants or Company Secretaries or Cost Accountants, in practice or Legal Practitioners or any of its officers to present his/its case before the Securities Appellate Tribunal.

SECURITIES AND EXCHANGE BOARD OF INDIA (PROHIBITION OF INSIDER TRADING) REGULATIONS, 1992

In simple terms, insider trading implies illegal buying and selling of shares based on privileged information, which is known only to a few who belong to a limited circle of 'insiders' in a company. Insider is a person in possession of corporate information not generally available to the public, as a director, an accountant, or other officer or employee of a corporation. This is clearly dealing in company securities with a view to making a profit or avoiding a loss while in possession of information that, if generally known, would affect their price. In India, by the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, the SEBI has attempted to give a concrete shape, by a legislative measure, to one of the specific functions which section 11 of the Securities and Exchange Board of India Act, 1992 ("the SEBI Act") requires SEBI to discharge. Where a person is an insider, he will be affected by the prohibitions contained in Regulation 3, which is the key provision for prohibition on insider trading and creating it an offence punishable, on conviction, under section 24 of the SEBI Act.

Prohibition on dealing, communicating or counselling on matters relating to insider trading

The objective of the Regulations is banning insider trading. Regulation 3 contains the main provision in this regard. It prohibits an insider from dealing in listed securities when he possesses any unpublished price sensitive information. It provides that no insider shall either on his own behalf or on behalf of any other person; deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information.

The expression 'when in possession of any unpublished price sensitive information' when read with the expression 'no insider shall deal in securities' indicates that merely having knowledge of unpublished price sensitive information while dealing in securities is enough to charge a person with the wrong of insider trading; actually using the unpublished price sensitive information for or in relation to dealing in securities is not necessary to be proved.

The expression 'dealing in securities' is defined as an act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person either as principal or agent.

Price sensitive information

As per Regulation 2(ha) "price sensitive information" means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

The following shall be deemed to be price sensitive information:—

- (i) periodical financial results of the company;
- (ii) intended declaration of dividends (both interim and final);
- (iii) issue of securities or buy-back of securities;
- (iv) any major expansion plans or execution of new projects.
- (v) amalgamation, mergers or takeovers;

- (vi) disposal of the whole or substantial part of the undertaking;
- (vii) and significant changes in policies, plans or operations of the company.

Insider

Under Regulation 2(e), any person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access to Unpublished Price Sensitive Information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information, is 'insider'. It will be noticed from this definition that an 'insider' must be a connected person.

Regulation 2(h) defines the expression 'connected person' and it embraces in its ambit directors, officers or employees of the company and every person who holds a position involving a professional or business relationship between himself and the company whether temporary or permanent and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company. According to the Explanation appended to the above definition, any person who has been a connected person (according to the above definition) for a period of six months prior to an act of insider trading is also to be treated as connected person.

Company Secretary's Duties

Company secretaries of listed companies are in almost all cases compliance officers under the Insider Trading Code recommended by SEBI under the Regulations. There are several compliances of administrative nature that a company secretary has to ensure compliance with in order to get the Code implemented in the company. The company secretary is, however, responsible not only for implantation of the Code, but also for creating awareness among the people in and outside the company who have or likely to have access to unpublished price sensitive information to make it known to them the SEBI Regulations and the Code and dissuade them from indulging in insider trading or tipping insider information to other people. However, making people connected with the company (directly or indirectly) about the SEBI Regulations and consequences of breach is an important duty of company secretary as a compliance officer.

THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999 (FEMA)

The Foreign Exchange Management Act, 1999 (FEMA), is a unique legislation as it has simplified in many respects the erstwhile Foreign Exchange Regulation Act, 1973. FEMA extends to the whole of India and it also applies to all branches, offices, and agencies outside India, owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies. As part of economic liberalization, our country has witnessed a lot of changes in the provisions of law relating to transactions in foreign exchange, investments in India by persons resident outside India, investments outside India by persons resident in India, acquisition of properties in India by persons resident outside India and acquisition of properties outside India by person resident in India.

The objective of FEMA and the rules and regulations made thereunder is to facilitate economic development and at the same time open up the markets to remove the geographical barriers so that opportunities are available to be capitalised by those who seek to do so. The enactment of FEMA has also signalled a new era of liberalization and the continued removal of restrictions by means of notifications issued under various rules and regulations falling under FEMA suggests categorically the fact that the process of reforms is 'on going'. In this era of liberalization, there is naturally a spurt in the inflow of foreign funds, which triggers a lot of economic activity within the country. Concomitant with the growth in economic activity there is a growth in the corporate sector in terms of transactions in foreign exchange, joint ventures, foreign collaborations, acquisitions and many other business deals. Growth in Corporate Sector means increase in companies/

increase in activities of companies. Whether existing enterprises or new entities, there is no doubt that they do a lot of transactions that fall within the purview of FEMA. Company Secretaries, being professionals, are adequately equipped to address issues under any economic legislation and they would be the right choice for the purpose of guiding the corporate sector in appropriate compliances under FEMA while aiding the regulators by bringing out exceptional reporting system whereby the regulators are able to concentrate on material deviations and defaults. Much like the role of the regulator, the role of the professionals should also be to facilitate economic activity so that the wealth of the country as a whole increases without at the same time allowing material deviations and defaults.

FEMA - An Overview

The Foreign Exchange Management Act, 1999 was enacted to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. In fact it is the central legislation that deals with inbound investments into India and outbound investments from India and trade and business between India and the other countries. The FEMA provides:

- Free transactions on current account subject to reasonable restrictions that may be imposed
- RBI control over Capital Account Transactions
- Control over realization of export proceeds
- Dealings in Foreign Exchange through Authorised Person (e.g Authorised Dealer/ Money Changer/ Off-shore Banking Unit)
- Adjudication of Offences
- Appeal provisions including Special Director (Appeals) and Appellate Tribunal
- Directorate of Enforcement

Overall Scheme

- FEMA makes provisions for dealings in foreign exchange broadly; all Current Account Transactions are free. However Central Government can impose reasonable restrictions by issuing rules (section 3 FEMA Act, 1999)
- Capital account transactions are permitted to the extent specified by RBI by issuing Regulations (Section 6 FEMA)
- FEMA envisages that RBI shall have a controlling role in management of foreign exchange.
- “Authorised Persons” to deal in foreign exchange as per directions issued by RBI.
- RBI is empowered to issue directions to such “Authorised Persons” u/s 11.
- FEMA also makes provisions for enforcement, penalties, adjudication and appeal.
- The FEMA 1999 contains only basic legal framework. The practical aspects are covered in Rules made by Central Government and Regulations made by RBI.
- Industrial Policy announced by Ministry of Commerce and Industry, contains provisions in respect of FDI, foreign technical collaboration, royalty payments, joint ventures abroad, etc. which are directly relevant to understanding the provisions of FEMA.
- Policy in respect of External Commercial Borrowings (ECB) and FCCB/ADR/GDR is announced and controlled by Ministry of Finance.

- Instructions/Guidelines etc. of Securities and Exchange Board of India (SEBI) become relevant when capital market is involved.

Structure

FEMA contains 7 Chapters divided into 49 sections of which 12 sections cover operational part and the rest contravention, penalties, adjudication, appeals, enforcement directorate, etc. As far as transactions on account of trade in goods and services are concerned, FEMA has by and large removed the restrictions except for the enabling provision for the Central Government to impose reasonable restrictions in public interest. The capital account transactions regulated by RBI/Central Government for which necessary circulars/notifications issued under FEMA.

CHAPTER I – Preliminary (Sec 1&2)

CHAPTER II- Regulation and Management of Foreign Exchange (Sec 3 –9)

CHAPTER III – Authorised Person (Sec 10 –12)

CHAPTER IV – Contravention and Penalties (Sec 13-15)

CHAPTER V – Adjudication and Appeal (Sec 16- 35)

CHAPTER VI – Directorate of Enforcement (Sec 36-38)

CHAPTER VII- Miscellaneous (Sec 39 – 49)

Besides the FEMA, there are Sets of Rules made by Ministry under section 46 of FEMA and sets of Regulations made by RBI under section 47 of FEMA under the Act which help in implementation of the Act. Master circulars issued by RBI on 1st July of every year. Foreign Direct Investment policy issued by Department of Industrial Policy and Promotion and Reserve Bank of India through notifications and circulars.

The Rules under FEMA are:

1. F.E.M.(Encashment of Draft, Cheque, Instrument and Payment of Interest) Rules, 2000
2. F.E.M. (Authentication of Documents) Rules, 2000
3. F.E.M. (Current Account Transaction) Rules, 2000
4. F.E.M. (Adjudication Proceedings and Appeal) Rules, 2000
5. F.E.M. (Compounding Proceedings) Rules, 2000

The Regulations under FEMA are:

1. F.E.M. (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2000
2. F.E.M. (Borrowing and Lending in Rupees) Regulations, 2000
3. F.E.M. (Borrowing or Lending in Foreign Exchange) Regulations, 2000
4. F.E.M. (Deposit) Regulations, 2000
5. F.E.M. (Export and Import of Currency) Regulations, 2000
6. F.E.M. (Guarantees) Regulations, 2000
7. F.E.M. (Issue of Security in India by a Branch, Office or Agency of a Person Resident Outside India) Regulations, 2000

8. F.E.M. (Acquisition and Transfer of Immovable Property in India) Regulations, 2000
9. F.E.M. (Establishment in India of Branch or Office or Other Place of Business) Regulations, 2000
10. F.E.M. (Export of Goods and Service) Regulations, 2000
11. F.E.M. (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000
12. F.E.M. (Insurance) Regulations, 2000
13. F.E.M. (Investment in Firm or Proprietary Concern in India) Regulations, 2000
14. F.E.M. (Manner of Receipt and Payment) Regulations, 2000
15. F.E.M. (Permissible Capital Account Transactions) Regulations, 2000
16. F.E.M. (Possession and Retention of Foreign Currency) Regulations, 2000
17. F.E.M. (Realization, Repatriation and Surrender of Foreign Exchange) Regulations, 2000
18. F.E.M. (Remittance of Assets) Regulations, 2000
19. F.E.M. (Transfer or Issue of Security by a person Resident outside India) Regulations, 2000
20. F.E.M. (Foreign Exchange Derivative Contracts) Regulations, 2000
21. F.E.M. (Transfer or Issue of any Foreign Security) Regulations, 2004
22. F.E.M. (Offshore Banking Unit) Regulations, 2002
23. F.E.M. (Withdrawal of General Permission to Overseas Corporate Bodies (OCBs) Regulations, 2003.

Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) means investment by non-resident entity/person resident outside India in the capital of the Indian company under Schedule 1 of FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000 and it is a 'Capital account transaction' and Government of India and Reserve Bank of India regulate this under the FEMA, 1999 and consolidated FDI policy. Most of the sectors for foreign direct investment are under automatic route, where some of the sectors have sectoral cap and very few sectors are prohibited under the FDI policy.

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issues a "Consolidated FDI Policy" on an yearly basis (since 2010) elaborating the policy and the process in respect of FDI in India. The latest Consolidated FDI Policy governed by the provisions of the Foreign Exchange Management Act (FEMA), 1999. FEMA Regulations which prescribe amongst other things the mode of investments i.e. issue or acquisition of shares/convertible debentures and preference shares, manner of receipt of funds, pricing guidelines and reporting of the investments to the Reserve Bank

An Indian company may receive Foreign Direct Investment under the two routes as given under:

(i) Automatic Route

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

(ii) Government Route

FDI in activities not covered under the automatic route requires prior approval of the Government which are

considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. The Indian company having received FDI either under the Automatic route or the Government route is required to comply with provisions of the FDI policy including reporting the FDI to the Reserve Bank of India.

Foreign Direct Investment in India is allowed under automatic route except under the following circumstances.

- (i) Proposals that require an industrial licence
- (ii) Proposals in which the foreign collaborator has a previous venture/tie-up in India.
- (iii) Proposals relating to acquisition of shares in an existing Indian Company in favour of Foreign/NRI/OCB investor.
- (iv) Proposals falling outside notified sectoral caps
- (v) Sectors where FDI is not permitted.
- (vi) Investor chooses not to avail automatic route.

Foreign Investment under Automatic Route

An Indian company receiving investment from outside India for issuing shares/ convertible debentures/preference shares under the FDI Scheme, should report the details of the amount of consideration to the Regional Office concerned of the Reserve Bank not later than 30 days from the date of receipt through an AD Category – I bank, together with a copy/ies of the FIRC/s evidencing the receipt of the remittance along with the KYC report on the non-resident investor from the overseas bank remitting the amount. The report would be acknowledged by the Regional Office concerned, which will allot a Unique Identification Number (UIN) for the amount reported.

Reporting of issue of shares

After issue of shares (including bonus and shares issued on rights basis and shares issued under ESOP)/fully, mandatorily & compulsorily convertible debentures/fully, mandatorily & compulsorily convertible preference shares, the Indian company has to file Form FC-GPR(part A), not later than 30 days from the date of issue of shares, which is duly signed by Managing Director/Director/Secretary of the Company and submitted to the Authorized Dealer of the company, who will forward it to the Reserve Bank.

The following documents have to be submitted along with FC-GPR Part A:

- (a) A certificate from the Company Secretary of the company certifying that:all the requirements of the Companies Act, 1956 have been complied with; terms and conditions of the Government's approval, if any, have been complied with; the company is eligible to issue shares under these Regulations; and the company has all original certificates issued by authorized dealers in India evidencing receipt of amount of consideration.
For companies with paid up capital with less than ₹5 crore, the above mentioned certificate can be given by a practicing company secretary.
- (b) A certificate from Statutory Auditor or Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.
- (c) The report of receipt of consideration as well as Form FC-GPR have to be submitted by the AD Category-I bank to the Regional Office concerned of the Reserve Bank under whose jurisdiction the registered office of the company is situated.

It may be noted that the capital instruments should be issued within 180 days from the date of receipt of the

inward remittance or by debit to the NRE/FCNR (B) account of the non-resident investor. In case, the capital instruments are not issued within 180 days from the date of receipt of the inward remittance or date of debit to the NRE/FCNR (B) account, the amount of consideration so received should be refunded immediately to the non-resident investor by outward remittance through normal banking channels or by credit to the NRE/FCNR (B) account, as the case may be. Non-compliance with the above provision would be reckoned as a contravention under FEMA and would attract penal provisions. In exceptional cases, refund of the amount of consideration outstanding beyond a period of 180 days from the date of receipt may be considered by the RBI, on the merits of the case.

Issue price of shares

Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than-

- the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company is listed on any recognised stock exchange in India;
- the fair valuation of shares done by a SEBI registered Category – I Merchant Banker or a Chartered Accountant as per the discounted free cash flow method, where the shares of the company is not listed on any recognised stock exchange in India; and
- the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment..

It may be noted that Issue of bonus/rights shares or stock options to persons resident outside India directly or on amalgamation/merger/demerger with an existing Indian company, as well as issue of shares on conversion of ECB/royalty/lumpsum technical know-how fee/import of capital goods by units in SEZs, has to be reported in Form FC-GPR.

Reporting with respect to conversion of ECB into equity

Details of issue of shares against conversion of ECB has to be reported to the Regional Office concerned of the RBI, as indicated below:

- (i) In case of full conversion of ECB into equity, the company shall report the conversion in Form FC-GPR to the Regional Office concerned of the Reserve Bank as well as in Form ECB-2 to the Department of Statistics and Information Management (DSIM), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051, within seven working days from the close of month to which it relates.

The words "ECB wholly converted to equity" shall be clearly indicated on top of the Form ECB-2. Once reported, filing of Form ECB-2 in the subsequent months is not necessary.

- (ii) In case of partial conversion of ECB, the company shall report the converted portion in Form FC-GPR to the Regional Office concerned as well as in Form ECB-2 clearly differentiating the converted portion from the non-converted portion. The words "ECB partially converted to equity" shall be indicated on top of the Form ECB-2. In the subsequent months, the outstanding balance of ECB shall be reported in Form ECB-2 to DSIM.

Reporting of FCCB/ADR/GDR Issues

The Indian company issuing ADRs/GDRs has to furnish to the Reserve Bank, full details of such issue within 30 days from the date of closing of the issue.

The company should also furnish a quarterly return to the Reserve Bank within 15 days of the close of the

calendar quarter. The quarterly return has to be submitted till the entire amount raised through ADR/GDR mechanism is either repatriated to India or utilized abroad as per the extant Reserve Bank guidelines.

Annual Return for FDI

Reserve Bank of India (RBI) in order to capture the statistics relating to Foreign Direct Investment (FDI) and Overseas Direct Investment (ODI) outside India in a more comprehensive manner and to align with international best practices, introduced the concept of Annual Return which will replace Part B of the Form – FC GPR which was required to be filed by the companies annually.

This Annual Return should be submitted by all Indian Companies which have received FDI/made ODI in the previous years including the current year. The return is required to be filed by July 15th of every year to the Director of Balance of Payments, statistics division, Department of statistics and information Management (DSIM), Reserve Bank of India, C-9, 8th floor, Bandra Kurla Complex, Bandra (E), Mumbai – 400 005.

The Annual Return has three sections covering identification particulars, foreign assets and foreign liabilities. The methods of valuation of foreign liabilities and assets are also prescribed.

The information required to be given in the Annual Return should be based on audited Balance Sheet of the previous year. If the information is provided based on unaudited Balance Sheet and there are major difference in the information earlier provided, revised return along with audited Balance Sheet needs to be filed.

Repatriation of Dividend

Dividends are freely repatriable without any restrictions (net after Tax deduction at source or Dividend Distribution Tax, if any, as the case may be). The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time.

Repatriation of Interest

Interest on fully, mandatorily & compulsorily convertible debentures is also freely repatriable without any restrictions (net of applicable taxes). The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time.

Foreign Investment under Approval Route

Guidelines for consideration of FDI proposals by FIPB:

The following guidelines have been laid down to enable the FIPB to consider the proposals for FDI and formulate its recommendations:

- All applications should be put up before the FIPB by its Secretariat within 15 days and it should be ensured that comments of the administrative ministries are placed before the Board either prior to/or in the meeting of the Board.
- Proposals should be considered by the Board keeping in view the time frame of thirty (30) days for communicating Government decision.
- In cases in which either the proposal is not cleared or further information is required in order to obviate delays presentation by applicant in the meeting of the FIPB should be resorted to.
- While considering cases and making recommendations, FIPB should keep in mind the sectoral requirements and the sectoral policies vis-à-vis the proposal (s).

- FIPB would consider each proposal in its totality
- The Board should examine the following while considering proposals submitted to it for consideration:
 - (i) whether the items of activity involve industrial licence or not and if so the considerations for grant of industrial licence must be gone into;
 - (ii) whether the proposal involves any export projection and if so the items of export and the projected destinations.
 - (iii) Whether the proposal has any strategic or defence related considerations.
- While considering proposals the following may be prioritized:
 - (i) Items falling in infrastructure sector.
 - (ii) Items which have an export potential.
 - (iii) Items which have large scale employment potential and especially for rural people.
 - (iv) Items which have a direct or backward linkage with agro business/farm sector.
 - (v) Items which have greater social relevance such as hospitals, human resource development, life saving drugs and equipment.
 - (vi) Proposals which result in induction of technology or infusion of capital.
- The following should be especially considered during the scrutiny and consideration of proposals:
 - (i) The extent of foreign equity proposed to be held (keeping in view sectoral caps if any)
 - (ii) Extent of equity from the point of view whether the proposed project would amount to a holding company/wholly owned subsidiary/a company with dominant foreign investment (i.e. 76% or more) joint venture.
 - (iii) Whether the proposed foreign equity is for setting up a new project (joint venture or otherwise) or whether it is for enlargement of foreign/NRI equity or whether it is for fresh induction of foreign equity/NRI equity in an existing Indian company.
 - (iv) In the case of fresh induction offerings/NRI equity and/or in cases of enlargement of foreign/NRI equity, in existing Indian companies whether there is a resolution of the Board of Directors supporting the said induction/enlargement of foreign/NRI equity and whether there is a shareholders agreement or not.
 - (v) In the case of induction of fresh equity in the existing Indian companies and/or enlargement of foreign equity in existing Indian companies, the reason why the proposal has been made and the modality for induction/enhancement (i.e. whether by increase of paid up capital/authorized capital, transfer of shares (hostile or otherwise) whether by rights issue, or by what modality.
 - (vi) Issue/transfer/pricing of shares will be as per SEBI/RBI guidelines.
 - (vii) Whether the activity is an industrial or a service activity or a combination of both.
 - (viii) Whether the items of activity involves any restriction by way of reservation for the Micro & Small Enterprises sector.
 - (ix) Whether there are any sectoral restrictions on the activity
 - (x) Whether the proposal involves import of items which are either hazardous, banned or detrimental to environment (e.g. import of plastic scrap or recycled plastics).

It may be noted that the Companies may not require fresh prior approval of the Government for bringing in

additional foreign investment into the same entity, in the following cases:

- (i) Cases of entities whose activities had earlier obtained prior approval for their initial foreign investment but subsequently such activities/sectors have been placed under automatic route;
- (ii) Cases of entities whose activities had sectoral caps earlier and who had, accordingly, earlier obtained prior approval for their initial foreign investment but subsequently such caps were removed/increased and the activities placed under the automatic route; provided that such additional investment alongwith the initial/original investment does not exceed the sectoral caps; and
- (iii) The cases of additional foreign investment into the same entity where prior approval had been obtained earlier for the initial/original foreign investment due to requirements of Press Note 18/1998 or Press Note 1 of 2005 and prior approval of the Government under the FDI policy is not required for any other reason/purpose.

DIRECT INVESTMENT OUTSIDE INDIA

Direct Investment outside India' means investment by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity or by way of purchase of existing shares of a foreign entity whether by market purchase or private placements or through stock exchanges, but does not include portfolio investment.

Eligibility

An Indian party is eligible to make direct investment in Joint Venture or Wholly Owned Subsidiary outside India. As per Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 Indian party includes:

- (i) A company incorporated in India
- (ii) Body created under an Act of Parliament
- (iii) Partnership Registered under Indian Partnership Act, 1932
- (iv) Any other entity as may be notified by the Reserve Bank

In case of partnership, individual partner can hold foreign securities for and on behalf of the firm, only if host country regulations or operational requirements warrant such holding.

Restrictions/Prohibitions

- Indian parties are prohibited from making direct investment in a foreign entity engaged in real estate /banking business. It may be noted that Indian Banks operating in India can set up WOS abroad, provided they obtain clearance under Banking Regulation Act, 1949.
- Investment in Pakistan is not permitted under Automatic Route
- A person resident in India is not permitted to make Overseas Direct Investments unless RBI's prior approval is obtained. However he may purchase a foreign security out of funds held in Resident Foreign Currency (RFC) account maintained in accordance with the Foreign Exchange Management (Foreign Currency Accounts) Regulations, 2000.

Approvals Required

- Approval from Board of Directors

- Shareholders of the Company
- Approval from Department of Economic Affairs, Ministry of Finance, if required
- Approval from Reserve Bank of India (pre/post facto)

Limits and Conditions

According to Regulation 6 of Foreign Exchange Management (Transfer or issue of any Foreign Security) Regulations, 2000, an Indian party is permitted to make investment in overseas Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS), not exceeding 400 per cent of its net worth as on the date of the last audited balance sheet. However, the ceiling of 400 per cent of net worth will not be applicable where the investment is made out of balances held in Exchange Earners' Foreign Currency account of the Indian party or out of funds raised through ADRs/GDRs.

The Indian party is required to approach an Authorised Dealer Category - I bank with an application in Form ODI and prescribed enclosures/documents for effecting remittances towards such investments. Such overseas investments will include contribution to the capital of the overseas JV/WOS, loan granted to the JV/WOS and 100 per cent of guarantees issued to or on behalf of the JV/WOS.

It may be noted that Applications for investment in JV/WOS overseas in the energy and natural resources sectors (e.g. oil, gas, coal and mineral ores) in excess of 400 per cent of the net worth of the Indian companies as on the date of the last audited balance sheet may be considered by RBI and accordingly AD Category - I banks may forward such applications from their constituents to the Reserve Bank as per the laid down procedure.

These investments are subject to the following conditions:

- (i) The Indian entity may extend loan/guarantee to an overseas concern only in which it has equity participation. Indian entities may offer any form of guarantee - corporate or personal/primary or collateral/guarantee by the promoter company/guarantee by group company, sister concern or associate company in India; provided that
 - All financial commitments including all forms of guarantees are within the overall ceiling prescribed for overseas investment by the Indian party i.e. currently within 400 per cent of the net worth of the Indian party,
 - No guarantee is 'open ended' i.e. the amount of the guarantee should be specified upfront, and
 - As in the case of corporate guarantees, all guarantees are required to be reported to Reserve Bank, in Form ODI-Part II. Guarantees issued by banks in India in favour of WOSs/JVs outside India, would be outside this ceiling and would be subject to prudential norms issued by Reserve Bank from time to time.
 - It may be noted that Specific approval of the Reserve Bank will be required for creating charge on immovable property and pledge of shares of the Indian parent/ group companies in favour of a non- resident entity.
- (ii) The Indian party should not be on the Reserve Bank's Exporters caution list/ list of defaulters to the banking system circulated by the Reserve Bank/ Credit Information Bureau (India) Ltd (CIBIL)/or any other Credit Information company as approved by the Reserve Bank or under investigation by any investigation/enforcement agency or regulatory body.
- (iii) All transactions relating to a JV/WOS should be routed through one branch of an authorised dealer

bank to be designated by the Indian party.

- (iv) In case of partial/full acquisition of an existing foreign company, where the investment is more than USD 5 million, valuation of the shares of the company shall be made by a Category I Merchant Banker registered with SEBI or an Investment Banker/Merchant Banker outside India registered with the appropriate regulatory authority in the host country; and, in all other cases by a Chartered Accountant or a Certified Public Accountant.
- (v) In cases of investment by way of swap of shares, irrespective of the amount, valuation of the shares will have to be by a Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Foreign Investment Promotion Board (FIPB) will also be a prerequisite for investment by swap of shares.
- (vi) In case of investment in overseas JV/WOS abroad by a registered Partnership firm, where entire funding for such investment is done by the firm, it will be in order for individual partners to hold shares for and on behalf of the firm in the overseas JV/WOS if the host country regulations or operational requirements warrant such holdings.
- (vii) Investments in JV/WOS abroad by Indian parties through the medium of a Special Purpose Vehicle (SPV) is also permitted under the Automatic Route subject to the conditions that the Indian party is not included in the Reserve Bank's Caution list or is under investigation by the Enforcement Directorate or included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank Indian parties whose names appear in the Defaulters' list require prior approval of the Reserve Bank for the investment. It is clarified that setting up of an SPV under the Automatic Route is permitted only for the purpose of investment in JV/WOS overseas.
- (viii) An Indian party may acquire shares of a foreign company engaged in a bonafide business activity, in exchange of ADRs/GDRs issued to the latter in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued there under from time to time by the Central Government, provided:
 - ADRs/GDRs are listed on any stock exchange outside India;
 - The ADR and/or GDR issue for the purpose of acquisition is backed by underlying fresh equity shares issued by the Indian party;
 - The total holding in the Indian entity by persons resident outside India in the expanded capital base, after the new ADR and/or GDR issue, does not exceed the sectoral cap prescribed under the relevant regulations for such investment under FDI;
 - Valuation of the shares of the foreign company shall be
 - (a) as per the recommendations of the Investment Banker if the shares are not listed on any recognized stock exchange; or
 - (b) based on the current market capitalisation of the foreign company arrived at on the basis of monthly average price on any stock exchange abroad for the three months preceding the month in which the acquisition is committed and over and above, the premium, if any, as recommended by the Investment Banker in its due diligence report in other cases.

The Indian Party is required to report such acquisition in form ODI to the AD Bank for report to the Reserve

Bank within a period of 30 days from the date of the transaction. It may be noted that Investments in Nepal are permitted only in Indian rupees. Investments in Bhutan are permitted in Indian Rupees as well as in freely convertible currencies. All dues receivable on investments made in freely convertible currencies, as well as their sale/winding up proceeds are required to be repatriated to India in freely convertible currencies only. The automatic route facility is not available for investment in Pakistan.

Method of Funding

(1) Investment in an overseas JV/WOS may be funded out of one or more of the following sources:

- drawal of foreign exchange from an AD Bank in India;
- capitalisation of exports;
- swap of shares
- utilisation of proceeds of External Commercial Borrowings (ECBs)/Foreign Currency Convertible Bonds (FCCBs);
- in exchange of ADRs/GDRs issued in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued there under from time to time by the Central Government
- balances held in EEFC account of the Indian party; and
- utilisation of proceeds of foreign currency funds raised through ADR/GDR issues.

In respect of (vi) and (vii) above, the ceiling of 400 per cent of net worth will not apply. In respect of investments in the financial sector, they will be subject to compliance of Regulation 7 which has already been discussed in the previous paragraphs.

(2) General permission has been granted to residents for purchase/acquisition of securities in the following manner

- out of funds held in RFC account;
- as bonus shares on existing holding of foreign currency shares; and
- when not permanently resident in India, out of their foreign currency resources outside India

All applications of Direct Investment outside India which are not qualifying for Automatic route as mentioned in the above mentioned paragraphs are required to obtain prior approval from Reserve Bank of India.

Procedural Checklists

(a) Automatic Route

1. Board Resolution is required to be passed under Section 292 of the Companies Act, 1956, specifying the limits for investment by Directors, in respect of out bound investment by the company.
2. Special Resolution has to be passed under Section 372 A of the Companies Act, 1956 for investments in excess of 60% of the paid-up Capital and free reserves or 100% of free reserves whichever is higher and necessary e-form 23 has to be filed with ROC, in case of out bound investment by company.
3. It has to be ensured that direct investment outside India does not exceed 400% of the net worth of the company.
4. Statutory Auditors certificate has to be obtained in the specified format.

5. Valuation report has to be obtained from a Chartered Accountant or certified public accountant. In case the investment is more than USD 5 Million, then valuation has to be done by a category I Merchant Banker registered with SEBI or appropriate authority of the host country.

6. Certificate from Chartered accountant has to be obtained for the reasonableness of the acquisition price.

7. Authorised dealer has to be approached with form A-2, Board Resolution, Statutory Auditors' certificate etc for effecting the investment.

8. It has to be ensured that Reporting of ODI has to be made in form ODI (both Part I and Part II) with through authorized dealer to The Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Amar Bldg. 5th floor, Sir P. M. Road, Fort, Mumbai 400001 along with the following documents

- (a) A report from the bankers of the Indian party in a sealed/closed cover.
- (b) The latest Annual Accounts, i.e. Balance Sheet and Profit and Loss Account of the Indian party along with the Directors' Report.
- (c) Additional documents as under, if the application is made for partial/full take over of an existing foreign concern:
 - (i) A copy of the certificate of incorporation of the foreign concern;
 - (ii) Latest Annual Accounts, i.e. the Balance Sheet and Profit and Loss Account of the foreign concern along with Directors' Report; and
 - (iii) A copy of the share valuation certificate from:
 - a Category I Merchant Banker registered with SEBI, or, an Investment Banker /Merchant Banker registered with the appropriate regulatory authority in the host country, where the investment is more than USD 5 million, and
 - in all other cases, by a Chartered Accountant or a Certified Public Accountant.
- (d) A certified copy of the Resolution of the Board of Directors of the Indian party/ies approving the proposed investment.
- (e) Where investment is in the financial services sector, a certificate from a Statutory Auditor/Chartered Accountant to the effect that the Indian Party:
 - (i) has earned net profits during the preceding three financial years from the financial service activity;
 - (ii) is registered with the appropriate regulatory authority in India for conducting the financial services activity;
 - (iii) has obtained approval for investment in financial sector activities abroad from regulatory authority concerned in India and abroad; and
 - (iv) fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.

9. On submission of ODI to RBI, it will allot a unique identification number to each JVs and WOS abroad which is required to be quoted in all correspondence including additional investment in the existing overseas concern within the specified limits.

10. It has to be ensured to receive share certificate of any other documentary evidence of investment in foreign entity within six months, failing which an application for extension of the same has to be made.

11. Annual Performance Report in the format specified in part III of form ODI, within 3 months of closing the accounts of JVs/WOS as long as it is in existence.

12. It may be noted that an eligible Indian party making investment in a Joint Venture (JV)/Wholly Owned Subsidiary (WOS) outside India is required to route all its transactions relating to the investment through one branch of an AD Category – I bank designated and all communication from the Indian parties, to the Reserve Bank, relating to the investment outside India should be routed through the same branch of the AD Category – I bank that has been designated by the Indian investor for the investment.

(b) Approval Route

1. Board Resolution is required to be passed under Section 292 of the Companies Act, 1956, specifying the limits for investment by Directors, in respect of out bound investment by the company.

2. Special Resolution has to be passed under Section 372 A of the Companies Act, 1956 for investments in excess of 60% of the paid-up Capital and free reserves or 100% of free reserves whichever is higher and necessary e-form 23 has to be filed with ROC, in case of out bound investment by the company.

3. Part I of form ODI, along with the supporting documents, is required to be submitted after scrutiny and with specific recommendations by the designated AD Category - I bank, to The Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Amar Bldg. 5th floor, Sir P. M. Road, Fort, Mumbai 400001.

In case the proposal is approved, Part I will be returned by the Reserve Bank to the AD Category - I bank. After effecting the remittance, the AD Category – I bank should resubmit the same to the Reserve Bank along with Part II of form ODI along with the following documents.

- (a) A report from the bankers of the Indian party in a sealed/closed cover.
- (b) The latest Annual Accounts, i.e. Balance Sheet and Profit and Loss Account of the Indian party along with the Directors' Report.
- (c) Additional documents as under, if the application is made for partial/full take over of an existing foreign concern:-
 - (i) A copy of the certificate of incorporation of the foreign concern;
 - (ii) Latest Annual Accounts, i.e. the Balance Sheet and Profit and Loss Account of the foreign concern along with Directors' Report; and
 - (iii) A copy of the share valuation certificate from:
 - a Category I Merchant Banker registered with SEBI, or, an Investment Banker /Merchant Banker registered with the appropriate regulatory authority in the host country, where the investment is more than USD 5 million, and
 - in all other cases, by a Chartered Accountant or a Certified Public Accountant.
- (d) A certified copy of the Resolution of the Board of Directors of the Indian party/ies approving the proposed investment.
- (e) Where investment is in the financial services sector, a certificate from a Statutory Auditor/Chartered Accountant to the effect that the Indian Party:
 - (i) has earned net profits during the preceding three financial years from the financial service

activity;

- (ii) is registered with the appropriate regulatory authority in India for conducting the financial services activity;
- (iii) has obtained approval for investment in financial sector activities abroad from regulatory authority concerned in India and abroad; and
- (iv) fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.

4. On submission of ODI to RBI, it will allot a unique identification number to each JVs and WOS abroad which is required to be quoted in all correspondence including additional investment in the existing overseas concern within the specified limits.

5. It has to be ensured to receive share certificate of any other documentary evidence of investment in foreign entity within six months, failing which an application for extension of the same has to be made.

6. It has to be ensured that repatriation of all the dues takes place within 60 days of its falling due.

7. Annual Performance Report in the format specified in part III of form ODI, within 3 months of closing the accounts of JVs/WOS as long as it is in existence.

8. It may be noted that an eligible Indian party making investment in a Joint Venture (JV)/Wholly Owned Subsidiary (WOS) outside India is required to route all its transactions relating to the investment through one branch of an AD Category – I bank designated and all communication from the Indian parties, to the Reserve Bank, relating to the investment outside India should be routed through the same branch of the AD Category – I bank that has been designated by the Indian investor for the investment.

The Regulations mentioned in the Secretarial Audit are as under:

- The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
- The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
- The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
- The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998; and
- The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011.

(Check list of the stated above Regulations are available elsewhere in this Study Material).

Professional opportunities for Company Secretaries

- Compliances under FEMA rules and regulations and RBI circulars etc.
- Consultancy in realization and repatriation of foreign exchange
- Representation before Authorities
- Taxation

- Applications to RBI
- Foreign exchange derivative contracts
- Obtaining Government Approval wherever required
- Adherence to compliances in matters of borrowings and lendings in foreign exchange, if permitted by RBI
- Consultancy on Issue of Foreign Currency Convertible Bonds, American Depository Receipt, Global Depository Receipt etc
- Valuation of Shares in certain cases.

LESSON ROUNDUP

- Today adoption of good governance practices has emerged as an integral element for doing business. It is not only a prerequisite to face intense competition for sustainable growth in the emerging global market scenario but is also an embodiment of the parameters of fairness, accountability, disclosures and transparency to maximize value of the stakeholders.
- The purpose of a company, formed as a commercial enterprise, is mainly to make profits by carrying on its business and maximize its wealth. While doing so, a company is directed by the Board of Directors, which is assisted by officers and professionals.
- General Compliance required that whether the company has kept and maintained all the statutory registers, filed all forms, returns and notices to the prescribed authorities as per the provisions of the Companies Act, 1956 and mention the name of each register, return, form or notice together with date of filing of the return, form or notice.
- The Securities Contracts (Regulation) Act, 1956 enacted to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith. The Act defines various terms in relation to securities and provides the detailed procedure for the stock exchanges to get recognition from Government/SEBI, procedure for listing of securities of companies and operations of the brokers in relation to purchase and sale of securities on behalf of investors.
- Depositories Act, 1996 enacted to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto. SEBI notified Regulations in order to provide the regulatory framework for the depositories. Depositories gave a new dimension and a new scope for conducting transactions in capital market-primary as well as secondary, in a more efficient and effective manner, in a paperless form on an electronic book entry basis. It provided electronic solution to the aforementioned problems of bad deliveries and long settlement cycles.
- In simple terms, insider trading implies illegal buying and selling of shares based on privileged information, which is known only to a few who belong to a limited circle of 'insiders' in a company. Insider is a person in possession of corporate information not generally available to the public, as a director, an accountant, or other officer or employee of a corporation.
- Company Secretaries of listed companies are in almost all cases compliance officers under the Insider Trading Code recommended by SEBI under the Regulations. There are several compliances of administrative nature that a company secretary has to ensure compliance with in order to get the Code implemented in the company.
- The objective of FEMA and the rules and regulations made thereunder is to facilitate economic development and at the same time open up the markets to remove the geographical barriers so that opportunities are

available to be capitalised by those who seek to do so. The enactment of FEMA has also signalled a new era of liberalization and the continued removal of restrictions by means of notifications issued under various rules and regulations falling under FEMA.

SELF TEST QUESTIONS

1. Today adoption of good governance practices has emerged as an integral element for doing business. Compliances are being regarded as value addition measures to Corporate Governance. Comment.
2. Prepare a check list on Buy-back of shares by your Company, where you are the Company Secretary.
3. Prepare a check list on Company's Inter-corporate loan and investments under Companies Act, 1956.
4. Briefly discuss about reporting requirement under Foreign Direct Investment.
5. Indian party desired to invest in outside India. Advise Indian Part on method of funding.

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Lesson 3

SECRETARIAL STANDARDS

LESSON OUTLINE

- Establishment of Secretarial Standards Board and its objectives
- Need, scope of Secretarial Standards
- Advantages of Secretarial Standards
- Procedure for issuing Secretarial Standards
- Compliance of Secretarial Standards
- A brief Analysis of Secretarial Standards issued (Secretarial Standard 1 – Secretarial Standard 10)
- Guidance notes

LEARNING OBJECTIVES

Companies follow diverse secretarial practices and, therefore, there is a need to integrate, harmonise and standardise such practices so as to promote uniformity and consistency. The formulation of Secretarial Standards by the 'Secretarial Standards Board' (SSB) of the Institute of Company Secretaries of India (ICSI) is a unique and pioneering step towards standardisation of diverse secretarial practices prevalent in the corporate sector.

The institute has so far issued 10 secretarial standards and several guidance notes. After reading this lesson you will be able to understand the intention and content of secretarial standards, procedure for issuing secretarial standards, advantages of secretarial standards, etc.,

INTRODUCTION

Secretarial Standards - Meaning

Secretarial Standards are the policy documents relating to various aspects of secretarial practices in the corporate sector. These Standards lay down a set of principles which companies are expected to adopt and adhere to, in discharging their responsibilities.

Establishment of Secretarial Standards Board And its Objectives

The Institute of Company Secretaries of India, (ICSI), recognising the need for integration, harmonisation and standardisation of diverse secretarial practices, has constituted the Secretarial Standards Board (SSB) with the objective of formulating Secretarial Standards. The establishment of Secretarial Standards Board by ICSI in the year 2000 is a visionary step.

The Secretarial Standards Board (SSB) formulates Secretarial Standards taking into consideration the applicable laws, business environment and the best secretarial practices prevalent. Secretarial Standards are developed:

- in a transparent manner;
- after extensive deliberations, analysis, research; and
- after taking views of corporates, regulators and the public at large.

The SSB comprises of eminent members of the profession holding responsible positions in well-known companies and as senior members in practice, as well as representatives of regulatory authorities such as the Ministry of Corporate Affairs, the Securities and Exchange Board of India and the sister professional bodies viz. the Institute of Chartered Accountants of India and the Institute of Cost Accountants of India.

Scope and Functions of the Secretarial Standards Board

The scope of SSB is to identify the areas in which Secretarial Standards need to be issued by the Council of ICSI and to formulate such Standards, taking into consideration the applicable laws, business environment and best secretarial practices. SSB will also clarify issues arising out of such Standards and issue guidance notes for the benefit of members of ICSI, corporates and other users.

The main functions of SSB are :

- (i) Formulating Secretarial Standards;
- (ii) Clarifying issues arising out of the Secretarial Standards;
- (iii) Issuing Guidance Notes; and
- (iv) Reviewing and updating the Secretarial Standards / Guidance Notes at periodic intervals.

Scope of Secretarial Standards

The Secretarial Standards do not seek to substitute or supplant any existing laws or the rules and regulations framed thereunder but, in fact, seek to supplement such laws, rules and regulations.

Secretarial Standards that are issued will be in conformity with the provisions of the applicable laws.

However, if, due to subsequent changes in the law, a particular Standard or any part thereof becomes inconsistent with such law, the provisions of the said law shall prevail.

Procedure for issuing Secretarial Standards

The following procedure shall be adopted for formulating and issuing Secretarial Standards:

1. SSB, in consultation with the Council, shall determine the areas in which Secretarial Standards need to be formulated and the priority in regard to the selection thereof.
2. In the preparation of Secretarial Standards, SSB may constitute Working Groups to formulate preliminary drafts of the proposed Standards.
3. The preliminary draft of the Secretarial Standard prepared by the Working Group shall be circulated amongst the members of SSB for discussion and shall be modified appropriately, if so required.
4. The preliminary draft will then be circulated to the members of the Central Council as well as to Chairmen of Regional Councils/Chapters of ICSI, various professional bodies, Chambers of Commerce, regulatory authorities such as the Ministry of Corporate Affairs, the Department of Economic Affairs, the Securities and Exchange Board of India, Reserve Bank of India, Department of Public Enterprises and to such other bodies/organisations as may be decided by SSB, for ascertaining their views, specifying a time-frame within which such views, comments and suggestions are to be received.

A meeting of SSB with the representatives of such bodies/organisations may then be held, if considered necessary, to examine and deliberate on their suggestions.

5. On the basis of the preliminary draft and the discussion with the bodies/organisations referred to in 4 above, an Exposure Draft will be prepared and published in the “Chartered Secretary”, the journal of ICSI, and also put on the Website of ICSI to elicit comments from members and the public at large.
6. The draft of the proposed Secretarial Standard will generally include the following basic points:
 - (a) Concepts and fundamental principles relating to the subject of the Standard;
 - (b) Definitions and explanations of terms used in the Standard;
 - (c) Objectives of issuing the Standard;
 - (d) Disclosure requirements; and
 - (e) Date from which the Standard will be effective.
7. After taking into consideration the comments received, the draft of the proposed Secretarial Standard will be finalised by SSB and submitted to the Council of ICSI.
8. The Council will consider the final draft of the proposed Secretarial Standard and finalise the same in consultation with SSB. The Secretarial Standard on the relevant subject will then be issued under the authority of the Council.

Need for Secretarial Standards

Companies follow diverse secretarial practices. These practices have evolved over a period of time through varied usages and as a response to differing business cultures. As an illustration, the Companies Act, 1956, provides that companies must convene their Board Meetings by giving notice to directors in this regard. However, no minimum period for giving such Notice has been laid down and, companies are at liberty to give

any or no length of notice for convening a Board Meeting. Further, there is no requirement for sending Agenda for the Meeting. Companies, therefore, follow varied practices with regard to giving Notices and sending Agenda and Notes on Agenda for Meetings of the Board of Directors. Some companies specify the business to be transacted in the Notice itself, while others send a separate Agenda. In addition, some companies also send detailed Notes, explaining each item on the Agenda. While some companies send the Agenda in advance of the Meeting, others place the Agenda at the Meeting itself. Even in case of those companies which send the agenda in advance, the period varies. These divergent practices need to be harmonised by laying down the best practices in this regard.

A need was, therefore, felt to integrate, consolidate, harmonise and standardise all the prevalent diverse secretarial practices, so as to ensure that uniform practices are followed by the companies throughout the country. Such uniformity of practices, consistently applied, would result in the establishment of sound corporate governance principles.

Compliance of Secretarial Standards for Good Governance

The ultimate goal of the Secretarial Standards is to promote good corporate practices leading to better corporate governance. The Standards are for good secretarial practices and desirable corporate governance with a view to ensuring shareholders democracy and utmost transparency, integrity and fair play, going beyond the minimum requirements of law.

The adoption of the Secretarial Standards by the corporate sector will, over the years have a substantial impact on the improvement of quality of secretarial practices being followed by companies, making them comparable with the best practices in the world.

Many companies today are voluntarily adopting the Secretarial Standards in their functioning. The annual reports of several companies released during the last few years include a disclosure with regard to the compliance of the Secretarial Standards.

By following the Secretarial Standards in true letter and spirit, companies will be able to ensure adoption of uniform, consistent and best secretarial practices in the corporate sector. Such uniformity of best practices, consistently applied, will result in furthering the shareholders democracy by laying down principles for better corporate disclosures thus adding value to the general endeavour to strive for good governance.

Secretarial Standards under Companies Bill 2012

Clause 118 of the Companies Bill makes it mandatory for every company to observe such Secretarial Standards as may be prescribed with respect to General and Board Meetings. Every company is required to observe such Secretarial Standards as may be prescribed with respect to General and Board Meetings. [Clause 118 (10)]. Clause 205 casts duty on the Company Secretary to ensure that the company complies with the applicable Secretarial Standards. It is the beginning of a new era where non financial standards have been given importance and statutory recognition besides Financial Standards.

SECRETARIAL STANDARDS ISSUED SO FAR BY THE ICSI

The Institute has so far issued the following Secretarial Standards:

- Secretarial Standard on Meetings of the Board of Directors (SS-1)
- Secretarial Standard on General Meetings (SS-2)
- Secretarial Standard on Dividend (SS-3)
- Secretarial Standard on Registers and Records (SS-4)

- Secretarial Standard on Minutes (SS-5)
- Secretarial Standard on Transmission of Shares and Debentures (SS-6)
- Secretarial Standard on Passing of Resolutions by Circulation (SS-7)
- Secretarial Standard on Affixing of Common Seal (SS-8)
- Secretarial Standard on Forfeiture of Shares (SS-9)
- Secretarial Standard on Board's Report (SS-10)

BRIEF ANALYSIS OF SECRETARIAL STANDARDS

A Brief Analysis of various Secretarial Standards issued so far is discussed hereunder:

Secretarial Standard on Meetings of the Board of Directors (SS-1)

The Secretarial Standard on Meetings of the Board of Directors lays down a set of principles which companies are expected to adopt in the convening and conduct of meetings of the Board of Directors and committees thereof. These principles relate to frequency of meetings, quorum, attendance, resolutions, recording and preservation of minutes etc. Illustrative lists of items to be considered at different meetings of the Board are enunciated in the Standard. Further, the Standard seeks to enhance stakeholders confidence by focussing on the principles relating to responsibilities of the Chairman of the Board, maintenance of attendance registers, preservation of minutes, disclosures in Annual Report etc.

Briefly, the Secretarial Standard provides for the following, amongst others:

- A Board Meeting should be convened by giving at least 15 days notice. The agenda should be sent at least 7 days before the date of the meeting.

Companies Act does not prescribe any length of Notice for calling a meeting.

- Notice should be given to all Directors, whether in India or abroad and may be sent by hand, post, facsimile or e-mail. Where a director specifies a particular mode, the Notice is to be given to him in that mode.

Section 286 (1) of Companies Act provides that Notice of every meeting of the Board of directors of a company shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.

- Standard provides that the Notice of a meeting should be given even when meetings are held on pre-determined dates or at pre-determined intervals. Companies Act is silent on this issue.
- To avoid any item of significance being considered and approved without the prior knowledge of Directors, the Standard provides that prior Notice for such item is essential.

Companies Act does not provide for any such requirement.

- The quorum should be present at every stage of the Meeting. Any business transacted by a number lesser than the quorum is void. Companies Act only prescribes the quorum requirement - one-third of the total strength of the Board, or two Directors, whichever is higher. As per the standard, it is not sufficient that quorum is present only at the commencement of meeting.
- Leave of absence to Directors should not be granted as a ritual. It should be granted only when specifically sought by a Director.

Section 283(1)(g) of Companies Act only provides for vacation of office if director absents himself from

three consecutive meetings without obtaining leave of absence. No mention is made regarding communication of leave of absence. Granting of leave should not be a ritual. Leave be granted only when specifically sought for by a Director. Communication may be oral or written.

- To ascertain the 'will of the majority', resolutions to be passed by circulation should be sent to all Directors, whether in India or abroad.
- Recognising its importance, the Standard crystallises the date on which a Resolution sent for passing by circulation shall be deemed to have been passed.
- To ensure authenticity, the standard provides that the Resolutions passed by circulation should be placed before the next Meeting of the Board for noting and should be reproduced as part of the minutes of that Meeting.
- Annual, quarterly or half-yearly financial results should be approved at a meeting of the Board or its Committee and should not be approved by means of a Resolution passed by circulation.

Companies Act does not specify any such requirement.

- The limited review report, in case of material variance, should be discussed and approved at a Meeting of the Board and not by Resolution passed by circulation. Companies Act is silent on this aspect.
- Within seven days from the date of the meeting of the Board, the draft Minutes thereof should be circulated to all the Directors for their comments.
- The Minutes of meetings of any Committee should be circulated to the Board along with the Agenda for the next meeting and should be noted by the Board.

Companies Act does not provide for circulation of minutes amongst directors.

- Apart from the Resolution or decision, the Minutes should mention the brief background of the proposal and the rationale for passing the Resolution or taking the decision. Companies Act is silent on this aspect.
- As decisions taken by the Board are collective decisions. Standard provides that the names of the Directors who dissented or abstained from the decision should be recorded.

Section 193(4) only provides that Minutes should contain the names of Directors dissenting from or not concurring in the resolution. However, as decisions taken by the Board of Directors are collective decisions, the names of the Directors who not only dissented or but also abstained from the decision should also be recorded. This is essential, since the minutes of a meeting of directors are very persuasive evidence of the proceedings therein and prima facie evidence in any subsequent proceeding challenging the directors' conduct in respect of a particular decision.

- The Minutes of all meetings should be preserved permanently.

Secretarial Standard on General Meetings (SS-2)

The Secretarial Standard on General Meetings prescribes a set of principles which companies are expected to observe in the convening and conducting of General Meetings and matters related thereto. Principles have been laid down with respect to requirements of quorum, voting, proxies, conduct of poll, withdrawal/rescinding/modification of resolutions, adjournment of meetings, recording in and preservation of minutes as well as the duties of the Chairman and the disclosures to be made in the Annual Reports of companies. Further, explicit principles have been laid down on the related critical aspects such as distribution of gifts, presence and duties of Company Secretary/Auditors in the meetings, preservation of minutes. Besides, it

intends to integrate and standardize the diverse secretarial practices prevalent in the corporate sector for conducting General meetings.

The salient features of this Standard which supplement the Company Law and on which the Companies Act is silent are—

- Notice of every General Meeting should be given to every member at the address provided by him whether in India or outside India and Notice should also be placed on the website of the company, if any. If the venue of the meeting is not a prominent place, a site map of the venue should be enclosed with the Notice. Notice should also be given to the Directors and other specified recipients such as banks and financial institutions and other interested parties.
- In the case of listed companies, the Notice, listing the items of business and the day, date, time and venue of the Meeting, should be hosted on the website of the company..
- All Directors of the company should attend all meetings of shareholders and be available to reply to shareholders' queries. If any Director is unable to attend the Meeting for reasons beyond his control, the Chairman should explain such absence at the Meeting.
- Framing of Resolutions and explanatory statement in simple language in the Notice is emphasized for the benefit of members.
- The Practicing Company Secretary who has been giving the compliance certificate should attend every Annual General Meeting. The Standard also makes it obligatory for the auditors of the company to attend the Annual General Meeting if there are any reservations, qualifications or adverse remarks in the Auditor's Report.
- Onerous responsibility has been placed on the Chairman of the meeting who is expected to be fair and impartial in the conduct of his duties. He is enjoined upon to provide a fair opportunity to Members who are entitled to vote to raise questions and/or offer comments and ensure that these are answered.
- The Chairman should explain the objective and implication of each resolution, before the resolution is put to vote.
- The Standard deals in depth with the concept of voting by poll.
- In case of listed companies with over 5,000 Members, the result of the poll should be published in a leading newspaper circulating in the neighbourhood of the registered office of the company.
- Resolutions specified in the Notice for items of business which are likely to affect the market price of the securities of the company should not be withdrawn.
- No gifts, gift coupons or cash in lieu of gifts should be distributed before, at or in connection with the General Meetings.
- Annual Report of companies should disclose the particulars of all general meetings held during the last three years.
- Best practices for entering, recording and signing as well as preservation of the Minutes have been laid down.

Secretarial Standard on Dividend (SS-3)

The Secretarial Standard 3 lays down a set of principles in relation to the declaration and payment of dividend, interim dividend, treatment of unpaid Dividend, revocation of dividend as well as the preservation of

dividend warrants, maintenance of dividend registers, disclosure requirements and matters incidental thereto. The Standard, by stipulating requirements in regard to all allied and significant matters such as intimation to members before transferring unpaid dividend to Investor Education and Protection Fund, preservation of dividend Registers, validity of dividend warrants etc. attempts to give the right direction to the corporate sector, promote uniformity of practices and ensure effective corporate governance.

The salient features of this standard are:

- Dividend can be declared out of free reserves and surplus in the profit and loss account of the company. However, dividend should not be declared out of the Securities Premium Account or the Capital Redemption Reserve Account or Revaluation Reserve or Amalgamation Reserve or out of profit on reissue of forfeited shares or out of profit earned prior to the incorporation of the company.
- Interim Dividend may be declared after the Board has considered the Interim financial statements for the period for which Interim Dividend is to be declared, after taking into account depreciation for the full year and arrears of depreciation, appropriations and transfers to statutory reserves, taxation, Dividend at the contracted rate on preference shares and transfer to reserves as per provisions of the Companies (Transfer of Profits to Reserves) Rules, 1975.
- Interim Dividend should not be declared out of reserves.
- Dividend may be paid by cash, cheque, warrant, demand draft, pay order or directly through ECS.
- Calls in arrears and any other sum due from a member may be adjusted against Dividend payable to the member.
- Dividend, whether interim or final, once declared becomes a debt and should not be revoked.
- Unpaid/Unclaimed Dividend should be transferred to the Investor Education and Protection Fund on expiry of seven years from the date on which such Dividends were transferred to unpaid Dividend Account after giving individual intimation to the claimant shareholders.
- Any interest earned on unpaid Dividend Account should also be transferred to Investor Education and Protection Fund.
- Paid Dividend warrant instruments returned by the Bank and Dividend Registers should be preserved for a period of eight years.
- The Balance Sheet, Annual Report and Annual Return of the company should make separate disclosures of the amount of Dividend lying in the unpaid or unclaimed Dividend account for seven years. Annual Return and Annual Report should also disclose the amount transferred to Investor Education and Protection Fund.

Secretarial Standard on Registers and Records (SS-4)

The salient features of this standard are as below:

A company is required to maintain certain registers and records. There are some registers and records, the maintenance of which is not statutorily required but is essential for the smooth, efficient and systematic functioning of the company. Some of the registers and records are required to be kept open by a company for inspection by directors and members of the company and by other persons, including creditors of the company. The right to inspect such registers and records is an enforceable right. Companies are also required to allow extracts to be made from certain documents, registers and records and to furnish copies thereof. This Standard deals with the various registers/records to be kept, manner of their keeping, their place of keeping, entry of particulars and information to be made and recorded therein, their inspection and preservation etc.

The standard prescribes a set of principles and good practices in relation to various registers and records including the maintenance and inspection thereof and gives a direction to the companies to establish and maintain systems that comply with all statutory provisions and meet the needs of the stakeholders.

The Information Technology Act, 2000 permits the maintenance of registers and records in electronic mode. Such registers and records should be maintained in accordance with the provisions of the said Act.

The standard deals with the following registers:

- Register of Investments in securities not held in the name of the Company
- Register of buy-back of securities
- Register of charges
- Register and index of members
- Register and index of debenture holders
- Foreign Register of members or debenture holders
- Register of renewed and duplicate certificates
- Register of contracts in which directors are interested
- Register of directors, Managing Director, Manager and Secretary
- Register of Directors' Shareholdings
- Register of Inter corporate Loans and investments
- Register of Deposits
- Register of Allotment
- Register of payment of dividend
- Register of Directors' Attendance
- Register of Postal ballot
- Register of proxies
- Register of Inspection
- Register of investments (other than securities not held in the name of the Company)
- Register of documents executed under Common seal
- Register of records and documents destroyed
- Register of Investors' Complaints
- Register of transfer of shares
- Register of transmission of shares
- Register of transfer of debentures
- Register of Transmission of debentures
- Register of employee stock options
- Register of sweat equity shares

- Register in respect of SEBI (Substantial Acquisition of shares and takeovers) regulations, 2011
- Register in respect of SEBI (Prohibition of Insider trading) regulations, 1992
- Books of Accounts
- Annual Return

Secretarial Standard on Minutes (SS-5)

Every company is required to keep minutes of all proceedings of the meetings conducted during its existence. Minutes kept in accordance with the provisions of the Act, evidence that the meeting has been duly convened and held, all proceedings thereat have taken place and all appointments made thereat are valid.

The Minutes should contain a fair and correct summary of the discussions and decisions taken at the meeting so as to enable absentee directors/ committee members/shareholders to form an idea of what transpired at these meetings.

This Secretarial Standard on Minutes has dealt with Minutes of the Meetings of:

- (a) the Board or Committees of the Board,
- (b) members,
- (c) debentureholders,
- (d) creditors,
- (e) others as may be required under the Act,

and matters related thereto.

The Standard prescribes a set of principles for maintaining, recording, signing, dating, inspecting and preserving the minutes so as to ensure that the minutes record the true proceedings of the meetings and are accessible for future reference.

Some of the features of this Secretarial Standard which supplement the Companies Act are:

- A separate Minutes Book should be maintained for each type of Meeting.
- Generally, the Minutes should begin with the number and type of the Meeting and then go on to state the name of the company, day, date, venue, time of commencement and time of conclusion of the Meeting.
- Minutes of Meetings of the Board or Committee should also include:
 - The names of officers in attendance and invitees for specific items.

Section 193(4)(a) of the Companies Act requires only the names of directors present at the Meeting of the Board of Directors or of a Committee of the Board to be included in the Minutes of such Meeting.

- If any director has participated only for a part of the Meeting, the reference to the agenda items in which he had participated.
- In case of a director joining through video or tele-conference, the place from and the agenda items in which he participated.

- The names of directors who abstained from any decision.

The Companies Act only provides for recording of the names of the directors, if any, dissenting from, or not concurring in the resolution. [Section 193(4)(b)].

- The name of Company Secretary present at the Meeting. The Companies Act does not contain any such requirement.

Also, the Minutes should mention the brief background of the proposals made in the Meeting, summarise the deliberations and the rationale for taking the decisions.

- The Minutes of General Meetings should also include:
 - The information regarding presence of the Chairman of the Audit Committee at the Annual General Meeting.
 - The information regarding presence if any, of the Auditors, the Practising Company Secretary who issued the Compliance Certificate, the Court appointed observers or scrutineers.
 - Summary of the opening remarks of the Chairman.
 - Summary of the clarifications provided.
 - In the case of resolutions passed through postal ballot, the name of the scrutinizer appointed and the result of the ballot.
- In respect of recording the Minutes of Meetings of the Board, any document, report or notes placed before the Board and referred to in the Minutes should be identified by initialling of such document, report or notes by the Chairman or the concerned director.
- Draft Minutes should be circulated to all the members of the Board or the Committee, as the case may be, within fifteen days from the date of the conclusion of the Meeting of the Board or Committee, for their comments.
- Minutes of the Meetings of all Committees should be placed and noted at a subsequent Meeting of the Board.
- Minutes of all Meetings should be preserved permanently.
- Office copies of Notices, Agenda, Notes on Agenda and other related papers should be preserved in good order for as long as they remain current or for ten years, whichever is later, and may be destroyed thereafter under the authority of the Board.
- Minutes Books should be kept in the custody of the Secretary of the company or any director duly authorized for the purpose by the Board.

Secretarial Standard on Transmission of Shares and Debentures (SS-6)

Realizing the divergent practices involved in the transmission of shares and the difficulties faced by both the companies and the investors, the Secretarial Standards Board has formulated the Secretarial Standard on Transmission. This Standard lays down principles in relation to the documentation and for verification of legal claimants in case of physically and electronically held shares for smooth functioning of the process. The Standard *inter alia* deals with situations where shares are singly or jointly held, nominee has been appointed, shareholder has died intestate etc.

The absence of detailed provisions in the Act has resulted into companies developing varying and diverse documentary compliances and procedures. To address this issue and to evolve a uniform procedure as well

as to alleviate and redress the grievances of shareholders arising from disparate practices, this Standard has been evolved.

SS-6 has set standards in several areas to bring clarity and to unify the disparate practices, including:

- Documents required
- Time period within which the transmission process should be completed
- Preservation.

Briefly, the Secretarial Standard provides for the following, amongst others:

- In case of transmission of shares of a sole shareholder who has appointed a nominee, the company should register the shares in the name of the nominee within a period of 30 days.
- Similarly, in the case of transmission of shares of a sole shareholder who has not appointed a nominee, the company should register shares in the name of any other person (i.e. beneficiary of a Will or legal Heir) within a period of 30 days.
- The Secretarial Standard lays down the procedure for transmission of shares in case where sole shareholder has not appointed a nominee. It clearly provides for both the situations, i.e. where the sole-shareholder dies leaving a Will and where the sole-shareholder dies intestate.

Regulation 25 of Table A of Schedule I to the Companies Act merely provides that legal representatives shall be entitled to transmission of shares in both these cases.

- In case of transmission of shares held jointly, whether nomination has been made or not, the company should register the shares in the name of the nominee or in the name of any other person elected by such nominee, within a period of 30 days.
- In respect of transmission of shares held jointly, where no nomination has been made, the Secretarial Standard lays down provisions for different permutation and combinations covering all aspects. This is to say that it covers the case where the last shareholder dies leaving a Will; case where shares are held jointly and the last of the surviving shareholders dies intestate without appointing a nominee; case where shares are held jointly and all the shareholders die simultaneously without appointing a nominee but the first holder leaves a Will; case where shares are held jointly and all the shareholders die simultaneously intestate without appointing a nominee.
- The Secretarial Standard requires that every company should maintain a register containing particulars of all transmissions.
- The register and records pertaining to transmission should be preserved permanently and kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

Secretarial Standard on Passing of Resolutions by Circulation (SS-7)

Decisions relating to the policy and operations of a Company are arrived at meetings of the Board, held periodically. However, it may not always be practicable to convene a meeting of the Board to discuss matters on which decisions are needed urgently. In such circumstances, passing of resolution by circulation can be resorted to. Section 289 of the Companies Act enables the Board of Directors to pass resolutions by circulation. However, it merely provides that the resolution is to be circulated to all members of the Board or Committee and is to be passed by the requisite majority. As the law is silent on who is to propose the resolution, what matters to be passed through circulation, the mode of circulation, timing of approval of the resolution etc., SS-7 lays down the best practices to be followed.

SS-7 authorizes the Chairman of the Board or Managing Director and in their absence any other director to decide whether the approval of the Board for a particular matter is to be obtained by means of resolution by circulation. The Standard also enlists a number of matters which are to be passed only at duly convened meetings of the Board and which should not be passed by circulation. This is to ensure that the important items of business which require deliberations by the Board are passed only after necessary debate and discussion at Board room.

Briefly, the Secretarial Standard provides, amongst others, for the following:

- The proposed resolution with all the papers should be sent to all directors including interested directors and directors who are usually residing abroad.
- There should be a note with every such resolution setting out the details of the proposal and draft of resolution proposed and also indicating how to signify assent or dissent to the resolution proposed.
- The draft resolution alongwith necessary papers should be circulated by hand, or by post or by facsimile, or by e-mail or by any other electronic mode.
- The resolution is deemed to have been passed on the date on which it is approved by the majority of the Directors.
- In case a director does not append a date, the date of receipt by the company of the signed resolution should be taken as the date of signing.
- The minutes of the next meeting of the Board or, committee should record the text of the resolution passed and dissent, if any.
- Passing of resolution by circulation should be considered valid as if it had been passed at a duly convened meeting. This does not dispense with the requirement for the Board to meet at the specified frequency.
- The standard provides, as an Appendix, list of illustrative notes to be passed at a duly convened Board meeting and which cannot be passed by circulation.

Secretarial Standard on Affixing of Common Seal (SS-8)

Substantive law is mainly silent on fixation of common seal. SS-8 deals with Affixing of Common Seal. The standard aims at clarifying documents which need to be common sealed and procedure thereof. The unique feature of the standard is that it introduces the concept of Official Seal. This would substitute the common seal in case affixation of common seal is not possible physically.

As per the Standard the common seal should be adopted by a resolution of the Board and the impression of the seal should be made part of the minutes of the meeting in which it is adopted. The common seal should be affixed to any document in the presence of Managing Director or any two Directors, and the Company Secretary or any other person as may be authorized by the Board. Every company is required to maintain a register containing details of documents on which the common seal of the company has been affixed for attestation of documents outside India. In order to facilitate Indian MNCs operating abroad, the Standard further provides that a company may have an official seal for use outside India which is a facsimile of the common seal.

Briefly, the Secretarial Standard provides, amongst others, for the following:

- As per the Standard, Common Seal means the metallic seal of a company which can be affixed only with the approval of the Board of directors of the company.

- The Common seal should be adopted by a resolution of the Board and its impression should be made part of the minutes of the meeting in which it is adopted.
- The persons in whose presence the seal is affixed should sign every instrument to which seal of the company is so affixed.
- The common seal should be kept in the custody of a director of the company or the Company Secretary or any other official, as authorised by the Board.
- A company whose objects require or comprise transactions of business outside India may have for use in any territory, district or place not situated in India an official seal, which shall be a facsimile of the common seal.
- Use of official seal requires an enabling provisions in the Articles.
- The official seal should be facsimile of the common seal.
- Official seal should have engraved in it the name of the territory where it is to be so used in addition to the name and state in which the registered office of the company is situated.
- The person affixing the official seal shall sign and write on deed or other instrument, the date and place at which it is affixed.
- Every company should maintain a register containing particulars of documents on which the official seal of the company has been affixed.
- The register should be maintained at the office where the official seal is kept.

Secretarial Standard on Forfeiture of Shares (SS-9)

Articles 29 to 35 of Table 'A' deal with forfeiture of shares. The Act being silent on forfeiture gave rise to the need for issuing the secretarial standard. SS-9 ensures that the forfeiture is carried out bona fide and in the interests of the shareholders.

This standard lays down a set of principles for forfeiture both for equity and preference shares arising from non-payment of calls. Initiation of forfeiture process, effect of forfeiture, re-issue of forfeiture sales, pricing of reissue of forfeiture shares, annulment of forfeiture of shares are the major aspects which are being dealt under SS-9. The standard dwells upon the authority for the forfeiture. Forfeiture of shares is to be made only with the approval of the Board. No forfeiture can be made unless notice is served on the shareholder whose shares are being forfeited. The notice to the defaulting member should be served by registered post acknowledgement due. The standard also specifies the contents of notice. The standard also empowers the Board to annul forfeiture at its discretion, if the member pays all outstanding calls due together with interest. The standard also clarifies about the pricing on re-issue of forfeited shares.

Briefly, the Secretarial Standard provides, amongst others, for the following:

- The Articles should contain a provisions for forfeiture of shares.
- Forfeiture of shares requires approval of the Board in a duly convened meeting.
- If a call on the shares, together with interest accrued thereon, in accordance with the terms of issue of shares, remains unpaid after the day appointed for payment thereof, then forfeiture of shares should be made under the authority of the Board.
- The notice should be served by the company on the defaulting member by registered post acknowledgement due.

- The notice should state the amount of the call due and interest accrued thereon. It should specify a date (not more than 21 days from date of posting of notice) before which the payment should be made. Also specify that in case of non-payment forfeiture shall be offered.
- The Board should approve the forfeiture at a duly convened meeting.
- The date of approval by the Board in the date of forfeiture.
- The Board should issue individual notices to the defaulting members whose shares have been forfeited.
- Entries in the register of members should be made with regard to forfeited shares.
- There should be a reference to the forfeiture of shares in the report of the directors to the shareholders.
- On annulment of the forfeited shares, the name of the member should be restored in the register of members for those shares.
- A forfeited share may be reissued or otherwise disposed of on such terms and in such a manner as the Board may think fit.
- On reissue the transferee should be registered as the holder of the share.
- The title of the transferee should not be affected by any irregularity or invalidity in the proceedings in reference to the forfeiture, sale or disposal of the share.

Secretarial Standard on Board's Report (SS-10)

The Board's Report is the most important means of communication by the Board of Directors of a company with its stakeholders. The Companies Act, 1956 requires the Board of Directors of every company to present annual accounts to the shareholders along with its report, known as the "Board's Report". Disclosures in the Board's Report are specified under various sections of the Act. The Board's Report should cover wide spectrum of information that stakeholders need, more than financial data, to understand fully the prospects of the company's business and the quality of the management. Looking at its importance and substantial information involved in preparation of Board's report, the Secretarial Standard on Board's report is prepared.

Apart from various disclosures required under the Companies Act, this Standard seeks to lay down certain additional disclosures which are required to be made in Board's Report under various other enactments like disclosures pursuant to employee stock option and employee stock purchase schemes, pursuant to directions of Reserve Bank of India, pursuant to directions of national housing bank directions, various disclosures under listing agreement etc. An attempt is made to cover every aspect for preparation and presentation of the Board's Report. This Standard also seeks to cover the approval, signing, dating aspects for its preparation.

Briefly, the Secretarial Standard provides, amongst others, for the following:

- The Board's Report should be attached with balance sheet of the company.
- As per the Standard, the disclosure in the Board's Report are as under:
 - state of affairs of the company;
 - material changes and commitments, if any, affecting the financial position of the company;
 - amount, if any, proposed to carry to any reserves;

- amount, if any, recommended by way of dividend per share;
- particulars with respect to conservation of energy, technology, absorption and foreign exchange earnings and outgo in accordance with the prescribed rules;
- changes during the year of the specified items;
- director's responsibility statement;
- a statement by the Board that the company has devised proper systems to ensure compliance of all laws applicable to the company;
- the factors leading sickness and the steps proposed to be taken;
- specified details of issue of sweat equity shares;
- status of buy-back process;
- reasons for failure to implement any proposal relating to preferential allotment; to redeem debentures or preference shares on due date(s);
- changes in the composition of board;
- any disqualification or vacation of office of director;
- amount transferred to Investor Education and Protection Fund;
- payment of managerial remuneration in excess of limit;
- composition of audit committee;
- specified disclosures pursuant to the listing agreement of stock exchanges;
- specified disclosures pursuant to employee stock option and employee stock purchase schemes;
- additional disclosures by producer company;
- specified disclosures pursuant to directions of Reserve Bank of India;
- specified disclosures pursuant to National Housing Bank directions;
- other disclosures;
- explanations in the Board's Report in response to Auditors' Qualifications;
- explanations in the Board's Report in response to Qualification of Secretary in whole-time practice;
- information on accounts.
- The report should be considered and approved at a duly convened meeting of the Board.
- The report and any addendum thereto should be signed by the chairman of the Board, if any, or by not less than two directors of the company, one of whom shall be a managing director, where there is one;
- The report shall be collective responsibility of all the directors though the report may have been approved only by a majority of directors.

The students are advised to go through the entire Secretarial Standards (SS1 – SS10) issued by ICSI for more details.

8. GUIDANCE NOTES ISSUED

To facilitate the corporate sector to comply with the Secretarial Standards, the SSB also formulates Guidance Notes. The Institute has issued Guidance Notes on:

- Passing of Resolution by Postal Ballot
- Non-Financial Disclosures
- Board Processes
- Listing of Corporate Debt
- Related Party Transactions
- Internal Audit of Stock Brokers
- Diligence Report for Banks
- Board's Report
- Compliance Certificate
- Dividend
- Code of Conduct for CS
- Certification under Investor Education and Protection Fund
- Buy-Back of Securities
- Meeting of the Board of Directors
- Passing of Resolution by Postal Ballot
- General Meetings
- Corporate Governance Certificate
- Preferential Issue of Shares

LESSON ROUND UP

- The Institute of Company Secretaries of India, (ICSI), recognising the need for integration, harmonisation and standardisation of diverse secretarial practices, has constituted the Secretarial Standards Board (SSB) with the objective of formulating Secretarial Standards.
- Secretarial Standards lay down a set of principles which companies are expected to adopt and adhere to, in discharging their responsibilities.
- Institute has so far issued Ten Secretarial Standards on: Meetings of the Board of Directors (SS-1); General Meetings (SS-2); Dividend (SS-3); Registers and Records (SS-4); Minutes (SS-5); Transmission of Shares and Debentures (SS-6); Passing of Resolutions by Circulation (SS-7); Affixing of Common Seal (SS-8); Forfeiture of Shares (SS-9) and Board's Report (SS-10).
- To facilitate the corporate sector to comply with the Secretarial Standards, the SSB also formulates Guidance Notes.
- The adoption of the Secretarial Standards by the corporate sector will have a substantial impact on the quality of secretarial practices being followed by companies, making them comparable with the best practices in the world.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What are Secretarial Standards? Discuss the need for Secretarial Standards.
2. Discuss the scope and function of Secretarial Standard Board.
3. Write down the brief analysis of following:
 - (a) Secretarial Standard on Dividend (SS-3)
 - (b) Secretarial Standard on Minutes (SS-5)
4. Secretarial Standards are currently recommendatory. Comment.

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Lesson 4

DUE DILIGENCE — AN OVERVIEW

LESSON OUTLINE

- Meaning, nature, objectives, significance, scope of due diligence, need for due diligence
- Types of Due diligence
- Steps involved in due diligence
- Various transactions requiring due diligence exercise
- Concept of Data Room
- Virtual and Physical Data Room
- Difference between Due diligence and Audit
- Confidentiality/Non-disclosure agreement

LEARNING OBJECTIVES

Business transactions in dynamic business environment require detailed analysis, as it involves number of issues both financial and non-financial that requires careful and methodological investigation of business processes and the parties involved. Due diligence is an art of evaluation of a business transaction through methodical investigation of financial; business, technical and human aspects and its' impact before and after the business transaction.

After reading this lesson you will be able to understand the concept of due diligence, types of business transactions requiring due diligence, types of information analyzed during due diligence process, concept of data room, confidentiality elements in due diligence process etc.

INTRODUCTION

Due Diligence is the process by which confidential legal, financial and other material information is exchanged, reviewed and appraised by the parties to a business transaction, which is done prior to the transaction.

“Due diligence” is an analysis and risk assessment of an impending business transaction. It is the careful and methodological investigation of a business or persons, or the performance of an act with a certain standard of care to ensure that information is accurate, and to uncover information that may affect the outcome of the transaction.

It is basically a “background check” to make sure that the parties to the transaction have the required information they need, to proceed with the transaction.

Due diligence is used to investigate and evaluate a business opportunity. The term due diligence describes a general duty to exercise care in any transaction. As such, it spans investigation into all relevant aspects of the past, present, and predictable future of the business of a target company.

Due diligence report should provide information and insight on aspects such as the risks of a transaction, the value at which a transaction should be undertaken, the warranties and indemnities that needs be obtained from the vendor etc.

Why Due Diligence?

Misrepresentations and fraudulent dealings are not always obvious or straight. These are to be uncovered, especially in a major business transaction, as it would create a major impact on the business. Proper due diligence services explore and asses the details behind the same and to become fully informed about the financials, business, internal systems, profitability, key operational aspects, management team, promoters and other material factors that will help in making an informed decision about an investment. Due diligence is designed to protect the interests of the Company by providing objective and reliable information on the target company before making any written commitments.

Due diligence is an investigative process for providing, the desired comfort level about the potential investment and to minimize the risks such as hidden uncovered liabilities, poor growth prospects, price claimed for proposed investment being on higher side etc. Due diligence is also necessary to ensure that there are no onerous contracts or other agreements that could affect the acquirer's return on investment.

The procedures and analyses ultimately represent a window into the target Company's success and potential, including what opportunities exist to grow the business further to meet your goals and objectives. Due diligence exercise is needed to confirm that the nature and genuineness of a business, Identify defects/weakness in the target company and to avoid a bad business transaction, to gather information that is required for valuation of assets, and to negotiate in a better manner. In nutshell due diligence is a SWOT analysis of an investment which is essentially required to make an informed decision about a potential investment.

Objectives Of Due Diligence

The objective of due diligence is to verify the strategic identification or attractiveness of the target company, valuation, risk associated etc.

The objective of due diligence includes—

1. Collect material of information from the target company.
2. Conduct a SWOT analysis to identify the strength and to uncover threats and weaknesses.
3. For improving the bargaining position depending on SWOT analysis.
4. To take an informed decision about an investment.
5. Identification of areas where representations and warranties are required.
6. To provide a desired comfort level in a transaction.
7. To ensure complete and accurate disclosure.
8. Bridge the gap between the existing and expected.
9. To take smooth/accurate action/decision.
10. To enhance the confidence of stake holders.

The SWOT analysis of the target business carried out as a part of due diligence has to reveal the strengths and weaknesses of not only the financials but also intangibles. To do this effectively, the potential buyer needs to be clear about the goals and motives for acquiring the target company, as well as the value the buyer is attempting to create with the purchase. For example, if there is a legal risk, such as an outstanding lawsuit, that will not only jeopardize the financial stability of the company but also the loyalty of existing customers. This will erode the target company's market by a new and stronger competitor. The target company's talent is the asset desired, and much of this depends on employee relations and accordingly cultural issues has to be addressed in time.

A thorough due diligence helps to reveal any of the negatives, but the process of due diligence rarely goes smoothly because of one major stumbling block and that is availability of information. The target company is rarely eager to reveal to the other party that it is up for sale and wants to keep this information confidential from its competitors, customers and employees. So getting any information from these sources can be tricky, depending upon what the potential buyer wants to gain from the transaction. The buyer who aims to get new market of customers with the transaction wants to make sure that the target company has a good relationship with existing customers. But, during due diligence, the target company does not want any contact with its existing customers for fear that customers might leave because of the impending sale. As another example, a potential buyer sees the employee talent as the company's main asset, but the target company is nervous about letting the potential buyer talk to key employees because it does not want to let on that it is going to be sold. Because of the confidential nature of transactions, not all the information that is necessary to make a good decision can be revealed. This is why services of experts are hired in due diligence before beginning the process so the buyer receives reliable guidance. It is also critical to meet with trusted advisors—both inside and outside about what has been discovered and brainstorm the different scenarios of what can go wrong before going ahead with the deal.

Scope Of Due Diligence

Scope of due diligence is transaction-based and is depending on the needs of the people who is involved in the potential investments, in addressing key uncovered issues, areas of concern/threat and in identifying additional opportunities.

Due diligence is generally understood by the legal, financial and business communities/potential investors to mean the disclosure and assimilation of public and proprietary information related to the assets and liabilities

of the business being acquired. This information includes financial, human resources, tax, environmental, legal matters, intellectual property matters etc.

Due diligence would include thorough understanding of all the obligations of the target company: debts, rights and obligations, pending and potential lawsuits, leases, warranties, all high and impact laden contracts – both inter-corporate and intra-corporate.

The investigation or inspection would cover:

- Compliance with applicable laws
- Regulatory violations or disciplinary actions
- Litigation and assessment of feasibility of pursuing litigation
- Financial statements
- Assets – real and intellectual property, brand value etc.
- Unpaid tax liens and/or judgements
- Past business failures and consequential debt
- Exaggerated credentials/Fraudulent claims
- Misrepresentations or character issues
- Cross-border issues – double taxation, foreign exchange fluctuation, sovereign risk, investment climate, cultural aspects.
- Reputation, goodwill and other intangible assets.

Types of Due Diligence

In business transactions, the due diligence process varies for different types of companies. The relevant areas of concern may include the financial, legal, labour, tax, environment and market/commercial situation of the company. Other areas include intellectual property, real and personal property, insurance and liability coverage, debt instrument review, employee benefits and labour matters, immigration, and international transactions.

The most important types of Due Diligence are:

- A. Business Due Diligence
 - (i) Operational due diligence
 - (ii) Strategic due diligence
 - (iii) Technical due diligence
 - (iv) Environmental due diligence
 - (v) Human Resource Due diligence
 - (vi) Information Security due diligence
 - (vii) Ethical Due Diligence
- B. Legal Due Diligence (including secretarial due diligence)
- C. Financial Due Diligence (including tax due diligence).

A. Business Due Diligence

Business due diligence involves looking at quality of parties to a transaction, business prospects and quality

of investment. It involves,

(i) Operational due diligence

Operational due diligence aims at the assessment of the functional operations of the target company, connectivity between operations, technological upgradation in operational process, financial impact on operational efficiency etc. It also uncovers aspects on operational weakness, inadequacy of control mechanisms etc.

(ii) Strategic due diligence

Strategic due diligence tests the strategic rationale behind a proposed transaction and analyses whether the deal is commercially viable, whether the targeted value would be realized. It considers factors such as value creation opportunities, competitive position, critical capabilities.

(iii) Technical Due Diligence

Technical due diligence covers—

- (a) intellectual property due diligence; and
- (b) technology due diligence.

(a) Intellectual Property due diligence

The recent concept of valuation of intangible assets related to Intellectual Property like Patents, Copyrights, Design, Trademarks, Brands etc., also getting greater importance as these Intellectual Properties of the business are now often sold and purchased in the market by itself, like any other tangible asset. Many Indian companies and corporate entities however do not give much importance to the portfolio management of their Intellectual Property Rights (IPR). The main objective of intellectual property due diligence is to ascertain the nature and scope of target company's right over the intellectual property, to evaluate the validity of the same and to ensure whether there is no infringement claims.

(b) Technology due diligence

Technology due diligence considers aspects such as current level of technology, company's existing technology, further investments required etc. Technology is a key component of merger and acquisition activities; it's imperative to look at IT considerations.

(iv) Environmental Due Diligence

Environmental due diligence analyses environmental risks and liabilities associated with an organisation. This investigation is usually undertaken before a merger, acquisition, management buy-out, corporate restructure etc.

Environmental due diligence provides the acquirer with a detailed assessment of the historic, current and potential future environmental risks associated with the target organisation's sites and operations.

It involves risk identification and assessment with respect to:

- (a) review the environmental setting and history of the site
- (b) assessment of the site conditions
- (c) operations and management of sites
- (d) confirm legal compliance and pollution checks from regulatory authorities etc.

(v) Human Resource Due Diligence

Human Resource Due Diligence aims at people or related issues. Key managers and scarce talent leave unexpectedly. Valuable operating synergies gets disturbed, when cultural differences between companies aren't understood or are simply ignored. It's crucial to consider cultural and employees issues upfront, for success of any venture.

(vi) Information Security Due Diligence

Information security due diligence is often undertaken during the information technology procurement process to ensure that risks are uncovered.

(vii) Ethical Due Diligence

Ethical Due Diligence measures ethical character of the company and identify the possibilities of ethical risks, which is a non-financial risk. It may relate to reputation, governance, ethical values etc. It helps an organization to decide whether the partner is ethically viable. This is an effective reputation management tool for any type of business decisions.

B. Legal Due Diligence

A legal due diligence covers the legal aspects of a business transaction, liabilities of the target company, potential legal pitfalls and other related issues. Legal due diligence covers intra-corporate and intercorporate transactions.

It includes preparation of regulatory checklists meeting with personnel, independent check with regulatory authorities etc. apart from document verification.

C. Financial Due Diligence

Financial due diligence provides peace of mind to both corporate and financial buyers, by analysing and validating all the financial, commercial, operational and strategic assumptions being made.

Financial Due Diligence includes review of accounting policies, review of internal audit procedures, quality and sustainability of earnings and cash flow, condition and value of assets, potential liabilities, tax implications of deal structures, examination of information systems to establish the reliability of financial information, internal control systems etc.

The tax due diligence comprises an analysis of:

- tax compliance
- tax contingencies and aggressive positions
- transfer pricing
- identification of risk areas
- tax planning and opportunities

Factors To Be Kept In Mind While Conducting Due Diligence**Objectives and purpose**

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction. The goal of due diligence is to provide the party proposing the transaction with sufficient information to make

a reasoned decision as to whether or not to complete the transaction as proposed. It should provide a basis for determining or validating the appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction. The following factors may be kept in mind in this regard:

- (i) Be clear about your expectations in terms of revenues, profits and the probability of the target company to provide you the same.
- (ii) Consider whether you have resources to make the business succeed and whether you are willing to put in all the hard work, which is required for any new venture.
- (iii) Consider whether the business gives you the opportunity to put your skills and experience to good use.
- (iv) Learn as much as you can about the industry you are interested in from media reports, journals and people in the industry.

Planning the schedule

Once it is decided for a particular business, make sure of the following things:

- Steps to be followed in due diligence process
- Areas to be checked
- Aspects to be checked in each area
- Information and other material to be requested from the seller

Negotiation for time

Some times, it may be the case that, sellers want the process to get over as soon as possible and try to hurry the proceedings. When the seller gives a short review period, negotiations can be made for adequate time to have a complete review on crucial financial and legal aspects.

Risk Minimisation

All the information should be double checked— financials, tax returns, patents, copyrights and customer base to ensure that the company does not face a lawsuit or criminal investigation. The financials are very important and one needs to be certain that the target company did not engage in creative accounting. The asset position and profitability of the company are vital.

Since, Due diligence exercise deals with the overall business, it is important to consider aspects such as:

- background of promoters
- performance of senior management team
- organizational strategy
- business plans
- risk management system
- technological advancement
- infrastructure adequacy
- optimum utilization of available resources

Information from external sources

The company's customers and vendors can be quite informative. It may be found from them whether the target company falls in their most favored clients list.

Any flaws that the audit uncovers would help to negotiate down the sale price. Due diligence is “a chance to get a better deal”. But don’t go overboard. Remember that the whole point of buying a company is to add people to your own organization. Even if the seller and staff do not stay on after the deal, they may prove useful as advisers in the future.

Limit the report with only material facts

While preparing the report it is advisable to be precise and only the information that has a material impact on the target company is required to be included.

Structure of information

Once the due diligence process is over, while preparing the report, information has to be structured in an organized manner in order to have a better correlation on related matters.

Stages/Process of Due Diligence

A due diligence process can be divided into three stages (i) pre diligence, (ii) diligence, and (iii) post diligence.

(i) Pre diligence

A pre diligence is primarily the activity of management of paper, files and people.

1. Signing the Letter of Intent (LOI) and the Non Disclosure Agreement (NDA)/ Engagement letter.(A sample format is enclosed at Annexure I)
2. Receipt of documents from the company and review of the same with the checklist of documents already supplied to the company.
3. Identifying the issues.
4. Organising the papers required for a diligence.
5. Creating a data room.

The first and foremost in a deal for the management of the target company, is that the investor is to sign a Letter of Intent (LOI) or a term sheet which underlines the various terms on which the proposed deal is to be concluded. Immediately on receipt of the LOI the investors sign an NDA with the various agencies conducting a diligence, be it finance, accounting, legal or a secretarial diligence.

The company, would usually receive a checklist from the agency conducting the diligence. The checklist is invariably exhaustive in nature, and therefore, the company may either collate and compile the documents in-house, or outsource this to an external agency. While the data is being collated care should be taken to ensure that there are no loose ends that may probably arise.

As regards a data room, some of the important things that one should take cognizance of from the corporate view point are the following:

- (a) Do not delay deadlines (leads to suspicion).
- (b) Mark each module of the checklist provided for separately.
- (c) In case some issues are not applicable spell it out as “Not Applicable”.
- (d) In case some issues can not be resolved immediately, admit it.
- (e) Put a single point contact to oversee the process of diligence.

- (f) Keep a register, to track people coming in and going out.
- (g) An overview on the placement of files.
- (h) Introduction to the point person.

During the diligence, care should be taken to adhere to certain hospitality issues, like:

- (a) Be warm and receptive to the professionals who are conducting diligence.
- (b) Enquire on the DD team.
- (c) Join them for lunch.
- (d) Ensure good supply of refreshments.
- (e) In case of any corrections – admit and rectify.

As regards the process of diligence, as a professional care should be taken to scrutinize every document that is made available and ask for details and clarifications, though, generally the time provided to conduct the diligence may not be too long and though things have to be wrapped up at the earliest. The company may be provided an opportunity to clear the various issues that may arise out of the diligence.

(ii) Diligence

After the diligence, is conducted, the professionals submit a report, which is common parlance is called the DD report. These reports can be of various kinds, a summary report; a detailed report or the like; and the findings mentioned in the report can be very significant, in as much as the deal is concerned.

There are certain terms used to define the outcome of these reports:

Deal Breakers: In this report the findings can be very glaring and may expose various non-compliance that may arise – any criminal proceedings or known liabilities.

Deal Diluters: The findings arising out a diligence may contain violations which may have an impact in the form of quantifiable penalties and in turn may result in diminishing the value of company.

Deal Cautioners: It covers those findings in a diligence which may not impact the financials, but there exist certain non compliances which though rectifiable, require the investor to tread a cautious path.

Deal Makers: Which are very hard to come by and may not be a reality in the strict sense, are those reports wherein the diligence team have not been able to come across any violations, leading them to submit what is called a 'clean report'.

Interestingly, only after the reporting formalities are over and various rectifications are carried out, the “shareholders agreement” (which is the most important document) is executed. This agreement contains certain standard clauses like the tag along and drag along rights; representations and warranties; condition precedents, and other clauses that have an impact on the deal.

(iii) Post Diligence

Post diligence sometimes result in rectification of non-compliances found during the course of due diligence. There can be interesting assignments arising out of the diligence made by the team of professionals. It can range from making applications/filing of petition for compounding of various offences or negotiating the shareholders' agreement, since the investors will be on a strong wicket and may negotiate the price very hard.

Transactions Requiring Due Diligence

1. Mergers, amalgamations and Acquisitions

Due diligence investigations are generally for corporate acquisitions and mergers— i.e., investigation of the company being acquired or merged. These are also generally the most thorough types of due diligence investigations. The buyer or transferee company wants to make sure it knows what it is buying. Partnerships are another time when parties investigate each other in conjunction with negotiations. Some other transactions where due diligence is appropriate could be:

- (a) Strategic Alliances, and Joint Ventures
- (b) Strategic partnerships
- (c) Partnering Agreements
- (d) Business Coalitions
- (e) Outsourcing Arrangements
- (f) Technology and Product Licensing
- (g) Technology Sharing and Cross Licensing Agreements
- (h) Distribution Relationships, etc.

As regards the acquirer due diligence is an opportunity to confirm the correct value of the business transaction, accuracy of the information disclosed by the target company as well as determines whether there are any potential business concerns that need to be addressed. This process helps evaluation and plan for the integration of business between the transacting parties. As regards the target company, it is ascertaining the ability of the acquirer to pay or raise funds to complete the transaction, of rights that should be retained by the target company, determination of any obstacles that could delay the closing and aid in the preparation of the target company's disclosure schedules for the definitive and final transactional document.

2. Joint venture and collaborations

Before entering into a major commercial agreement like a joint venture or other collaboration with a company, a collaboration partner will want to carry out a certain amount of due diligence. This is particularly likely to be the case where a large company is forming a relationship for the first time with a relatively small start-up company. The due diligence may not be as extensive as in an acquisition, but the larger company will be seeking comfort that its investment will be secure and the small company has the systems personnel, expertise and resources to perform its obligations.

3. Venture Capital Investment

Before making an investment in any company, venture capitalizes will conduct business due diligence, which generally includes aspects such as a review of the market for the product of the company, background check on the founders and key management team, competition for the company, discussions with key customers of the company, analysis of financial projections for the business, review of any weakness/differences in the management team, minutes and consents of the board of directors and shareholders, corporate charter and bylaws, documents on litigations, patents and copyrights, and other intellectual property-related documents etc.

4. Public Offer

Public issue due diligence spans the entire public issue process. The steps involved may be

- (1) Decisions on public issue.

- (2) Business due diligence.
- (3) Legal and financial due diligence.
- (4) Disclosures in prospectus.
- (5) Marketing to investors.
- (6) Post issue compliance.

DOCUMENTS TO BE CHECKED IN DUE DILIGENCE PROCESS

The following are the few types of information or documents to be checked, during the process of due diligence.

1. Basic information
2. Financial Data
3. Important business Agreements
4. Litigation aspects
5. IPR Details
6. Marketing information
7. Internal control system
8. Taxation aspects
9. Insurance coverage
10. Human resources aspects
11. Environmental impact
12. Cultural aspects

However, the list mentioned above is not an exhaustive. The purpose of providing this list is to provide a general idea of documents that are required to be checked in any type of due diligence.

THE CONCEPT OF DATA ROOM IN DUE DILIGENCE

What is data room?

A Data Room provides all important business documents/information which may be on Financial, regulatory, IPR, marketing, Press report or any important material aspect pertaining to a business transaction. Other wise it provides for a common platform/place where all records of important business information are kept for the review by a potential buyer after signing of a Non Disclosure Agreement (NDA). As data room discloses confidential data which is not available for public and may relate to business process, trade secret, technology information etc, the access to data room is made after signing of Non Disclosure Agreement.

Provisions are also made to mitigate the risks of data destruction or data stealing. For this purpose the restrictive provisions are made for entry, study, noting and exit from the data room. This includes physical checking of the persons conducting such study in the data room. Installing close circuit camera in the data room and monitoring the activity of the persons on time to time basis is a regular activity. It results in adequate expenditure and prior to that make proper budgeting is required.

Principles are also laid down for copying documents to clearly state about the nature of documents which could be copied in the data room. For this purpose also photocopiers and scanning machines are kept, electronic data similarly also monitored for which copies are required to be made.

Why Data Room?

1. Removes ambiguity in the minds of buyer about the profitability, growth prospectus, and sustainability of business that is proposed to be bought.
2. Provides material information that helps in doing a SWOT analysis.
3. It enables the buyer to do a better bargain through the analysis of the data.
4. May expose the weakness of the seller which is not directly provided to the buyer- For example, a material off balance sheet transaction.
5. Provides data that helps in better Valuation of business for both buyer and seller.

What type of information is provided under a data room?

The following are the examples of information that is provided in a Data Room. This list is not however exhaustive.

1. Financial documents such as Annual Reports, Financial statements filed with regulatory authorities, cash flow statements, documentation with bankers etc.
2. Basic corporate documents such as certificate of incorporation, Memorandum and Articles of Association, Share-holding agreement, various types of registrations, documents on General and Board Meetings, insurance contracts etc.
3. HR information
4. Equipment and information on operational aspects.
5. Information relating to sales, marketing etc
6. Compliance related information
7. Information published in media.
8. IPR details
9. Information on litigation

Some Occasions those require creation of Data Room.

1. Mergers, amalgamations and Acquisitions
2. Strategic Alliances
3. Partnering agreement
4. Business Coalitions
5. Outsourcing agreement
6. Technology or Product Licensing
7. Joint Ventures through technical or financial collaboration
8. Venture Capital investment
9. Public Issue

Data Room – Virtual or Physical

Earlier data room was a physical location where all confidential and other documents are kept in a paper form and were kept under lock and key with custody of a responsible person. Generally the data room was created at vendor's premises or lawyer's office and specific time was allotted to the buyer and the authorised representatives of the buyer to enter and exit the premises which were set up as Data Room. Only one

prospective buyer was allowed to view the documents at a time. When a prospective bidder demands additional or new documents it was provided to them in physical copy through courier or registered post. It demanded the physical availability of experts from different fields at the place where the due diligence exercise was being carried out.

Under the prevailing globalised economy, using of traditional physical data rooms for due diligence is not only a time-consuming and difficult process but also is very expensive as it demands the prospective buyers to travel from their place to the place where the data room is located.

Technology has enhanced the efficiency of many business processes and activities. New and creative uses of technology are expected to have similar positive effects on existing businesses. Introduction of Virtual Data Room which is an effect of technology has come as a boon for due diligence exercise.

Virtual Data Room is a site where all the required data of the prospective buyer are stored in digitalized or electronic form. Due diligence exercise these days is carried out through creation of virtual data room in the form of internet site where all the confidential/material business information is stored.

In general the following steps are involved in creation of a virtual data room.

1. Demands of the prospective bidders are identified.
2. Identify a trust worthy data room service provider if necessary and enter into necessary agreement with them.
3. Creation of a website where all the required documents are stored with internet security, restriction to access the site etc
4. Signing of Non-Disclosure Agreement with prospective bidders
5. Service agreement with data room service provider and the prospective bidder
6. Prospective bidders, on signing of Non-Disclosure Agreement and the service agreement, are given Use Id and pass word of the virtual data room so that any number of prospective bidders and access to it.

Major Advantages of Virtual Data Room

1. Savings in cost
2. Saving in time
3. More Comfort to buyer and Seller
4. Availability of information at any time of the day
5. Enables multiple prospective bidders to access the Virtual Data Room
6. Easy to Set up
7. More Secured
8. Improved Efficiency
9. Copying/printing of documents may be restricted.
10. Closure of Virtual Data Room may happen at any time

Some Disadvantages of Virtual Data Room

1. Limited interaction with prospective sellers.
2. lack of clarity of documents loaded on the data-site

3. inability to copy or print information some times becomes a hurdle
4. access to sensitive information such as contracts to third parties poses legal challenges relating to confidentiality of information.

Virtual and Physical Data Room – A comparison

<i>Sl. No.</i>	<i>Particulars</i>	<i>Physical Data Room</i>	<i>Virtual Data Room</i>
1	Form of documents	Papers, files, boxes or any tangible thing	Electronic/Digital/soft copies of documents including video/audio documents
2	Security of documents	Lies with the integrity of person who is in charge of the data room	More secured through specific log-in id and pass word. In addition facilities like internet fire walls are there.
3	Time required for creation of data room	Longer time required.	Can be created within 48 hours also once demands of prospective bidders are identified.
4	Cost	High because of reasons like— Requirement of one person to take care of data room. Requires bidders to travel from their place to the place of location of data room etc	Low as the documents can be viewed from any location with internet security.
5	Convenience	Low Level because of reasons like— Only one prospective bidder can review the documents at a time Difficult to search the documents that is required	More convenient as it enables multiple bidders to review documents with search facility also.
6	Accessibility to data room	Restricted time	Any time.
7	Facility to restrict access of document access	Not there	Access can be restricted.
8	Facility to check who has reviewed what documents and how many times	Not available	Available
9	Facility to highlight new information	To be conveyed manually to all bidders	A highlight can be made in the site created as data room
10	Ability to copy documents	Possible	Not possible always
11	One to one communication in person with the seller or his representatives	Available	Not available

Data room administration and data security

Administration of data room and its management including entry access and other security aspects including data security to be planned in detail and a trial run to be conducted before making the data room operational.

Due Diligence Vs Audit

An audit is concerned with historical financial statements only and provides an opinion as to whether the financial statements represent a “true and fair” view of the company’s operations. Due diligence, on the other hand, review not only look the historical financial performance of a business but also consider the forecast financial performance for the company under the current business plan. The following table describes the difference between Due Diligence and Audit.

<i>Particulars</i>	<i>Audit</i>	<i>Due diligence</i>
Scope	Limited to financial analysis	Includes not only analysis of financial statements, but also business plan, sustainability of business, future aspects, corporate and management structure, legal issues etc.
Data	Based on historical data	Covers future growth prospects in addition to historical data.
Mandatory	Mandatory	Mandatory based on the transaction.
Assurance	Positive assurance i.e. true and fairness of the financial statements	Negative assurance. i.e. identification of risks if any.
Type	Post mortem analysis	It is required for future decision.
Nature	Always uniform	Varies according to the nature of transaction
Repetitiveness	Recurring event	Occasional event

ANNEXURE I

XYZ Limited Non Disclosure Agreement

This Agreement is entered into effective as of _____ between _____. (the “Company”) and _____, (“Recipient”). Recipient is acting as an expert advising the Company in connection with a [_____], and for that purpose the Company may make certain Confidential Information (as defined below) available to the Recipient (the “Purpose”).

As a condition to, and in consideration of, the Company's furnishing of Confidential Information to the Recipient, the Recipient agrees to the restrictions and undertakings contained in this Agreement.

IT IS HEREBY AGREED AS FOLLOWS.

1. Definitions

In this Agreement:

1.1 Confidential Information’:

- (a) means any information disclosed by one Party (the “Disclosing Party”) to any other Party (the “Receiving Party”) or which is otherwise communicated to or comes to the attention of the Receiving

Party whether such information is in writing, oral or in any other form or media and whether such disclosure, communication or coming to the attention of the Receiving Party occurs prior to or during this Agreement; and

(b) includes, without limit:

- (i) any information which can be obtained by examination, testing or analysis of any hardware, any component part thereof, software or material samples provided by the Disclosing Party under the terms of this Agreement;
- (ii) all information disclosed by one Party to any of the other Parties relating directly or indirectly to the Purpose;
- (iii) the fact that the Parties are interested in or assessing the Purpose and/or are discussing the Purpose with each other; and
- (iv) the terms of any agreement reached by the Parties or proposed by any of the Parties (whether or not agreed) in connection with the Purpose ;
- (v) all knowledge, information or materials (whether provided in hardcopy or electronic or other form or media) whether of a technical or financial nature or otherwise relating in any manner to the business affairs of the Disclosing Party (or any parent, subsidiary or associated company of that party) software, samples, devices, demonstrations, know-how or other materials of whatever description, whether subject to or protected by copyright, patent, trademark, registered or unregistered design.

2. Undertakings

Subject to clause 3 below and in consideration of the disclosure of Confidential Information by the Disclosing Party, the Receiving Party agrees:-

- (i) to keep confidential and not disclose to any third party, copy, reproduce, adapt, divulge, publish or circulate any part of or the whole of any Confidential Information without the prior written consent of the Disclosing Party; and
- (ii) to restrict access to the Confidential Information disclosed to it under this Agreement to those of its employees and officers who need to know the same strictly for the Purpose; and
- (iii) not to use Confidential Information disclosed to it under this Agreement for any purpose other than the Purpose; and
- (iv) not to combine any part of or the whole of the Confidential Information with any other information; and
- (v) not to disclose the whole or any part of the Confidential Information to any third party without (a) the prior written consent of the Disclosing Party and (b) prior to disclosure to such third party procuring that the third party is bound by obligations which are no less onerous than those contained in this Agreement; and
- (vi) to procure that each employee and officer to whom Confidential Information is disclosed under this Agreement is, prior to such disclosure, informed of the terms of this Agreement and agrees to be bound by them; and
- (vii) to procure that the Confidential Information in its possession is stored securely and that physical access to it is controlled.

3. Exceptions

3.1 The protections and restrictions in this Agreement as to the use and disclosure of Confidential

Information shall not apply to any information which the Receiving Party can show:-

- (a) is, at the time of disclosure hereunder, already published or otherwise publicly available; or
- (b) is, after disclosure hereunder published or becomes available to the public other than by breach of this Agreement; or
- (c) is rightfully in the Receiving Party's possession with rights to use and disclose, prior to receipt from the Disclosing Party; or
- (d) is rightfully disclosed to the Receiving Party by a third party with rights to use and disclose; or
- (e) is independently developed by or for the Receiving Party without reference or access to Confidential Information disclosed hereunder.

3.2 The Receiving Party shall not be in breach of Clause 2 if it can demonstrate that any disclosure of Confidential Information was made solely and to the extent necessary to comply with a statutory or judicial obligation.

4, No title of Use

Nothing contained in this Agreement shall be construed as conferring upon the Receiving Party any right of use in or title to Confidential Information received by it from the Disclosing Party, other than as expressly provided herein:-

5. No Obligation to Disclose, No Representations

Nothing in this Agreement shall be construed as—

- (i) creating an obligation on any of the Parties to disclose particular information; or
- (ii) creating an obligation on the parties to negotiate; or
- (iii) as a representation as to the accuracy, completeness, quality or reliability of the information.

6. Term & Termination

- 6.1 Subject to clause 3, the obligations contained in clause 2 shall continue to apply for so long as the Receiving Party has in its possession or has procured that any third party authorized under this Agreement has in its possession any Confidential Information.
- 6.2 The Receiving Party shall, on the request of the Disclosing Party, return to the Disclosing Party (whose property they shall remain) all documents and things containing Confidential Information, together with all relevant samples and models which it has in its possession pursuant to this Agreement.

7. Miscellaneous

- 7.1 No Party shall assign its rights and/or obligations pursuant to this Agreement without the prior written consent of the other Party.
- 7.2 No failure or delay by either party in exercising any rights, power or legal remedy available to it hereunder shall operate as a waiver thereof.
- 7.3 In the event any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement but this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been set forth herein, and the Agreement shall be carried out as nearly as possible according to its original terms and intent.

7.4 This Agreement shall be construed and governed in all respects in accordance with the laws of India and the Parties hereby submit to the jurisdiction of the Indian courts.

7.5 The signing of this Agreement shall not be construed as the forming of an agency, joint venture, employment or partnership.

Signed for and on behalf

“XYZ Limited”

By its duly authorised representative

(Signature)

(Name)

(Title/position)

(Date)

Signed for and on behalf

“ABC Limited”

By its duly authorised representative

(Signature)

(Name)

(Title/position)

(Date)

LESSON ROUND UP

- Due Diligence is the process by which confidential legal, financial and other material information is exchanged, reviewed and appraised by the parties to a business transaction, which is done prior to the transaction.
- The nature and scope of Due Diligence vary from transaction to transaction.
- The aspects such as Creation of data room, execution of non-disclosure agreement are very important to carry out due diligence exercise. The data room may be virtual or physical.
- Due Diligence may be business, operational strategic, human resource, ethical, cultural, legal, secretarial etc.
- Certain transactions like Mergers, Acquisitions, Venture Capital Investment, Initial Public Offer etc requires Due diligence exercise.
- Due diligence is different from audit. Audit is the financial post mortem analysis. Due diligence analyses past, present and future issues (both financial and non financial).

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. The exercise of Due diligence is not based on the defined data, but of the application of mind to a transaction – discuss.
2. What are the different stages of due diligence?
3. Describe the importance of data room in the exercise of due diligence?
4. How does due diligence different from Audit?
5. Due diligence is not a financial post mortem'- Describe

Lesson 5

ISSUE OF SECURITIES

LESSON OUTLINE

- Introduction and Regulatory Framework
- Pre/post issue due diligence –IPO/FPO
- Due diligence of preferential issue by listed and unlisted companies
- Issue of rights/bonus shares, Debt issues, ESOPs, qualified institutional placement
- Issue of securities by SMEs
- Issue of debt securities
- Role of company secretaries in issue of securities

LEARNING OBJECTIVES

The options as to the issue of securities have been getting diversified as the market grows with more number of financial instruments and funding options. To raise the money in the capital market, the company may resort to IPO/FPO, rights issue, preferential issue, issue of different debt instruments etc.

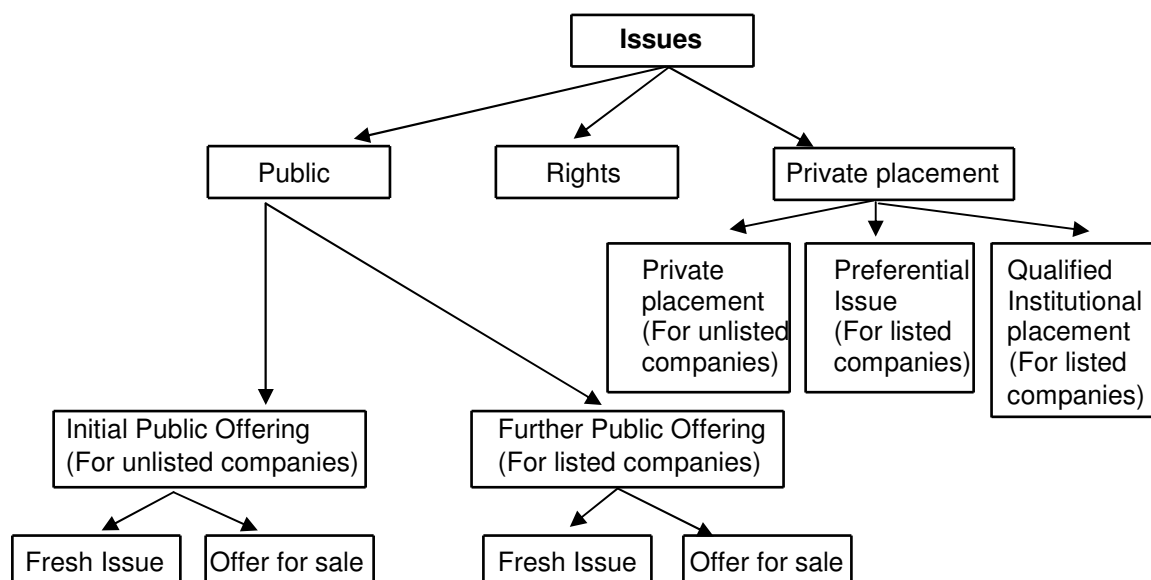
As regards compliances with respect to raising of funds, the listed companies are to comply with SEBI rules and Regulations and unlisted companies are to comply with the rules/circulars etc issued by the Ministry of Corporate Affairs, in addition to the provisions of the Companies Act. Similarly, SEBI(Issue of Capital and Disclosure Requirements)(ICDR) Regulations 2009 regulates the issue of convertible debt instruments and issue of non-convertible debt instruments are regulated by SEBI(Issue and Listing of Debt securities) Regulations 2008.

After reading this lesson you will be able to understand the broader compliances with respect to various types of issues including IPO/FPO, rights issue, bonus issue, ESOPs, preferential issues, debt instruments etc.

INTRODUCTION AND REGULATORY FRAMEWORK

Introduction¹

Primarily, issues can be classified as a Public, Rights or preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler. The classification of issues is illustrated below:



Public issues can be further classified into Initial Public offerings and further public offerings. In a public offering, the issuer makes an offer for new investors to enter into shareholding family. The issuer company makes detailed disclosures as per the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 in its offer document and offers it for subscription.

Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

A further public offering (FPO) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document. An offer for sale in such scenario is allowed only if it is made to satisfy listing or continuous listing obligations.

Rights Issue (RI) is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders unless they do not intend to subscribe to their entitlements.

Bonus issue: When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.

¹ Source: sebi.gov.in

A private placement is an issue of shares or of convertible securities by a company to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital.

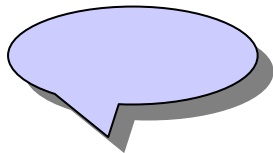
A private placement of shares or of convertible securities by a listed company is generally known by name of **preferential allotment**. A listed company going for preferential allotment has to comply with the requirements contained in Chapter VII of SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 .

“**Qualified Institutions Placement**” means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009

SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009 [(SEBI(ICDR) Regulations)]

The SEBI (ICDR) Regulations, 2009 have been introduced by repealing the SEBI (Disclosure and Investor Protection) Guidelines, 2000

While incorporating the provisions of the rescinded Guidelines into the ICDR Regulations, certain changes have been made, by removing the redundant provisions, modifying certain provisions on account of changes necessitated due to market design and bringing more clarity to the provisions of the rescinded Guidelines.



Applicability of ICDR Regulations

- *a public issue;*
- *a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;*
- *a preferential issue;*
- *an issue of bonus shares by a listed issuer;*
- *a qualified institutions placement by a listed issuer;*
- *an issue of Indian Depository Receipts.*

Provided that the provisions of these regulations shall not apply to issue of securities under clause (b), (d) and (e) of sub-regulation (1) of regulation 9 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Is SEBI (ICDR) Regulations, 2009 applicable to Companies Issuing Global Depository Receipts?

Yes, as Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) 1993 requires simultaneous listing of shares in Indian Exchanges, for issue of Global Depository Receipts, it has to comply with SEBI (ICDR) Regulations, 2009.

Who is eligible for making Public Offer?

Eligibility norms are made uniformly to all companies under SEBI (ICDR) Regulations, 2009 irrespective of whether it is a banking company or infrastructure company which were given exemptions under erstwhile SEBI (DIP) Guidelines.

Conditions for making initial public offer (Regulation 26)

- The issuer has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent are held in monetary assets and if more than fifty per cent. of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project. However, the limit of fifty percent on monetary assets shall not be applicable in case the public offer is made entirely through an offer for sale.
- it has a minimum average pre-tax operating profit of rupees fifteen crore, calculated on a restated and consolidated basis, during the three most profitable years out of the immediately preceding five years.
- it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
- the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
- if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

An issuer not satisfying the condition stipulated above, may make an initial public offer if the issue is made through the book-building process and the issuer undertakes to allot, at least seventy five percent of the net offer to public, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

An issuer may make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing thereof.

No issuer shall make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares, subject to certain exceptions specified.

Subject to provisions of the Companies Act, 1956 and these regulations, equity shares may be offered for sale to public if such equity shares have been held by the sellers for a period of at least one year prior to the filing of draft offer document with the Board in accordance with sub- regulation (1) of regulation 6. However, in case equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period.

The requirement of holding equity shares for a period of one year shall not apply: (a) in case of an offer for sale of specified securities of a government company or statutory authority or corporation or any special

purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector; (b) if the specified securities offered for sale were acquired pursuant to any scheme approved by a High Court under sections 391-394 of the Companies Act, 1956, in lieu of business and invested capital which had been in existence for a period of more than one year prior to such approval.

No issuer shall make an initial public offer, unless as on the date of registering prospectus or red herring prospectus with the Registrar of Companies, the issuer has obtained grading for the initial public offer from at least one credit rating agency registered with the Board.

Conditions as to the issue of warrants along with public issue (Regulation 4(3))

Warrants may be issued along with public issue or rights issue of specified securities subject to the following:

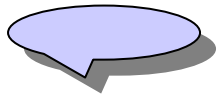
(a) the tenure of such warrants shall not exceed twelve months from their date of allotment in the public/rights issue; (b) not more than one warrant shall be attached to one specified security.

Limit regarding money proposed to be spent on General Corporate Purposes(Regulation 4(4))

The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document filed with the Board, shall not exceed twenty five per cent of the amount raised by the issuer by issuance of specified securities.

Who is not Eligible for Making Public Offer?

- (a) The issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board;
- (b) if any of the promoters, directors or persons in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by the Board;
- (c) if the issuer of convertible debt instruments is in the list of wilful defaulters published by the Reserve Bank of India or it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months;
- (d) Those who has not made an application to one or more recognised stock exchanges for listing of specified securities on such stock exchanges and has chosen one of them as the designated stock exchange: In case of an initial public offer, the issuer shall make an application for listing of the specified securities in at least one recognised stock exchange having nationwide trading terminals;
- (e) Those who has not entered into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued;
- (f) Companies where all existing partly paid-up equity shares of the issuer have not either been fully paid up or forfeited;
- (g) The companies that has not made firm arrangements of finance through verifiable means towards seventy five percent. of the stated means of finance, excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals.



Regulatory Framework on Public Offer

Public issue is mainly governed by the following legislations/regulations/rules:

- *The Companies Act, 1956*
- *Securities Contracts (Regulation) Act, 1956*
- *Foreign Exchange Management Act, 1999*
- *Securities Contracts Regulation (Rules) 1957*
- *SEBI (ICDR) Regulations 2009*
- *Listing Agreement*

II. DUE DILIGENCE - Initial Public Offer (IPO)/Further Public Offer (FPO)

When the due diligence is carried out as part of the steps leading to an IPO, the exercise takes on added meaning and encompasses a wider scope, as it identifies the areas or the issues where the company exhibits weaknesses and the due diligence process becomes a tool, which shows the company the way to optimize its potential and thereby increasing its value to potential investors. Pre-IPO due diligence process will result in a gap analysis between the present status of the company and the company that should be floated i.e., a gap is an expectations gap created as a result of how the market expects a listed company to conduct its affairs. In this scenario, once these gaps have been highlighted the due diligence exercise should not stop there but should include advice given by the advisors to the company on the processes and activities which are required to fill the gaps identified. In an IPO the due diligence exercise is a broader, fuller exercise which apart from identifying the weaknesses also looks at resolving them with the purpose of increasing the value of the company.

The due diligence process aspires to achieve the following:

- to assess the reasonableness of historical and projected earnings and cash flows;
- to identify key vulnerabilities, risk and opportunities;
- to gain an intimate understanding of the company and the market in which the company operates such that the company's management can anticipate and manage change;
- to set in motion the planning for the post-IPO operations.

It will result in a critical analysis of the control, accounting and reporting systems of the company and a critical appraisal of key personnel. It will identify the value drivers of the company thus enabling the directors to understand where the value is and to focus their efforts on increasing that value.

Due diligence spans the entire public issue process. The steps involved in due diligence are given broadly below:

1. Decision on public issue
2. Business due diligence
3. Legal and Financial Due Diligence
4. Disclosures in Prospectus
5. Marketing to Investors

6. Post issue compliance

Key areas to be focused:

- (a) the financial statements – to ensure their accuracy;
- (b) the assets – confirm their value, condition existence and legal title;
- (c) the employees – identification and evaluation of the key movers and shakers;
- (d) the sales strategy – analyzing the policies and procedures in place and assessing what works and what does not;
- (e) the marketing – what is driving the business and is it effective?
- (f) the industry in which the company operates – understand trends and new technologies;
- (g) the competition – identify the threats;
- (h) the systems – how efficient are they? Are upgrades required?
- (i) legal and corporate and tax issues – is the shareholding structure robust? Are there any tax issues which need to be resolved?
- (j) company contracts and leases – identify what the risks and obligations are;
- (k) suppliers – are they expected to remain around?

Illustrative list of documents/information to be examined:

(i) Basic documents

Review of basic corporate documents like:

- Memorandum and Articles of Association of the Company
- Copies of Incorporation Certificate/Commencement of Business Certificate/ Change of Name certificate (if applicable)
- Registered office address of the company
- History/businesses of the company
- Special rights available to any persons through shareholder or other Agreements.

(ii) Promoters/Personnel

1. Promoters' bio-data with special reference to qualification and experience. Track record of the promoters in the capital market – public issue by other group companies, violation of securities laws.
2. Directors' & Key Personnel – details bio-data including father's name, address, occupation, year-wise experience. Background of the Directors – including examining the list of willful defaulters periodically prepared by RBI.
3. Constitution of Audit Committee, Remuneration Committee etc., Terms of reference of these committees.
4. Organization Chart.
5. Key Personnel/employees/Directors left in the last two years with reasons.
6. Break-up of employees – whether any agreement are entered into with employee – If so, copy of agreement.
7. Details of Pay scales/bonus (including performance)/PF/Gratuity etc.
8. Employment of contract labour – no. of workers, copy of contract.

(iii) Financials

1. Projections of combined operations (existing + proposed) for 5 years including the following:
 - Income details including prices
 - Cash flow and Balance Sheet
 - Capacity utilization details
 - Interest calculation – Assessment of rate/Repayment schedule
 - Depreciation
 - Tax
 - Assumptions w.r.t. cost items
 - Commencement of commercial production (Year to be mentioned)
 - IT depreciation table for past (in case projections have to be prepared)
 - Latest provisional accounts with all schedules
 - Latest income Tax Depreciation calculation
 - Input-Output ration (consumption norms) for each segment alongwith prices and input prices
 - Services-wise capacity & Capacity utilization projects for the next 5 years
 - Working Capital norms
 - Basis for working out various expenses
 - Month from which the commercial production will commence for the new project
 - IT depreciation table for past.
2. Bankers to the Company – name & addresses.
3. Details of Banks Loan, Term Loan, Promissory notes, Hundis, Credit Agreements, Lease, Hire Purchase, Guarantees or any other evidences of indebtedness, Copies of Sanction letters, Original amount, Interest rate, Amount outstanding, Repayment schedule.
4. Details of default/reschedulements, if any – copy of correspondence with lenders.
5. Accounts for last 3 years and latest unaudited accounts.
6. Associate/Group Companies' concerns accounts for last 3 years. Also give: Profile of the concerns.
7. Audited Balance Sheet, P&L Account for last 3 years of the promoter company (i.e. if promoter is a Co.)
8. In case any liabilities are not disclosed in the Balance Sheet, details thereof, or any secret reserves.
9. Age-wise analysis of stocks, debtors, creditors and loans & advances given
10. Terms of various loans & advances given
11. If names of any associates/related units are present in the debtors or parties to whom loans & advances have been given
12. Details of contingents liabilities including guarantees given by Co./directors
13. Trends in profit ratios.

(iv) Project Information

1. Project Feasibility report

2. Reports/documents prepared by independent research agencies in respect of the state of the industry and demand and supply for the company's products
3. Break-up of Cost of Project:
 - Land – Locational site & map, area, copy of documents i.e. Sale/lease Deed for land, Soil Test Report, Order for converting land into Industrial land etc.
 - Building – Details break-up from Architect, Approval details from Municipality etc. and Valuation Report from a chartered engg. (for existing building and suitability of site)
 - Equipments – Invoices/Quotations of main items. (Indicate Imported mach. Separately)
 - Margin Money for Working Capital – Margin Money for Working Capital (calculation)
 - Preliminary & Pre-operative expenses – break-up
 - Provision for contingencies – break-up
4. Schedule of Implementation.
5. Status of Project as on a recent date – Amount spent & sources
6. Promoter's contribution till date (supported by Auditor's certificate if possible)
7. Current & proposed Shareholding pattern
8. Sanctions received by the issuer from bankers/institutions for debt financing in the project
9. Notes on the following: Technical process, utilities (power, water, transport, effluent treatment, location, land building, Plant & Machinery).
 - (a) Manpower
 - (i) Break-up of employees – whether any agreements are entered into with employee – If so, copy of agreement
 - (ii) Details of Pay scales/bonus (including performance bonus)/PF/ Gratuity etc.
 - (iii) Employment of contract labour – no. of workers, copy of contract.
 - (b) Quality Control facilities, Research & Development.
10. Market (Demand/supply with sources alongwith copies),
11. Marketing & Distribution (network etc.) & relevant documents wherever applicable.
12. Arrangements and strategy of the company for marketing its products
13. Discussions with important customers, suppliers, Joint Venture partners, collaborators of the company.

(v) General Information

1. Details on Litigation, Disputes, overdue, statutory dues, other Material development and tax status of Company & promoters.
2. Copies of IT returns of the Company along with copies of Assessment orders for last three years.
3. Copies of IT/Wealth tax returns of the promoters along with copies of Assessment orders for last three years.
4. Copy of documents for Collaborations/Marketing Tie-ups/Other Tie-ups if any.
5. NOC/Approval/Sanctions from State Government authorities as applicable.
6. Copy of SIA Registration/SSI Registration/EOU License/LOI or License, as applicable.

7. Incentives if any – such as subsidy, Sales tax loans/exemption/concession/ power subsidy.
8. List of existing plant & machinery with cost & age & type of ownership (lease etc.)
9. R&D (if any) cost for the project for the last three years. (Sources of any outside R&D funds including any joint venture agreements)
10. Summary of Bad Debts experience for the last five years.
11. Approvals from company's Board of Directors/Shareholders to issue securities to the public.
12. Copies of documents filed with Registrar of Companies.
13. Names of stock exchanges where shares of the Co. are listed.
14. Stock Market quotation of share, wherever applicable, as on recent date.
15. Special legislation applicable, if any, and compliance thereof (e.g. NBFCs etc.)

(vi) Third Parties

1. Brochure on collaborators, copy of Government approval for collaboration.
2. Copy of Agreement with Consultants, Copy of Government approval in case of foreign consultants.
3. Copies of important Agreements/Contracts of any sort with all the parties concerned with the company.
4. Copy of FIPB/RBI approvals (NRI/Foreign participant etc.), wherever applicable.
5. Details of Patents, Trademarks, Copyrights, Licenses etc., if any.
6. List of major customers/clients (attach copies of main pending orders).
7. Competitors & Market shares for Company's products (with sources, wherever possible).
8. Sales arrangements, terms & conditions.
9. Main suppliers – terms & conditions.

A check list on Major IPO Compliances under SEBI (ICDR) Regulations 2009

1. Appointments

- Check whether the issuer has appointed one/more merchant bankers atleast one of whom shall the lead merchant banker, to carry out the obligations relating the issue.
- If the merchant banker is an associate of an issuer it shall declare itself as marketing lead merchant banker and its role shall be limited to the marketing of the issue.
- Check whether the issuer has appointed SEBI registered intermediaries in consultation with lead merchant banker.
- Check whether the issuer has appointed syndicate member in respect of issue through book building.
- Check whether the issuer appointed registrars who has connectivity with both depositories.(ie NSDL/CDSL)
- Ensure that the lead merchant banker is not acting as registrar to the issue in which it is also handling post issue obligations.
- Ensure that in case of book built issue lead merchant banker and lead book runner are not different persons.

2. Filings/approvals/submissions

- Check whether the draft offer document is filed with SEBI at least thirty days prior to registering a prospectus, red herring prospectus or shelf prospectus with ROC or filing the letter offer with the registrar of companies.
- Check whether the draft offer document is made available to the public for atleast 21 days from the date of such filing with SEBI .
- Check whether a statement on the comments received from public on draft offer document is filed with SEBI.
- Ensure whether the observations/suggestions of SEBI on draft offer documents has been carried out while registering of prospectus with ROC.
- Check whether a copy of letter of offer is filed with SEBI and with stock exchanges where the securities are proposed to be listed, simultaneously while registering the prospectus with ROC /before opening of the issue.
- Check whether the company has obtained in-principle approval in respect of IPO/FPO from all the exchanges where the securities are proposed to be listed.
- Ensure whether the issuer has filed necessary documents before opening of the issue while
 - (a) Filing the draft offer documents with SEBI
 - (b) Required documents after issuance of observations by SEBI
 - (c) Filing of draft offer document with stock exchanges where the securities are proposed to be listed.

It may be noted that contents of offer documents hosted on Websites are the same as printed versions filed with ROC. Further the information contained in the offer document and particulars as per audited financial statements in the offer document are not more than six months old from the opening of the issue.

Ensure that the offer document/red herring prospectus, abridged prospectus etc contain necessary disclosures.

Filing of Offer Document is

Mandatory for:

- (i) *All Public Issues*
- (ii) *Rights Issue in excess of ₹50 lakhs or more*



3. Pre issue-Due Diligence Certificates

Ensure whether the lead merchant bankers has submitted due diligence certificate with SEBI at the time of

- (a) filing of draft offer document with SEBI
- (b) At the time of Registering prospectus with ROC
- (c) Immediately before opening of the issue
- (d) After the opening of the issue and before its closure before it closes for subscription

4. Time limitation in opening of issue

Ensure that subject to compliance of Section 60(4) of the Companies Act, 1956, public/rights issue is opened within

- (i) Twelve months from the date of issuance of observations from the SEBI on draft offer document or
- (ii) Within three months from the later of the following dates if there are not observations.
 - (a) Draft of Receipt of draft offer document by SEBI
 - (b) Date of receipt of satisfactory reply from the lead merchant bankers, where the SEBI has sought for any clarification/information
 - (c) Date of receipt of clarification or information from any regulator or agency, where the SEBI has sought for any such clarification/information
 - (d) Date of receipt of a copy of in-principle approval letter issued by the recognized stock exchanges.
 - (i) In case of Fast Track issues the issue shall be opened within 90 days from the registration of prospectus with ROC.
 - (ii) In case of Shelf prospectus, the first issue may be opened within 3 months from the date of observation of SEBI.

An issue shall be opened after at least three working days from the date of registering the red herring prospectus with the Registrar of Companies.

5. Dispatch of offer documents and other materials

Ensure that the offer document and other issue related instruments is dispatched to Bankers, Syndicate Members, underwriters etc in advance.

6. Underwriting for issue through book building

Where the issuer makes a public issue through the book building process, such issue shall be underwritten by book runners or syndicate members:

7. Minimum Subscription

Ensure that the company has received minimum subscription of 90% of the offer.

8. Minimum allottees

Ensure that the number of prospective allottees is at least one thousand.

9. Monitoring agency

Ensure that the issue size of more than 500 crores has been monitored by a Public Financial Institution or by one of the scheduled commercial banks named in the offer document as bankers of the issuer.

10. Time limitation for receiving the call money

Ensure that the subscription money if made in calls, the outstanding subscription money is called within 12 months from the date of allotment. and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited: Provided that it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency

11. Time limit for allotment or refund of Subscription money

Ensure that the securities are allotted and the excess amounts are refunded within 15 days from the closure of the offer. In the case of an initial public offer, the minimum subscription to be received shall be subject to allotment of minimum number of specified securities, as prescribed in sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957.

12. Pricing

- Ensure the norms relating to price/price band, cap on price bands is complied with.
- Check whether the pricing norms are complied with respect to differential pricing
- Check whether the floor price/final price is not less than the face value of securities

13. Promoters Contribution

- Ensure that the promoters' contribution is
 - (a) in case of an initial public offer, not less than twenty per cent. of the post issue capital; In case the post issue shareholding of the promoters is less than twenty per cent., alternative investment funds may contribute for the purpose of meeting the shortfall in minimum contribution as specified for promoters, subject to a maximum of ten per cent of the post issue capital.
 - (b) in case of a further public offer, either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital;
 - (c) in case of a composite issue, either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital excluding the rights issue component.
- Ensure that the promoters contribution is kept in an escrow account with a scheduled banks and shall be released to the issuer along with the release of issue proceeds.
- Ensure that the securities ineligible for promoters contribution is not included while calculating the above limits.
- Ensure that the minimum promoters contribution and excess promoters contribution is locked in for 3 years and one year respectively.

For the computation of minimum promoters' contribution, the following specified securities(Equity Shares and Convertible Securities)shall not be eligible:

- (a) specified securities acquired during the preceding three years, if they are:
 - (i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or
 - (ii) resulting from a bonus issue by utilisation of revaluation reserves or unrealized profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution;
- (b) Specified securities acquired by promoters and alternative investment funds during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer subject to certain specified exemptions.
- (c) Specified securities allotted to promoters and alternative investment funds during the preceding one

year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms, where the partners of the erstwhile partnership firms are the promoters of the issuer and there is no change in the management:

- (d) Specified securities pledged with any creditor.

The requirements of minimum promoters' contribution shall not apply in case of: (a) an issuer which does not have any identifiable promoter; (b) a further public offer, where the equity shares of the issuer are not infrequently traded in a recognised stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least immediately preceding three years; (c) right issue.

14. Lock in requirements

Date of commencement of lock in and inscription of non-transferability.

In a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:

- (a) minimum promoters' contribution including contribution made by alternative investment funds, referred to in proviso to clause (a) of sub-regulation (1) of regulation 32, shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later;
- (b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year: Provided that excess promoters' contribution as provided in proviso to clause (b) of regulation 34 (In those cases where the minimum promoters' contribution is not applicable) shall not be subject to lock-in. It may be noted that "date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

In case of an initial public offer, the entire pre-issue capital held by persons other than promoters shall be locked-in for a period of one year:

It does not apply to:

- (a) equity shares allotted to employees under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with Part A of Schedule VIII;
- (b) equity shares held by a venture capital fund or alternative investment fund of category I or a foreign venture capital investor. However, such equity shares shall be locked in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

In case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid and no further consideration is payable at the time of their conversion.

The lock-in provisions of Chapter III Part IV shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such

specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation 45. The specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

Specified securities held by promoters and locked-in may be pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution, subject to the following: (a) if the specified securities are locked-in in terms of clause (a) of regulation 36, the loan has been granted by such bank or institution for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan; (b) if the specified securities are locked-in in terms of clause (b) of regulation 36 and the pledge of specified securities is one of the terms of sanction of the loan.

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, the specified securities held by promoters and locked-in as per regulation 36 may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and the specified securities held by persons other than promoters and locked-in as per regulation 37 may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred. The lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

Minimum offer to the Public

Subject to the provisions of sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957, check the net offer to public:

- (a) in case of an initial public offer, is at least ten per cent or twenty five per cent of the post-issue capital, as the case may be; and
- (b) in case of a further public offer, is at least ten per cent or twenty five per cent of the issue size, as the case may be.

16. Reservation on Competitive Basis

- For issue made through the book building process

In case of an issue made through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies
 - (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer
 - (c) persons who, as on the date of filing the draft offer document with the Board, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer.
- For issue made other than through the book building process

In case of an issue made other than through the book building process, the issuer may make

reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies;
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in the case of a new issuer; and
 - (ii) listed group companies, in the case of an existing issuer
- Ensure that reservations have not been made in respect of the following persons who are not eligible.
 - (a) In case of promoting companies being financial institutions or state and central financial institutions, the shareholders of such promoting companies
 - (b) In case of issue made through book building process, the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees;
- In case of a further public offer (not being a composite issue), the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of retail individual shareholders of the issuer.

The reservation on competitive basis shall be subject to following conditions:

- (a) the aggregate of reservations for employees shall not exceed five per cent. of the post issue capital of the issuer;
- (b) reservation for shareholders shall not exceed ten per cent. of the issue size;
- (c) reservation for persons who as on the date of filing the draft offer document with the Board, have business association as depositors, bondholders and subscribers to services with the issuer making an initial public offer shall not exceed five per cent. of the issue size;
- (d) no further application for subscription in the net offer to public category shall be entertained from any person (except an employee and retail individual shareholder) in favour of whom reservation on competitive basis is made;
- (e) any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such inter-se adjustments among the reserved categories shall be added to the net offer to the public category;
- (f) in case of under-subscription in the net offer to the public category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public offer category;
- (g) value of allotment to any employee in pursuance of reservation made under sub-regulations (1) or (2) of Regulation 4, as the case may be, shall not exceed two lakh rupees. In the case of reserved categories, a single applicant in the reserved category may make an application for a number of specified securities which exceeds the reservation.

The term "reservation on competitive basis" means reservation wherein specified securities are allotted in proportion of the number of specified securities applied for in respect of a particular reserved category to the number of specified securities reserved for that category and new issuer means an issuer which has not completed twelve months of commercial production and its operative results are not available.

17. Allocation in net offer to public

No person shall make an application in the net offer to public category for that number of specified securities which exceeds the number of specified securities offered to public.

In an issue made through the book building process under subregulation (1) of regulation 26, the allocation in the net offer to public category shall be as follows: (a) not less than thirty five per cent to retail individual investors; (b) not less than fifteen per cent to non-institutional investors; (c) not more than fifty per cent to qualified institutional buyers, five per cent. of which shall be allocated to mutual funds: Provided that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process under sub-regulation (2) of regulation 26, the allocation in the net offer to public category shall be as follows: (a) not more than ten per cent to retail individual investors; (b) not more than fifteen per cent to non-institutional investors; (c) not less than seventy five per cent to qualified institutional buyers, five per cent. of which shall be allocated to mutual funds: Provided that in addition to five per cent. allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process, the issuer may allocate upto thirty per cent. of the portion available for allocation to qualified institutional buyers to an anchor investor in accordance with the conditions specified in this regard in Schedule XI.

In an issue made other than through the book building process, allocation in the net offer to public category shall be made as follows: (a) minimum fifty per cent. to retail individual investors; and (b) remaining to: (i) individual applicants other than retail individual investors; and (ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for; (c) the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

18. Period of subscription

Ensure that the public issue is kept open at least for three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band.

What is the Minimum and Maximum period of Subscription?

Minimum Period – 3 working days

Maximum Period – 10 working days



19. Advertisements

Pre issue

Ensure that after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in the prescribed format and with required disclosures, in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

- Issue opening and closing

Ensure that the advertisement on issue opening and closing is made in the specified format.

- Advertisement

Ensure that advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of dispatch of refund

orders or instructions to Self Certified Syndicate Banks by the Registrar, date of dispatch of certificates and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

Major issues to be taken care while issuing advertisement/publicity material

- Ensure that issuer, advisors, brokers or any other entity connected with the issue do not publish any advertisement stating that issue has been oversubscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public.
- Ensure that all public communications and publicity material issued or published in any media during the period commencing from the date of the meeting of the board of directors of the issuer in which the public issue or rights issue is approved till the date of filing draft offer document with the Board is consistent with its past practices
- Ensure that any public communication including advertisement and publicity material issued by the issuer or research report made by the issuer or any intermediary concerned with the issue or their associates contains only factual information and does not contain projections, estimates, conjectures, etc. or any matter extraneous to the contents of the offer document
- Ensure that the announcement regarding closure of the issue is made only after the receipt of minimum subscription.
- Ensure that no product advertisement contains any reference, directly or indirectly, to the performance of the issuer during the period commencing from the date of the resolution of the board of directors of the issuer approving the public issue or rights issue till the date of allotment of specified securities offered in such issue.
- Ensure that no advertisement or distribution material with respect to the issue contains any offer of incentives, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise.
- Ensure that the advertisement does not include any issue slogans or brand names for the issue except the normal commercial name of the issuer or commercial brand names of its products already in use
- Ensure that no advertisement uses extensive technical, legal terminology or complex language and excessive details which may distract the investor.
- Ensure that no issue advertisement contains statements which promise or guarantee rapid increase in profits.
- Ensure that no issue advertisement displays models, celebrities, fictional characters, landmarks or caricatures or the likes.
- Ensure that no issue advertisement appears in the form of crawlers (the advertisements which run simultaneously with the programme in a narrow strip at the bottom of the television screen) on television.
- in any issue advertisement on television screen, the risk factors shall not be scrolled on the television screen and the advertisement shall advise the viewers to refer to the red herring prospectus or other offer document for details
- Ensure that no issue advertisement contains slogans, expletives or non-factual and unsubstantiated titles.

- If an advertisement or research report contains highlights, it shall also contain risk factors with equal importance in all respects including print size of not less than point seven size;

Test Your Knowledge

Can information Scroll on Television Screen on Public Issue/Offer Document etc.?

Can an IPO advertisement use models?

Can a product advertisement refer to the performance of the issues during subscription period?

20. Minimum Application Value

Ensure that Minimum application Value is kept between ten thousand rupees to fifteen thousand rupees.

21. Allotment procedure and basis of allotment

The allotment of specified securities to applicants other than retail individual investors and anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer.

Provided that value of specified securities allotted to any person in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 42, shall not exceed two lakhs rupees.

The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

The executive director or managing director of the designated stock exchange along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified

22. Appointment of Compliance officer

The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

23. Redressal of investor grievances

The post-issue lead merchant bankers shall actively associate himself with post-issue activities such as allotment, refund, despatch and giving instructions to syndicate members, Self Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

24. Post issue diligence

(1) The lead merchant bankers shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.

(2) The lead merchant bankers shall call upon the issuer, its promoters or directors or in case of an offer for sale, the selling shareholders, to fulfil their obligations as disclosed by them in the offer document and as required in terms of these Regulations.

(3) The post-issue merchant banker shall continue to be responsible for post-issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application

moneys and the listing agreement is entered into by the issuer with the stock exchange and listing/ trading permission is obtained.

(4) The responsibility of the lead merchant banker shall continue even after the completion of issue process.

25. Post issue Reports

The lead merchant banker shall submit post-issue reports as follows:

- (a) initial post issue report in specified form within three days of closure of the issue
- (b) final post issue report in specified format within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue. The lead merchant banker shall also submit a due diligence certificate in the specified format along with the final post issue report.

The initial post issue monitoring report is to be sent within 3 days of closure of the issue and the final post issue report is to be sent within 15 days from the date of finalization of basis of allotment.

Annual Updation of Offer Document

The disclosures made in the red herring prospectus while making an initial public offer, shall be updated on an annual basis by the issuer and shall be made publicly accessible in the manner specified by the Board.

ROLE OF COMPANY SECRETARY IN AN IPO

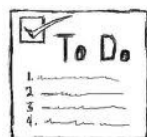
The plethora of services, which a Practising Company Secretary can render in IPOs can be listed as under:

- 1. Planning Stage
 - (a) Deciding the time line
 - (b) Compliance related issues
 - (c) Importance of Corporate Governance
 - (d) Structure of Board
 - (e) Promoters consent
 - (f) Method of issuance of shares (Demat/Physical/Both) - Compliance
- 2. Due diligence
 - (a) Company Contract and Leases
 - (b) Legal and Tax Issues
 - (c) Corporate issues
 - (d) Financial Assets
 - (e) Financial Statement
 - (f) Creditors & Debtors
 - (g) Legal Cases against the company
- 3. Appointing Advisors and other intermediaries such as:
 - (a) Investment Bankers
 - (b) Book Running Lead Managers
 - (c) Issues with Depository
 - (d) Legal Advisor
 - (e) Bankers

4. Offer Document
 - (a) Drafting the offer document
 - (b) Filing with SEBI
 - (c) In-principle approval of Stock Exchange
 - (d) Filing with Designated Stock Exchanges
 - (e) Complying with Comments received from SEBI
 - (f) Filing with ROC
5. Issue Period
 - (a) Adhering to Issue Opening/Closing Date
 - (b) Compiling Field Reports on subscription status
 - (c) Coordinating with Registrar/Bankers to the issue
6. Allotment of shares
 - (a) Basis of allotment
 - (b) Board meeting for allotment
 - (c) Crediting shares in beneficiary account/dispatch of share certificates
 - (d) Despatch of refund orders
 - (e) Payment of stamp duty
7. Listing
 - (a) Filing for Listing with Designated Stock Exchange
 - (b) Finalisation of Listing Process
8. Post issue compliances
 - (a) To ensure proper compliance with Listing Agreement
 - (b) Redressal of shareholder complaints
 - (c) Timely filing of required reports with ROC/SEBI/Stock Exchange

As can be seen from the above, a Company Secretary is a key member in an IPO team. Apart from checking the applicability and eligibility norms or exemption from eligibility norms and the pre-listing requirements of Stock Exchange, he is responsible for ensuring that the company has complied with the pre-issue, issue and post-issue obligations of the company and corporate governance requirements including disclosures with respect to, *inter alia*, material contracts, statutory approvals, subsidiaries and promoter holding and litigations.

Compliance of SEBI (ICDR) Regulation 2009 and other applicable Acts and guidelines is a primary responsibility of the Company Secretary in case the company proposes to list its securities abroad, he is also required to comply with conditions for listing abroad.



Activities to do

1. Reading and analyzing various offer documents published in news paper
2. Reading various pre-issue and post issue advertisement
3. Reading offer documents filed with SEBI

III. DUE DILIGENCE – ISSUES OTHER THAN IPO/FPO

Companies might issue shares through routes other than IPO/FPO. It might include preferential allotments, issue of shares through rights issue, bonus issue or ESOP scheme etc. various important aspects to be taken care before and after the issue are discussed below.

III-A. DUE DILIGENCE – PREFERENTIAL ISSUE

Due diligence of preferential issue may be

- (a) Due diligence of preferential issues by listed companies.
- (b) Due diligence of preferential issues by unlisted companies.

Due diligence of preferential issues by listed companies

(a) Due Diligence Preferential issue of listed Companies- a Check list under Chapter VII of SEBI(ICDR) Regulations 2009

Non Applicability

(1) The provisions of this Chapter shall not apply where the preferential issue of equity shares is made:

- (a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956;
- (b) pursuant to a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956;
- (c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985:

Provided that the lock-in provisions of this Chapter shall apply to such preferential issue of equity shares.

(2) The provisions of this Chapter relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993.

Section 2(h) of Recovery of Debts due to Banks and Financial Institutions Act, 1993, defines Financial Institutions as follows

“financial institution” means –

- (i) a public financial institution within the meaning of section 4A of the Companies Act, 1956;
- (ia) the securitization company or reconstruction company which has obtained a certificate of registration under sub-section (4) of section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- (ii) such other institution as the Central Government may, having regard to its business activity and the area of its operation in India, by notification, specify.”

(3) The provisions of regulation 73 (Disclosures) and regulation 76 (Pricing) shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer in terms of Securities and Exchange Board of India (Substantial

Acquisition of Shares and Takeovers) Regulations, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.

(4) The provisions of sub-regulation (2) of regulation 72 and sub-regulation (6) of regulation 78 shall not apply to a preferential issue of specified securities where the proposed allottee is a Mutual Fund registered with the Board or Insurance Company registered with Insurance Regulatory and Development Authority.

Check list for preferential issue of listed companies

1. Special Resolution

- Check whether a special resolution has been passed by its shareholders;
- The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated

"relevant date" means:

- (a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date. Where the relevant date falls on a Weekend/Holiday, the day preceding the Weekend/Holiday will be reckoned to be the relevant date.

- (b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.
- The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:
 - (a) the objects of the preferential issue;
 - (b) the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;
 - (c) the shareholding pattern of the issuer before and after the preferential issue;
 - (d) the time within which the preferential issue shall be completed;
 - (e) the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;
 - (f) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;
 - (g) an undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked- in till the time such amount is paid by the allottees.

2. Compulsory Dematerialisation

Check whether all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;

3. Condition for continued listing

Check the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement

4. Permanent Account Number of allottees

Check whether the issuer has obtained the Permanent Account Number of the proposed allottees.

5. Shares not to be allotted to persons who has sold any equity shares of the issuer in preceding six months

Ensure that the issuer has not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date: However, in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, to such preferential allotment.

6. Copy of the certificate of its statutory auditor

The issuer shall place a copy of the certificate of its statutory auditor before the general meeting of the shareholders, considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.

7. Valuation by an independent qualified valuer

Where specified securities are issued on a preferential basis to promoters, their relatives, associates and related entities for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent qualified valuer, which shall be submitted to the recognised stock exchanges where the equity shares of the issuer are listed: If the recognised stock exchange is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may obtain any information, as deemed necessary, from the issuer.

8. Time Limit for allotment.

Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

Exceptions

Where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of order on such application or the date of approval or permission, as the case may be.

Where the Board has granted relaxation to the issuer under SEBI (Substantial Acquisition of Shares and

Takeovers) Regulations, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation:

Requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India.

If the allotment of specified securities is not completed within fifteen days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under this Chapter will be taken with reference to the date of latter special resolution.

9. Tenure of convertible securities.

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

10. Pricing of equity shares.

(a) If listed for more than Twenty six weeks

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of six months or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:

- (a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the Twenty six weeks preceding the relevant date; or
- (b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(b) If listed for less than Twenty six weeks

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than Twenty six weeks as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:

(a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, pursuant to which the equity shares of the issuer were listed, as the case may be;

or

(b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or

(c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

This price shall be recomputed by the issuer on completion of Twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these Twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

c. Preferential issue to qualified institutional buyer

Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

'Stock exchange' means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding six months prior to the relevant date.

11. Payment of consideration.

Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities:

Exceptions/Conditions

In case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

An amount equivalent to at least twenty five per cent. of the consideration shall be paid against each warrant on the date of allotment of warrants. The balance seventy five per cent. of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such shall be forfeited by the issuer.

12. Lock-in of specified securities.

The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be.

Exceptions/Conditions

Not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment:

Equity shares allotted in excess of the twenty per cent. shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be.

- The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of their allotment.
- The lock-in of equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.
- The equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring

as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment: However partly paid up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid up.

If the amount payable by the allottee, in case of re-calculation of price after completion of Twenty six weeks from the date of listing, is not paid till the expiry of lock-in period, the equity shares shall continue to be locked in till such amount is paid by the allottee.

- The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date upto a period of six months from the date of preferential allotment.

13. Transferability of locked-in specified securities and warrants issued on preferential basis.

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, specified securities held by promoters and locked-in may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer:

However, that lock-in on such specified securities shall continue for the remaining period with the transferee.

Test your Knowledge

- (i) *Can locked in shares issued to promoters pursuant to preferential issue be transferred to other promoters?*

Due diligence – Preferential issues of unlisted companies

On 14 December 2011 the Ministry of Corporate Affairs (MCA) has issued Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011 (Amendment Rules) which is effective from the date of publication in Official Gazette. The Amendment Rules provide for amendment of Unlisted Public Companies (Preferential Allotment) Rules, 2003 (2003 Rules). The Amendment Rules does not replace the 2003 Rules but makes few significant additions.

Key Highlights of Preferential Allotment Amendment Rules 2011

Amendments

- **Definition of 'Preferential Allotment':** It is amended to specifically include allotment of convertible instrument including hybrid instruments convertible into shares.
- **Special Resolution:** Requirement of special resolution is made specifically applicable to issue of convertible instrument including hybrid instruments convertible into shares.
 - Under 2003 Rules such requirement was applicable only to issue of shares.
 - The offer for preferential allotment cannot be made to more than 49 persons.
 - Any offer or invitation not in compliance with provisions of Section 81(1A) read with section 67(3) of the Companies Act, 1956 (the Act) would be treated as public offer and provisions of the SCRA, 1956 and SEBI Act, 1992 will need to be complied with.
 - The money payable on subscription should be paid only by way of cheque or DD or other banking channels but not by cash.
- Allotment of securities should be completed within 60 days from the receipt of application money. If

not so allotted, the company should repay application money within 15 days thereafter, failing which it should be repaid along with an interest @ 12percent p.a.

- The application money should be kept in a separate bank account and should not be utilized prior to allotment.
- Company offering securities can not release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about the offer.
- Details of proposed allottees should be included in the Special Resolution.

III-B. DUE DILIGENCE – EMPLOYEE STOCK OPTION

Issue of shares through Employee Stock Option Scheme/Employee Stock Purchase scheme by listed companies are regulated by Securities And Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. The following aspects are to be checked while issue of shares/options to employees under ESOP scheme.

(a) Employee Stock Option

1. Eligibility to Participate

- (i) An employee is eligible to participate in Employee Stock Option Scheme (ESOS) of the company.

Who is an employee?

Employee means:

- (a) a permanent employee of the company working in India or out of India or
- (b) a director of the company whether whole time director or not, or
- (c) an employee as defined in sub-clauses (a) or (b) of a Subsidiary, in India or out of India, or of a holding company of the company.



It may be noted that where such employee is a director nominated by an institution as its representative on the Board of Directors of the company—

- (i) the contract/agreement entered into between the institution nominating its employee as the director of a company and the director so appointed shall, inter alia, specify the following:
 - (a) whether options granted by the company under its ESOS can be accepted by the said employee in his capacity as director of the company;
 - (b) that options, if granted to the director, shall not be renounced in favour of the nominating institution; and
 - (c) the conditions subject to which fees, commissions, ESOSs, other incentives, etc. can be accepted by the director from the company.
- (ii) the institution nominating its employee as a director of a company shall file a copy of the contract/agreement with the said company, which shall, in turn, file the copy with all the stock exchanges on which its shares are listed.
- (iii) the director so appointed shall furnish a copy of the contract/agreement at the first Board meeting of the company attended by him after his nomination.
- (ii) Check that employee is not a promoter nor belongs to the promoter group.
- (ii) Check that a director who either himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating as he is not eligible to participate in the scheme.

2. Compensation Committee

- (i) Check that the disclosures, as specified in Schedule IV are made by the company to the prospective option guarantors.
- (ii) Check that the company has constituted a Compensation Committee for administration and superintendence of the scheme.
- (iii) Check that the Compensation Committee is a Committee of the Board of Directors consisting of a majority of independent directors.
- (iv) Check that the Compensation Committee has formulated the detailed terms and conditions of the scheme including:
 - (a) the quantum of option to be granted under the scheme per employee and in aggregate;
 - (b) the conditions under which option vested in employees may lapse in case of termination of employment for misconduct;
 - (c) the exercise period within which the employee should exercise the option and that option would lapse on failure to exercise the option within the exercise period;
 - (d) the specified time period within which the employee shall exercise the vested options in the event of termination or resignation of an employee;
 - (e) the right of an employee to exercise all the options vested in him at one time or at various points of time within the exercise period;
 - (f) the procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case of corporate actions such as rights issues, bonus issues, merger, sale of division and others. In this regard, the following actions should be taken into consideration by the compensation Committee:
 - (i) The number and the price of ESOS shall be adjusted in a manner such that total value of ESOS remains the same after the corporate action.
 - (ii) For this purpose global best practices in this area including the procedures followed by the derivatives markets in India and abroad shall be considered.
 - (iii) The vesting period and the life of the options shall be left unaltered as far as possible to protect the rights of option holders.
 - (g) the grant, vest and exercise of option in case of employees who are on long leave; and
 - (h) the procedure for cashless exercise of options.
- (v) Check that suitable policies and systems have been framed by the compensation committee to ensure that there is no violation of the following by any employee—
 - (a) Securities and Exchange Board of India (Insider Trading) Regulations, 1992; and
 - (b) Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995.

3. Shareholders' Approval

- (i) Check that the approval of shareholders of the company has been obtained by passing a special resolution in general meeting.
- (ii) Check that the explanatory statement to the notice and the resolution proposed to be passed in

general meeting for scheme containing the following information has also been sent:

- (a) the total number of options to be granted;
 - (b) identification of classes of employees entitled to participate in the scheme;
 - (c) requirements of vesting and period of vesting;
 - (d) maximum period within which the option shall be vested;
 - (e) exercise price or pricing formula;
 - (f) exercise period and process of exercise;
 - (g) the appraisal process for determining the eligibility of employees to the scheme;
 - (h) maximum number of options to be issued per employee and in aggregate;
 - (i) a statement to the effect that the company shall conform to the accounting policies specified by SEBI in regard to ESOS;
 - (j) the method which the company uses to value its options, i.e., whether fair value or intrinsic value.
 - (k) in case the company calculates the employees compensation cost using the intrinsic value of the stock options, the difference between the employees compensation cost so computed and employee compensation cost that shall have been recognized, if it had used the fair value of the options, shall be disclosed in the directors report and also the impact of this difference on profits and on EPS of the company shall be disclosed in directors report.
- (iii) Check that approval of shareholders by way of a separate resolution in the general meeting has been obtained by company in case of—
- (a) grant of option to employees of subsidiary or holding company and,
 - (b) grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

4. Variation of Terms of ESOS

- (i) Check that the company does not vary the terms of the Scheme in any manner which may be detrimental to the interests of the employees.
- (ii) However, if such variation is not prejudicial to the interests of the option holders, Check that the company has passed a special resolution in a general meeting to vary the terms of scheme.
- (iii) the provisions of clause 6.3 of the guidelines, 1999 as above shall apply to such variation of terms as they apply to the original grant of option.
- (iv) Check that the notice for passing special resolution for variation of terms of ESOS has been sent.
- (v) Check that the notice discloses full details of the variation, the rationale therefor and the details of the employees who are beneficiary of such variation.
- (vi) The companies have been given an option to reprice the options which are not exercised if ESOSs were rendered unattractive due to fall in the price of shares in the market. The company must ensure that such re-pricing should not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such pricing.

5. Pricing

The companies granting option to its employees pursuant to the scheme have the freedom to determine the exercise price subject to adherence to the accounting policies. In case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, is required to be disclosed in the Director's Report and also the impact of this difference on profits and on Earnings per Share of the company shall also be disclosed in the Director's Report.

6. Lock-in-Period and Rights of the Option-holder

- (i) Check that there exists a minimum period of one year between the grant of options and vesting of option.

Also ensure that, in the case where options are granted by a company under an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required under this clause.

- (ii) The company has the freedom to specify the lock-in-period for the shares issued pursuant to exercise of option.
- (iii) Check that the employee does not have the right to receive any dividend or to vote or in any manner enjoys the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

7. Consequence of Failure to Exercise Option

- (i) Check that amount payable by the employee, if any, at the time of grant of option has been forfeited by the company if the option is not exercised by the employee within the exercise period; or
- (ii) Check that the amount has been refunded to the employee if the option is not vested due to non-fulfilment of condition relating to vesting of option as per the Scheme.

8. Non-Transferability of Option

- (i) Check that option granted to an employee is not transferable to any person.
- (ii) (a) No person other than the employee to whom the option is granted shall be entitled to exercise the option.
- (b) under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act, 1956.
- (iii) Check that the option granted to the employee is not pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- (iv) Check that in the event of the death of employee while in employment, all the options granted to him till such date are vested in the legal heirs or nominees of the deceased employee.
- (v) Check that in case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- (vi) Check that if an employee resigns or is terminated, all options not vested as on that day expire.

However, the employee shall, subject to the terms and conditions formulated by compensation committee, be entitled to retain all the vested options.

- (vii) Check that, the options granted to a director, who is an employee of an institution and has been nominated by the said institution, has not been renounced in favour of institution nominating him.

9. Disclosure in the Directors' Report

1. Check that the Board of Directors disclose either in the Directors Report or in the Annexure to the Director's Report, the following details of the Scheme:
 - (a) options granted;
 - (b) the pricing formula;
 - (c) options vested;
 - (d) options exercised;
 - (e) the total number of shares arising as a result of exercise of option;
 - (f) options lapsed;
 - (g) variation of terms of options;
 - (h) money realized by exercise of options;
 - (i) total number of options in force;
 - (j) employee-wise details of options granted to—
 - (i) senior managerial personnel;
 - (ii) any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;
 - (iii) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
 - (k) diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with Accounting Standard (AS) 20, Earning Per Share.
 - (l) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.
 - (m) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.
 - (n) A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted average information:
 - (1) risk-free interest rate,
 - (2) expected life,
 - (3) expected volatility,
 - (4) expected dividends, and
 - (5) the price of the underlying share in market at the time of option grant.

2. Ensure that until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosures are made either in the Directors' Report or in an Annexure thereto of the information specified above in respect of such options also.
3. Ensure that until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosure are made either in the Directors' Report or in an Annexure thereto of the impact on the profits and on the EPS of the company if the company had followed the accounting policies specified under clause 13 of these guidelines in respect of such options.

10. Accounting Policies

Check that the company which has passed a resolution for the scheme complies with the accounting policies specified by SEBI in regard to the Scheme under Schedule I of the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

11. Certificate from Auditors

Check that the Board of Directors of company present before the shareholders at each AGM, a certificate from the auditors of the company that the Scheme has been implemented in conformity with these guidelines and in accordance with the resolution of the company in the general meeting.

Test Your Knowledge

1. Can a director participate in an employee Stock Option Scheme?
2. What is the consequence of non-exercise of option?

(b) Employees Stock Purchase Scheme (ESPS)

1. Eligibility to Participate in the Scheme

- (i) An employee eligible to participate in the scheme should be:
 - (a) a permanent employee of the company working in India or out of India; or
 - (b) a director of the company, whether a whole time director or not;
 - (c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.
- (ii) Check that the employee is not a promoter nor belongs to the promoter group.
- (iii) Ensure that a director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating, as he is not eligible to participate in the scheme.

2. Shareholder Approval

- (i) Check that the Scheme has been approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.
- (ii) Check that the explanatory statement to the notice has been sent to the shareholders and it specifies—
 - (a) the price of the shares and also the number of shares to be offered to each employee;
 - (b) the appraisal for determining the eligibility of employee for the scheme;
 - (c) total number of shares to be issued.

- (iii) The number of shares offered may be different for different categories of employees.
- (iv) Check that special resolution states that the company shall conform to the accounting policies as specified in Schedule II of the SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.
- (v) Check that approval of shareholders have been obtained by way of separate resolution in the general meeting in case of—
 - (a) allotment of shares to employees of subsidiary or holding company and;
 - (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

3. Pricing and Lock-in-period

- (i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.
- (ii) Check that the shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.
 Also ensure that in a case where shares are allotted by a company under a ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in-period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in required under this clause.
- (iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

4. Disclosure and Accounting Policies

- (i) Check that the Director's Report or Annexure thereto shall contain, inter alia, the following disclosures:
 - (a) the details of the number of shares issued in the scheme;
 - (b) the price at which such shares are issued;
 - (c) employee-wise details of the shares issued to:
 - (i) senior managerial personnel;
 - (ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;
 - (iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;
 - (d) diluted Earning Per Share (EPS) pursuant to issuance of shares under the scheme; and
 - (e) consideration received against the issuance of shares.
- (ii) Check that every company that has passed a resolution for the scheme complies with the accounting policies as specified in Schedule II to the SEBI (Employee Stock Option Scheme and Employee Stock Purchase) Guidelines, 1999.

5. Preferential Allotment

Nothing in these guidelines shall apply to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

6. Listing

- (i) The shares arising pursuant to an ESOS and shares issued under an ESPS are required to be listed immediately upon exercise in any recognized stock exchange where the securities of the company are listed subject to compliance of the following:
 - (a) The ESOS/ESPS is in accordance with these Guidelines.
 - (b) In case of an ESOS the company has also filed with the concerned stock exchanges, before the exercise of option, a statement as per Schedule V and has obtained in-principle approval from such Stock Exchanges.
 - (c) As and when ESOS/ESPS are exercised the company has notified the concerned Stock Exchanges as per the statement as per Schedule VI.
- (ii) (a) Ensure that the shares arising after the IPO, out of options granted under any ESOS framed prior to its IPO is being listed immediately upon exercise in all the recognised stock exchanges where the equity shares of the company are listed subject to compliance with clause 15.3 (i.e. options outstanding at IPO) and, where applicable, clause 22.2A (conditions for fresh grant of options prior to IPO).
- (b) Ensure that any fresh grant of options under any ESOS framed prior to its IPO and prior to the listing of its equity shares is—
 - (i) in conformity with these guidelines; and
 - (ii) such pre-IPO scheme is ratified by its shareholders in general meeting subsequent to the IPO. However such ratification may be done any time prior to grant of new options under such pre-IPO scheme.
- (c) Ensure that no change shall be made in the terms of options issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise, unless prior approval of the shareholders is taken for such change. However, nothing in this sub-clause shall apply to any adjustments for corporate actions made in accordance with these guidelines.
- (iii) For listing of shares issued pursuant to ESOS or ESPS the company is required obtain the in-principle approval from Stock Exchanges where it proposes to list the said shares.
- (iv) The listed companies is required to file the ESOS or ESPS Schemes through EDIFAR filing.
- (vii) When holding company issues ESOS/ESPS to the employee of its subsidiary, the cost incurred by the holding company for issuing such options/shares is required to be disclosed in the 'notes to accounts' of the financial statements of the subsidiary company.
 In a case falling under above clause, if the subsidiary reimburses the cost incurred by the holding company in granting options to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the 'notes to accounts' to their financial statements
- (viii) The company shall appoint a registered Merchant Banker for the implementation of ESOS and ESPS as per these guidelines till the stage of framing the ESOS/ESPS and obtaining in-principal approval from the stock exchanges in accordance with these Guidelines.

7. ESOS/ESPS Through Trust Route

In case of ESOS/ESPS administered through a Trust, the accounts of the company shall be prepared as if the company itself is administering the ESOS/ESPS.

III-C. DUE DILIGENCE- BONUS ISSUE

Checklist for issue of Bonus shares

- Ensure that is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc. If there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;
- Ensure that issuer has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- Ensure that the issuer has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- Ensure that the partly paid shares, if any outstanding on the date of allotment, are made fully paid up
- It may be noted that no issuer shall make a bonus issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsory convertible debt instruments, if any, in proportion to the convertible part thereof.
- The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion at which the bonus shares were issued.
- The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.
- The bonus share shall not be issued in lieu of dividend.
- An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors. However, where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.
- Once the decision to make a bonus issue is announced, the issue can not be withdrawn.

III-D. DUE DILIGENCE – RIGHTS ISSUE

1. Record Date

- Ensure that the record date has been announced for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue. It may be noted that the issuer shall not withdraw rights issue after announcement of the record date.
- If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period

of twelve months from the record date announced. However, the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.

2. Restriction on rights issue.

No issuer shall make a rights issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.

The equity shares so reserved for the holders of fully or partially compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments at the same terms at which the equity shares offered in the rights issue were issued.

3. Letter of offer, abridged letter of offer.

The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue. The letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard. The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money. The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently. If any shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.

4. Pricing

The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

5. Period of subscription

A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

6. Payment Option

The issuer shall give only one payment option out of the following:

- (a) part payment on application and balance money paid in calls.
- (b) full payment on application

In case of part payment option necessary regulatory approvals are required.

7. Pre-Issue Advertisement for rights issue.

The issuer shall issue an advertisement for rights issue disclosing the following:

- (a) the date of completion of despatch of abridged letter of offer and the application form;
- (b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

8. Obligation of issuer/intermediaries

The obligation of issuer/intermediaries for a rights issuer, with respect to advertisement, appointment of compliance officer, redressal of investor grievances, due diligence, post issue reports, post issue advertisements etc is same as the public issue.

QUALIFIED INSTITUTIONS PLACEMENT

1. Conditions for qualified institutions placement.

Ensure to satisfy the following conditions:

- (a) a special resolution approving the qualified institutions placement has been passed by its shareholders;
- (b) the equity shares of the same class, which are proposed to be allotted through qualified institutions placement or pursuant to conversion or exchange of eligible securities offered through qualified institutions placement, have been listed on a recognised stock exchange having nation wide trading terminal for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution.

However, where an issuer, being a transferee company in a scheme of merger, de-merger, amalgamation or arrangement sanctioned by a High Court under sections 391 to 394 of the Companies Act, 1956, makes qualified institutions placement, the period for which the equity shares of the same class of the transferor company were listed on a stock exchange having nation wide trading terminals shall also be considered for the purpose of computation of the period of one year.

- (c) it is in compliance with the requirement of minimum public shareholding specified in the Securities Contracts (Regulations) Rules, 1957;
- (d) In the special resolution, it shall be, among other relevant matters, specified that the allotment is proposed to be made through qualified institutions placement and the relevant date.

"relevant date" means:

- (i) in case of allotment of equity shares, the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the proposed issue;
- (ii) in case of allotment of eligible convertible securities, either the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the issue of such convertible securities or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

2. Appointment of merchant banker.

A qualified institutions placement shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

3. In-principle approval, due diligence certificate etc.

The merchant banker shall, while seeking in-principle approval for listing of the eligible securities issued under qualified institutions placement, furnish to each stock exchange on which the same class of equity shares of the issuer are listed, a due diligence certificate stating that the eligible securities are being issued under qualified institutions placement and that the issuer complies with requirements under SEBI(ICDR)Regulations.

4. Placement Document.

The qualified institutions placement shall be made on the basis of a placement document which shall contain all specified material information.

The placement document shall be serially numbered and copies shall be circulated only to select investors.

The issuer shall, while seeking in-principle approval from the recognised stock exchange, furnish a copy of the placement document, a certificate confirming compliance with the provisions of this Chapter along with any other documents required by the stock exchange.

The placement document shall also be placed on the website of the concerned stock exchange and of the issuer with a disclaimer to the effect that it is in connection with a qualified institutions placement and that no offer is being made to the public or to any other category of investors.

5. Pricing.

The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date.

If eligible securities are convertible into or exchangeable with equity shares of the issuer, the issuer shall determine the price of such equity shares allotted pursuant to such conversion or exchange taking the relevant date as decided and disclosed by it while passing the special resolution.

The issuer shall not allot partly paid up eligible securities. However, in case of allotment of non convertible debt instruments along with warrants, the allottees may pay the full consideration or part thereof payable with respect to warrants, at the time of allotment of such warrants. In case of allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid up.

The prices determined for qualified institutions placement shall be subject to appropriate adjustments if the issuer:

- (a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;
- (b) makes a rights issue of equity shares;
- (c) consolidates its outstanding equity shares into a smaller number of shares;
- (d) divides its outstanding equity shares including by way of stock split;
- (e) re-classifies any of its equity shares into other securities of the issuer;
- (f) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

6. Restrictions on allotment.

- Allotment under the qualified institutions placement shall be made subject to the following conditions:
 - (a) Minimum of ten per cent. of eligible securities shall be allotted to mutual funds:
If the mutual funds do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
 - (b) No allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer:

If a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the said rights in the capacity of a lender shall not be deemed to be a person related to promoters.

- In a qualified institutions placement of non-convertible debt instrument along with warrants, an investor can subscribe to the combined offering of non- convertible debt instruments with warrants or to the individual securities, that is, either non- convertible debt instruments or warrants.
- The applicants in qualified institutions placement shall not withdraw their bids after the closure of the issue.

7. Minimum number of allottees.

The minimum number of allottees for each placement of eligible securities made under qualified institutions placement shall not be less than:

- (a) two, where the issue size is less than or equal to two hundred and fifty crore rupees;
- (b) five, where the issue size is greater than two hundred and fifty crore rupees:

Provided that no single allottee shall be allotted more than fifty per cent. of the issue size.

(2) The qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

8. Validity of the special resolution.

Allotment pursuant to the special resolution shall be completed within a period of twelve months from the date of passing of the resolution.

The issuer shall not make subsequent qualified institutions placement until expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

9. Restrictions on amount raised.

The aggregate of the proposed qualified institutions placement and all previous qualified institutions placements made by the issuer in the same financial year shall not exceed five times the net worth of the issuer as per the audited balance sheet of the previous financial year.

10. Tenure.

The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement shall not exceed sixty months from the date of allotment.

11. Transferability of eligible securities.

The eligible securities allotted under qualified institutions placement shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

INSTITUTIONAL PLACEMENT PROGRAMME

SEBI vide its notification dated January 30, 2012 has amended the Issue of Capital and Disclosure Requirements Regulations, 2009 whereby Chapter VIII-A - Institutional Placement Programme (IPP) has been inserted. The provisions of this Chapter shall apply to issuance of fresh shares and or offer for sale of shares in a listed issuer for the purpose of achieving minimum public shareholding in terms of Rule 19(2)(b) and 19A of the Securities Contracts (Regulation) Rules, 1957.

“Institutional Placement Programme” means a further public offer of eligible securities by an eligible seller, in which the offer, allocation and allotment of such securities is made only to qualified institutional buyers in terms of this Chapter. Eligible seller includes listed issuer, promoters group of listed issuer.

Conditions for Institutional Placement Programme

- An institutional placement programme may be made only after a special resolution approving the institutional placement programme has been passed by the shareholders of the issuer in terms of section 81(1A) of the Companies Act, 1956.
- No partly paid-up securities shall be offered.
- The issuer shall obtain an in-principle approval from the stock exchange(s).

Appointment of Merchant Banker

An institutional placement programme shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

Offer Document

- The institutional placement programme shall be made on the basis of the offer document which shall contain all material information.
- The issuer shall, simultaneously while registering the offer document with the Registrar of Companies, file a copy thereof with the Board and with the stock exchange(s) through the lead merchant banker.
- The issuer shall file the soft copy of the offer document with the Board, along with the fee.
- The offer document shall also be placed on the website of the concerned stock exchange and of the issuer clearly stating that it is in connection with institutional placement programme and that the offer is being made only to the qualified institutional buyers.
- The merchant banker shall submit to the Board a due diligence certificate, stating that the eligible securities are being issued under institutional placement programme and that the issuer complies with requirements of this Chapter.

Pricing and Allocation/allotment

- The eligible seller shall announce a floor price or price band at least one day prior to the opening of institutional placement programme.
- The eligible seller shall have the option to make allocation/allotment as per any of the following methods -
 - proportionate basis
 - price priority basis; or
- criteria as mentioned in the offer document.
- The method chosen shall be disclosed in the offer document.
- Allocation/allotment shall be overseen by stock exchange before final allotment.

Restrictions

- The promoter or promoter group who are offering their eligible securities should not have purchased and/ or sold the eligible securities of the company in the twelve weeks period prior to the offer and they should undertake not to purchase and / or sell eligible securities of the company in the twelve weeks period after the offer. However, such promoter or promoter group may , within the twelve weeks period offer eligible securities held by them through institutional placement programme or offer for sale through stock exchange mechanism subject to the condition that there shall be a gap of minimum two weeks between the two successive offer(s) and /or programme(s);
- Allocation/allotment under the institutional placement programme shall be made subject to the following conditions:
 - (a) Minimum of twenty five per cent of eligible securities shall be allotted to mutual funds and insurance companies. However, if the mutual funds and insurance companies do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
 - (b) No allocation/allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer. However, a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the rights in the capacity of a lender shall not be deemed to be a person related to promoters.
- The issuer shall accept bids using ASBA facility only.
- The bids made by the applicants in institutional placement programme shall not be revised downwards or withdrawn.

Restrictions on size of the offer

- The aggregate of all the tranches of institutional placement programme made by the eligible seller shall not result in increase in public shareholding by more than ten per cent or such lesser per cent as is required to reach minimum public shareholding.
- Where the issue has been oversubscribed, an allotment of not more than ten percent of the offer size shall be made by the eligible seller.

Period of Subscription and display of demand

- The issue shall be kept open for a minimum of one day or maximum of two days.
- The aggregate demand schedule shall be displayed by stock exchange(s) without disclosing the price.

Withdrawal of offer

The eligible seller shall have the right to withdraw the offer in case it is not fully subscribed.

Transferability of eligible securities

The eligible securities allotted under institutional placement programme shall not be sold by the allottee for a period of one year from the date of allocation/allotment, except on a recognised stock exchange.

ISSUE OF SECURITIES BY SMALL AND MEDIUM ENTERPRISES

Going for a public issue of capital would provide the SMEs with equity financing opportunities to grow their

business - from expansion of operations to acquisitions. In addition, equity financing lowers the debt burden leading to lower financing costs and healthier balance sheets for the firms. The continuing requirement for adhering to the stock market rules for the issuers lower the on-going information and monitoring costs for the banks.

In view of the aforesaid concerns raised by the market participants / industry representatives, there was a felt need for developing a dedicated stock exchange for the SME sector so that SMEs can access capital markets easily, quickly and at lower costs. Such dedicated SME exchange is expected to provide better, focused and cost effective service to the SME sector. The need for having a separate exchange / platform for SMEs was also discussed during the 32nd Annual Conference of IOSCO held in April 2007 in Mumbai and it was felt that the same would be necessary for the focused development of the SME sector.

Internationally also countries have provided for a separate exchange / trading platform to facilitate listing of securities of growth companies / new economy companies / small and medium companies. Some of the cases in point are the Alternative Investment Market (AIM), London, the Growth Enterprises Market (GEM), Hong Kong and MOTHERS(Market of High Growth Emerging Stocks), JAPAN.

SME EXCHANGES IN INDIA

In India BSE and NSE have created SME exchanges BSESME and EMERGE respectively. BCB Finance Ltd – the first Indian SME to get listed on BSE SME. The vision of BSESME is 'Wealth creation by the SMEs through inclusive economic growth' and the mission is 'Provide the world class Platform for SMEs and Investors to come together and raise equity capital'. The term 'EMERGE' stands for investment opportunities in emerging companies.

REGULATORY FRAMEWORK FOR LISTED SMES

In recognition of the need for making finance available to small and medium enterprises, SEBI has decided to encourage promotion of dedicated exchanges and/or dedicated platforms of the exchanges for listing and trading of securities issued by Small and Medium Enterprises ("SME"). Consequently, SEBI amended SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("SEBI (ICDR) Regulations") by inserting a Chapter on "Issue of specified securities by small and medium enterprises", through notification dated April 13, 2010.

Accordingly

1. SMEs having a post issue face value capital of upto ₹10 crores can get its shares listed on SME exchanges.
2. SMEs having a post issue face value capital of more than ₹10 crores upto ₹25 crores have the option to get its shares listed either on the main board of the exchange or on SME exchanges.
3. SMEs having post issue face value capital of more than ₹25 crores have to listed on or migrate to Main Board of the exchanges.
4. The minimum application and trading lot size shall not be less than ₹ 1, 00,000/-
5. The existing members would be eligible to participate in SME exchange.
6. The issues shall be 100% underwritten and merchant bankers shall underwrite 15% in their own account.

"SME Exchange" means a trading platform of a recognized stock exchange having nation wide trading terminals by SEBI to list the specified securities issued and includes a stock exchange granted recognition for this purpose but does not include the Main Board.

'Main board' means a recognized stock exchange having nation wide trading terminals other than SME exchange.

Exemptions available for securities listed at SME exchange

- Filing of draft offer document. (Regulation 6(1)(2) and (3).
- In-principle approval from the recognized exchanges(Regulation 7)
- Submission of certain documents before opening of an issue. (Regulation 8)
- Draft offer document to be made to the public. (Regulation 9)
- Fast Track Issues. (regulation 10)
- Conditions of initial public offer. (Regulation 26)
- Conditions for further public offer. (Regulation 27)
- Minimum application Value related provisions. (Regulation 49(1))

Market making compulsory for listed SMEs

Market making is compulsory for a period of minimum 3 years from the date of listing of securities on SME exchange or from the date of migration to main Board as the case may be and the merchant banker would ensure market making through the stock brokers of SME Exchange.

Model listing agreement for SMEs

To facilitate listing of specified securities in the SME exchange, "Model Equity Listing Agreement" to be executed between the issuer and the Stock Exchange, to list/migrate the specified securities on SME Exchange. The listing agreement covers routine listing compliances such as intimation to exchange, publication requirements, Corporate Governance compliances etc., All listed SMEs on SME platform are also required to appoint the Company Secretary of the Issuer as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Issuer's board in each meeting. The Compliance Officer will directly liaise with the authorities such as SEBI, Stock Exchanges, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter. Further Registrar & Transfer Agents of listed SMEs are required to produce a certificate from a practicing company secretary that all transfers have been completed within the stipulated time.

DEBT SECURITIES

REGULATORY FRAMEWORK FOR DEBT SECURITIES

- (a) SEBI(ICDR) Regulations 2009
- (b) Listing Agreement for Debentures issued through public issue/Rights issue.
- (c) Listing agreement for privately placed Debentures
- (d) SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- (e) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008
- (f) The Companies Act, 1956

COMPLIANCE CHECK LIST UNDER SEBI (ICDR) REGULATIONS 2009**Specified Securities includes convertible instruments.**

Under SEBI (ICDR) Regulations 2009, “specified securities” means equity shares and convertible securities. The “convertible security” has been defined to mean a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security and includes convertible debt instrument and convertible preference shares. Thus, the conditions specified under Chapter II regarding Due Diligence – Equity shares is equally applicable to public issue of convertible debt instruments also.

Additionally, the issuer of debt instruments has to comply with the following.

- (a) obtain credit rating from one or more credit rating agencies;
- (b) appoint one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;
- (c) create debenture redemption reserve in accordance with the provisions of section 117C of the Companies Act, 1956;
- (d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:
 - such assets are sufficient to discharge the principal amount at all times;
 - such assets are free from any encumbrance;
 - where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;
 - the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

The issuer shall redeem the convertible debt instruments in terms of the offer document.

Roll over of non convertible portion of partly convertible debt instruments.

(1) The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees, may be rolled over without change in the interest rate, subject to compliance with the provisions of section 121 of the Companies Act, 1956 and the following conditions:

- (a) seventy five per cent. of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;
- (b) the issuer has, along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;
- (c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;
- (d) credit rating has been obtained from at least one credit rating agency registered with the Board

within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over;

(2) The creation of fresh security and execution of fresh trust deed shall not be mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments;

Provided that whether the issuer is required to create fresh security and to execute fresh trust deed or not shall be decided by the debenture trustee.

Conversion of optionally convertible debt instruments into equity share capital.

(1) An issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares. However, where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provision stated in sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

Issue of convertible debt instruments for financing

No issuer shall issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management. However, an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Explanation: For the purpose of the issue of convertible debt instruments for financing

The expression “under the same management” shall have the same meaning as assigned to it in sub-section (1B) of section 370 of the Companies Act, 1956.

- **As the definition of specified securities include convertible securities also the compliances as applicable to equity issues are applicable to issue of debt securities**
- **SEBI(ICDR) Regulations specifies additional conditions to be complied with respect to issue of debt instruments**

B. SEBI (ISSUE AND LISTING OF DEBT SECURITIES) REGULATIONS, 2008 (COMPLIANCES WITH RESPECT TO NON-CONVERTIBLE DEBT INSTRUMENTS)

These regulations are applicable to (a) Public issue of debt securities and (b) listing of debt securities issued through public issue or on private placement basis on a recognized stock exchange.

1. General Conditions

- Ensure that the issuer/person in control of the issuer/promoter has not been restrained or prohibited or debarred by SEBI from accessing the securities market or dealing in securities.
- Ensure that as on the date of filing of draft offer document and final offer document an application is made to one or more recognized stock exchanges for listing and has chosen one of them as designated exchange and if any of such stock exchanges chosen have nationwide trading terminals, the issuer shall choose one of them as the designated stock exchange
- Ensure that in-principal approval has been obtained for listing on the exchanges where an application has been made
- Ensure that credit rating has been obtained from at least one credit rating agency registered with the Board and is disclosed in the offer document
- Ensure that where credit ratings are obtained from more than one credit rating agencies, all the ratings, including the unaccepted ratings, are disclosed in the offer document
- Ensure that the company has entered into an arrangement with a depository registered with the Board for dematerialization of the debt securities that are proposed to be issued to the public, in accordance with the Depositories Act, 1996 and regulations made thereunder.

2. Disclosures in the offer document

- Ensure that the offer document contains all material disclosures which are necessary for the subscribers of the debt securities to take an informed investment decision.
- Ensure that the offer document contains the following:
 - (a) the disclosures specified in Schedule II of the Companies Act, 1956;
 - (b) disclosure specified in Schedule I of these regulations;
 - (c) additional disclosures as may be specified by SEBI.

3. Filing of draft offer document

- Ensure that a draft offer document has been filed with the designated stock exchange through the lead merchant banker.
- Ensure that the draft offer document filed with the designated stock exchange has been made public by posting the same on the website of the designated stock exchange for seeking public comments for a period of seven working days from the date of filing the draft offer document with such exchange. The draft offer document may also be displayed on the website of the issuer, merchant bankers and the stock exchanges where the debt securities are proposed to be listed.
- Ensure that the draft offer document clearly specifies the names and contact particulars of the compliance officer of the lead merchant banker and the issuer including the postal and email address, telephone and fax numbers.
- Ensure that all comments received on the draft offer document are suitably addressed prior to the

filing of the offer document with the Registrar of Companies.

- Ensure that a copy of draft and final offer document has been forwarded to the Board for its records, simultaneously with filing of these documents with designated stock exchange.
- Ensure that the lead merchant banker, prior to filing of the offer document with the Registrar of Companies, furnishes to SEBI a due diligence certificate as per Schedule II of these regulations.
- Ensure that the debenture trustee, prior to the opening of the public issue, furnishes to SEBI a due diligence certificate as per Schedule III of these regulations.

4. Mode of Disclosure of Offer Document

- Ensure that the draft and final offer document is displayed on the websites of stock exchanges and shall be available for download in PDF / HTML formats.
- Ensure that the offer document is filed with the designated stock exchange, simultaneously with filing thereof with the Registrar of Companies, for dissemination on its website prior to the opening of the issue.
- Ensure that, where any person makes a request for a physical copy of the offer document, the same is being provided to him by the issuer or lead merchant banker.

5. Advertisements for Public issues

- Ensure that the issuer makes a advertisement in an national daily with wide circulation, on or before the issue opening date and such advertisement amongst other things, contains the disclosures as per Schedule IV.
- Ensure that the advertisement is not misleading in material particular or which contains any information in a distorted manner or which is manipulative or deceptive.
- Ensure that the advertisement is truthful, fair and clear and does not contain a statement, promise or forecast which is untrue or misleading.
- Ensure that the advertisement does not contain any matters which are extraneous to the contents of the offer document.
- Ensure that the advertisement urges the investors to invest only on the basis of information contained in the offer document.
- Ensure that any corporate or product advertisement issued by the issuer during the subscription period does not make any reference to the issue of debt securities or be used for solicitation.

6. Abridged Prospectus and application forms

- Ensure that:
 - (a) every application form issued by the issuer is accompanied by a copy of the abridged prospectus;
 - (b) the abridged prospectus does not contain matters which are extraneous to the contents of the prospectus;
 - (c) adequate space has been provided in the application form to enable the investors to fill in various details like name, address, etc.
- Ensure that the facility for subscription of application in electronic mode has been provided.

7. Electronic Issuances

- Ensure that debt securities to the public through the on-line system of the designated stock exchange has been made in compliance with relevant applicable requirements as may be specified by the Board.

8. Price Discovery through Book Building

- The issuer may determine the price of debt securities in consultation with the lead merchant banker and the issue may be at fixed price or the price may be determined through book building process in accordance with the procedure as may be specified by the Board.

9. Minimum Subscription

- The issuer may decide the amount of minimum subscription which it seeks to raise by issue of debt securities and disclose the same in the offer document.
- Ensure that, in the event of non receipt of minimum subscription all application moneys received in the public issue has been refunded forthwith to the applicants.

10. Underwriting

- Ensure that adequate disclosures regarding underwriting arrangements if any has been disclosed in the offer document.

11. Mis-statements in the offer document.

- Ensure that the offer document does not omit disclosure of any material fact which may make the statements made therein, in light of the circumstances under which they are made, misleading.
- Ensure that the offer document or abridged prospectus or any advertisement issued by an issuer in connection with a public issue of debt securities does not contain any false or misleading statement.

12. Trust Deed

- Ensure that a trust deed for securing the issue of debt securities is executed by the issuer in favour of the debenture trustee within three months of the closure of the issue.
- Ensure that the trust deed contains such clauses as may be prescribed under section 117A of the Companies Act, 1956 and those mentioned in Schedule IV of the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993.
- Ensure that the trust deed does not contain a clause which has the effect of—
 - (a) limiting or extinguishing the obligations and liabilities of the debenture trustees or the issuer in relation to any rights or interests of the investors;
 - (b) limiting or restricting or waiving the provisions of the Act , these regulations and circulars or guidelines issued by the Board;
 - (c) indemnifying the debenture trustees or the issuer for loss or damage caused by their act of negligence or commission or omission.

13. Debenture Redemption Reserve

- For the redemption of the debt securities issued by a company, the issuer shall create debenture redemption reserve in accordance with the provisions of the Companies Act, 1956 and circulars issued by Central Government in this regard. It may be noted that where the issuer has defaulted in

payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities, any distribution of dividend shall require approval of the debenture trustees.

14. Creation of security

- Ensure that the proposal to create a charge or security, if any, in respect of secured debt securities is disclosed in the offer document along with its implications.
- Ensure give an undertaking in the offer document that the assets on which charge is created are free from any encumbrances and if the assets are already charged to secure a debt, the permissions or consent to create second or *pari pasu* charge on the assets of the issuer have been obtained from the earlier creditor.
- Ensure that issue proceeds are be kept in an escrow account until the documents for creation of security as stated in the offer document, are executed.

15. Redemption and Roll-over

- Ensure to redeem the debt securities in terms of the offer document.
- Where it is desired to roll-over the debt securities issued, ensure to pass a special resolution of holders of such securities and give twenty one days notice, containing the disclosure with regard to credit rating, rationale for roll-over etc.
- The issuer shall, prior to sending the notice to holders of debt securities, file a copy of the notice and proposed resolution with the stock exchanges where such securities are listed, for dissemination of the same to public on its website.
- The debt securities issued can be rolled over subject to the following conditions:
 - (a) the roll-over is approved by a special resolution passed by the holders of debt securities through postal ballot having the consent of not less than 75% of the holders by value of such debt securities;
 - (b) atleast one rating is obtained from a credit rating agency within a period of six months prior to the due date of redemption and is disclosed in the notice;
 - (c) fresh trust deed shall be executed at the time of such roll –over or the existing trust deed may be continued if the trust deed provides for such continuation;
 - (d) adequate security shall be created or maintained in respect of such debt securities to be rolled-over.
- Ensure to redeem the debt securities of all the debt securities holders, who have not given their positive consent to the roll-over.

16. Listing of Debt Securities

- Ensure to make an application for listing to one or more recognized stock exchanges in terms of sub-section (1) of section 73 of the Companies Act, 1956 (1 of 1956).
- Ensure to comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.
- The issuer has disclosed the intention to seek listing of debt securities issued on Private Placement Basis, the issuer required to forward the listing application along with disclosures specified in

Schedule I to the recognized stock exchange within fifteen days from the date of allotment of such debt securities.

- An issuer may list its debt securities issued on private placement basis on a recognized stock exchange subject to the following conditions:
 - (a) the issuer has issued such debt securities in compliance with the provisions of the Companies Act, 1956, rules prescribed there under and other applicable laws;
 - (b) credit rating has been obtained in respect of such debt securities from at least one credit rating agency registered with the Board;
 - (c) the debt securities proposed to be listed are in dematerialized form;
 - (d) the disclosures as provided in regulation 21 have been made.
- The issuer shall comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.
- The issuer making a private placement of debt securities and seeking listing thereof on a recognized stock exchange shall make disclosures in a disclosure document, as specified in Schedule I of these Securities regulations accompanied by the latest Annual Report of the issuer and such disclosures are made available on the web sites of stock exchanges where such securities are proposed to be listed and shall be available for download in PDF/HTML formats.
- The issuer making private placement of debt securities and seeking listing, may file a Shelf Prospectus Document and updated disclosure document with each tranche.

17. Relaxation of strict enforcement of rule 19 of Securities Contracts (Regulation) Rules, 1957 (i.e. Requirements with respect to the listing of securities on a recognised stock exchange.)

- In exercise of the powers conferred by sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957, the Board hereby relaxes the strict enforcement of:
 - (a) sub-rules (1) and (3) of rule 19 the said rules in relation to listing of debt securities issued by way of a public issue or a private placement;
 - (b) clause (b) of sub-rule (2) of rule 19 of the said Rules in relation to listing of debt securities, (i) issued by way of a private placement by any issuer; issued to public by an infrastructure company, a Government company, a statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.

18. Continuous Listing

- Ensure to comply with the conditions of listing specified in the respective listing agreement for debt securities.
- Ensure that every rating obtained by an issuer is being periodically reviewed by the registered credit rating agency and any revision in the rating shall be promptly disclosed to the stock exchange(s) where the debt securities are listed.
- Ensure that any change in rating is promptly disseminated to investors and prospective investors in such manner as the stock exchange where such securities are listed may determine from time to time.
- Ensure that all information and reports on debt securities including compliance reports filed by the issuers and the debenture trustees regarding the debt securities to the investors and the general

public by placing on their respective websites.

- Ensure that debenture trustees disclose the information to the investors and the general public by issuing a press release in any of the following events and the same is placed on the websites:
 - (a) default by issuer to pay interest on debt securities or redemption amount;
 - (b) failure to create a charge on the assets;
 - (c) revision of rating assigned to the debt securities.

19. Trading of Debt securities

- The debt securities issued to the public or on a private placement basis, which are listed in recognized stock exchanges, shall be traded and such trades shall be cleared and settled in recognized stock exchanges subject to conditions specified by the Board.
- In case of trades of debt securities which have been made over the counter, such trades shall be reported on a recognized stock exchange having a nation wide trading terminal or such other platform as may be specified by the Board.

20. Obligations of Debenture Trustee

- The debenture trustee shall be vested with the requisite powers for protecting the interest of holders of debt securities including a right to appoint a nominee director on the Board of the issuer in consultation with institutional holders of such securities.
- The debenture trustee shall carry out its duties and perform its functions under these regulations, the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993, the trust deed and offer document, with due care, diligence and loyalty.
- The debenture trustee shall ensure disclosure of all material events on an ongoing basis.
- The debenture trustees shall supervise the implementation of the conditions regarding creation of security for the debt securities and debenture redemption reserve.

21. Obligations of the Issuer, Lead Merchant Banker, etc.

- The issuer shall disclose all the material facts in the offer documents issued or distributed to the public and shall ensure that all the disclosures made in the offer document are true, fair and adequate and there is no mis-leading or untrue statements or mis-statement in the offer document.
- The Merchant Banker shall verify and confirm that the disclosures made in the offer documents are true, fair and adequate and ensure that the issuer is in compliance with these regulations as well as all transaction specific disclosures required in Schedule I of these regulations and Schedule II of the Companies Act, 1956.
- The issuer shall treat the applicants in a public issue of debt securities in a fair and equitable manner as per the procedures as may be specified by the Board.
- The intermediaries shall be responsible for the due diligence in respect of assignments undertaken by them in respect of issue, offer and distribution of securities to the public.
- No person shall employ any device, scheme or artifice to defraud in connection with issue or subscription or distribution of debt securities which are listed or proposed to be listed on a recognized stock exchange.
- The issuer and the merchant banker shall ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.

UNDER SEBI (PUBLIC OFFER AND LISTING OF SECURITISED DEBT INSTRUMENTS) REGULATIONS 2008

Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.

Securitized Debt Instrument means any certificate or instrument by whatever name called, of the nature referred to in sub-clause (ie) of clause (h) of Section 2 of SCRA.

Section 2(h)(ie) of SCRA reads as follows:

'Any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.'

Special Purpose Distinct Entity means a trust which acquires debt or receivables not out of funds mobilized by it by issuances of securitized debt instruments through one or more schemes and includes any trust set up by the National Housing Bank under National Housing Bank Act 1987 or by the National Bank for Agricultural and Rural Development Act, 1981.

The amendments in SCRA has enabled SEBI to provide for disclosure based regulation (SEBI (Public Offer And Listing Of Securitized Debt Instruments) Regulations 2008) for public issue of or listing of securitized debt instruments on the recognized stock exchanges.

These regulations are principle based and have been made taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction.

The main features of the regulations are as follows:

- (a) The special purpose distinct entity (the issuer) will be a trust and the trustees thereof will require registration from SEBI. The instrument issued by the issuer to the investor shall acknowledge the beneficial interest of such investor in underlying debt or receivables assigned to the issuer. The issuer can undertake only the activities permitted by the regulations.
- (b) The regulations permit securitization of both existing as well as future receivables.
- (c) The regulations provide flexibility in terms of pay through / pass through structures.
- (d) In case of public issuances listing will be mandatory. The instruments issued on private placement basis may also be listed subject to the compliance of simplified provisions of the regulations.
- (e) Regulations require strict segregation of assets of each scheme.

Some Major Compliances

- Ensure that special purpose distinct entity files draft offer document with SEBI atleast 15 days before proposed opening of the issue.
- Ensure that special purpose distinct entity has made arrangements with Registered Depositories for dematerialization of the securitized debt instruments.
- Ensure that special purpose distinct entity has made an application for listing to one or more recognized exchanges in terms of 17A(2) of SCRA
- Ensure that credit rating is obtained from atleast two registered credit rating agencies and the same is disclosed in the offer document.

- Ensure that the contents of offer document has the required details and does not contain any misleading statements.
- Ensure to file necessary information/reports, post issue as directed by SEBI from time to time.
- Ensure that the special purpose distinct entity complies with its obligation relating to Minimum public offering for listing, continuous listing conditions etc.

LESSON ROUND UP

- The Company shall have a debenture trustee for each debenture issued and listed by it on a exchange on a continuous basis
- The Company shall create and maintain security ensuring adequate security cover at all times for secured debentures
- Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.
- Public issue is governed mainly by SEBI (ICDR) Regulations 2009.
- Public issue, whether through normal route or book building route involves various process such as appointment of merchant bankers and other intermediaries, filing of offer documents with SEBI/ROC, listing approvals from stock exchanges, co-ordination with intermediaries etc.
- As regards book building it involves mandatory electronic bidding facility, agreement with stock exchanges for online offer of securities, appointment of book runners, arrangement of collection centers, bidding process for arrival of price etc.
- Issue of stock options to employees by listed companies are governed by SEBI (ESOP &ESPS) Guidelines, 1999.
- Issue of preferential shares by listed companies are governed by SEBI Regulations and Issue of preferential allotments by unlisted companies is mainly governed by Unlisted Public Companies (Preferential Allotment) Rules, 2003.
- Issue of convertible debt Securities are regulated by SEBI (ICDR) Regulations 2009 and non-convertible debt Securities are regulated by SEBI (Issue and Listing of Debt Securities) Regulations 2008.
- Issue of Securities by SMEs are regulated by chapter XB of SEBI (ICDR) Regulations and listed in SME exchanges of BSE and NSE.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Draft a due diligence plan with respect to IPO through book building scheme?
2. Elaborate the check points while issuing of preferential allotments by listed entities.
3. Describe the role of Company Secretary in an IPO?
4. Draft a check list with respect to issue of rights shares by listed companies.
5. What are the compliances with respect to issue of non-convertible debt instruments?

Lesson 6

DEPOSITORY RECEIPTS

DUE DILIGENCE

LESSON OUTLINE

Global/American Depository Receipts/Foreign Currency Convertible Bonds

- Concept and types of Depository Receipts
- Sponsored Global Depository Receipts/Global Depository Receipts through Fresh issue of shares
- Regulatory framework in and outside India in respect of issue of GDRs
- Parties, documents, approvals and process involved in the issue of GDRs
- Check list for issue of Global Depository Receipts/American Depository Receipts
- Issue of FCCBS.

Indian Depository Receipts

- Concept of Indian Depository Receipts
- Regulatory Framework for issue of Indian Depository Receipts
- Procedures for making an issue of Indian Depository Receipts
- Checklist for issue of Indian Depository Receipts (IDRs) under
 - (a) Companies (Issue of Indian Depository Receipts) Rules, 2004
 - (b) Chapter VIII of SEBI(ICDR) Regulations 2009
 - (c) Listing Agreement for IDRs

LEARNING OBJECTIVES

Depository receipts (global and American) are one of the mode through which an Indian company raises money from international market or a foreign company raises money from Indian market. Similarly, foreign companies access Indian market through issue of Indian depository Receipts. Issue of Global/American Depository Receipts exposes Indian investors to international market, where as issue of Indian Depository Receipts exposes foreign investors to get exposed to Indian market. Issue of global depository receipts are mainly governed by Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003 in addition to SEC regulations, EU directive as applicable.

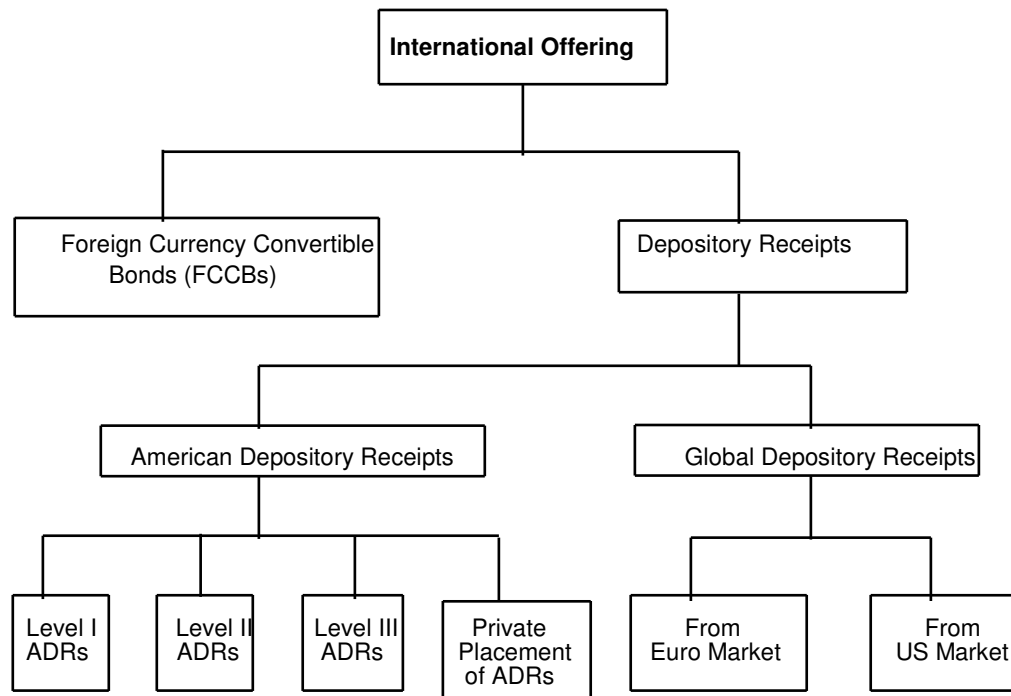
Similarly issue of Indian Depository Receipts are regulated by SEBI(ICDR) Regulations, listing Agreements, Companies (Issue of Indian Depository Receipts) Rules, 2004 etc.,

After reading this lesson you should be able to understand the concepts, regulatory framework and procedural aspects as to the issue of Global and Indian Depository Receipts.

GLOBAL DEPOSITORY RECEIPTS

I. INTRODUCTION

The Government has taken a number of policy initiatives to allow Indian companies to raise resources from the International markets. Consequently raising funds through Euro Issues has become popular with Indian companies and investors both. Indian companies found this route very attractive and today more and more companies are trying this avenue to raise funds. International offering made by companies for tapping the international capital markets can be through the following modes.



Foreign Currency Convertible Bond, is an Equity-linked convertible security that can be converted/exchanged for a specific number of shares of the issuer company.

Depository Receipts (DRs) are negotiable securities issued outside India by a Depository Bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian Bank in India. DRs are traded in Stock Exchanges in the US, Singapore, Luxembourg etc. DRs listed and traded in the US markets are known as American Depositary Receipts (ADRs) and those listed and traded elsewhere are known as Global Depositary Receipts (GDRs). In the Indian context, DRs are treated as FDI. Indian companies can raise foreign currency resources abroad through the issue of ADRs/GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time.

Exchange traded depository receipts from India have been relatively recent phenomenon (i.e. late 90's) though few companies have issued GDRs through private placement in early 90's. At present these are several active depository receipts such as Infosys, ITC, Dr. Reddys, L&T etc. that are listed either on American exchanges like the Newyork Stock Exchange or NASDAQ or on European/Asian exchanges such

as London, Dubai, Singapore exchanges. Reliance Industries was the first Indian company to be listed on NYSE and Infosys was the first Indian company to be listed on NASDAQ.

Why do Investors Invest in GDRs

- Convenience of holding foreign securities in domestic market.
- Diversification in portfolio.
- No restriction in trading as Depository Receipts are treated as domestic securities.
- Avoid currency risk.

Why do companies issue GDRs

- An effective source of finance.
- Global reputation.
- Extension of shareholder base beyond territory.

FAQS on Depository Receipts

1. What are Depository Receipts?

Depository Receipts are

- (a) negotiable Securities
- (b) issued outside India
- (c) by a overseas depository bank
- (d) representing local currency denominated equity shares of domestic company (i.e. India)

2. Who invest in Global/American depository receipts?

Foreign Investors.

3. Who initiates the issue of Global/American Depository Receipts?

Indian company initiates issue of Global/American Depository Receipts, through overseas depository bank.

4. Are there companies in India which has issued depository Receipts?

Yes, Infosys, Dr. Reddy laboratories, ITC etc.

5. What is the difference between Global Depository Receipts (GDR) and American Depository Receipts (ADR)?

ADR are US \$ denominated and traded in US.

GDRs are traded in various places such as NYSE, LSE etc.

6. What are the compliance requirements out side India for issue and trading of GDRs?

The Indian company has to comply with SEC compliance requirements, EU Directives, LSE Rules, NYSE Rules etc.

7. Where the GDRs are traded?

GDRs/ADRs are traded at a stock exchange outside India, in the currency of the respective country where GDRs are listed.

8. Does GDR results necessarily in issue of fresh shares?

No, GDR can be issued through fresh shares or through its procurement from existing share holders (known as sponsored GDRs).

9. Compliance of SEBI (SAST) Regulations 2011 required for acquiring GDRs?

Yes, when the holder becomes entitled to exercise of voting rights or when it is converted back to equity shares.

10. Is it required to obtain the approval of domestic stock exchange for issue of Depository Receipts?

Yes, the issuing company has to make a request to the domestic stock exchange for in principle consent for listing of underlying shares represented by Depository Receipt?

11. Is issue of GDR is subjected to FDI sectoral cap?

Yes.

12. What are the RBI Reporting requirements with respect to DRS?

The issuing company within 30 days of issue of GDRs has to inform RBI.

13. What are the eligibility of Issuer and of GDRs?

The Issuer should not be restrained from SEBI from accessing capital market.

14. Can unlisted company issue GDRs?

No, simultaneous listing of securities in Indian market is necessary.

II. TYPES OF DEPOSITARY RECEIPTS**1. American Depositary Receipts (ADRs)**

An American Depositary Receipt ("ADR") is a dollar denominated form of equity ownership in the form of depositary receipts in a non-US company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

Following are the types of ADRs

(a) Level I ADR (unlisted, OTC traded/Pink Sheets)

This is the least expensive level to provide for issuance of shares in ADR form in the US. The company issuing ADRs has to comply with the SEC registration requirements but can be exempted from full SEC reporting requirements under certain circumstances. It can only be traded over-the-counter and cannot be listed on a national exchange in the US. The electronic OTC markets are

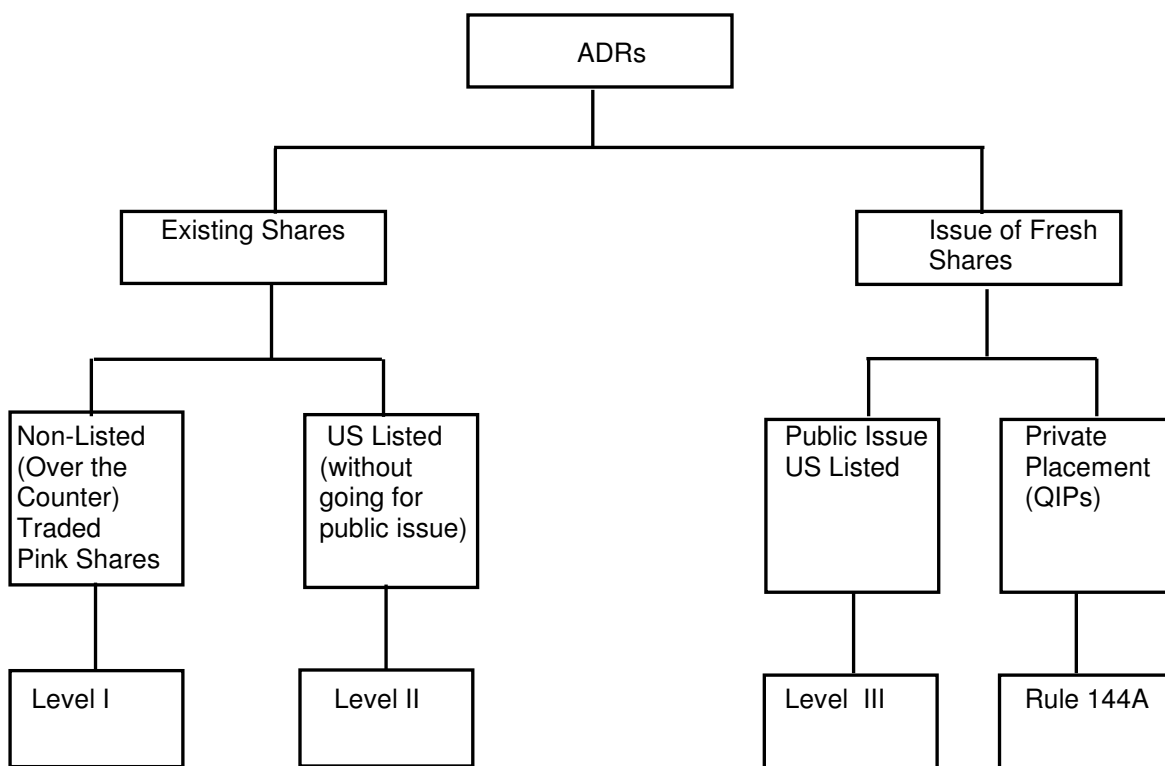
also called pink sheets which is a centralized quotation service that collects and publishes market maker quotes for OTC securities in real time.

(b) *Level II ADRs (US Listed, Non-capital Raising Transaction (i.e. without going for public issue))*

This programme gives more liquidity and marketability as it enables listing of ADRs in one or more of the US exchanges. Under this programme the company has to comply with the registration requirements, reporting requirements of SEC.

(c) *Level III ADRs (US listed Capital Raising Transaction i.e., through fresh issue of shares) – This type of ADRs which are to comply with SECA Registration, Reporting requirement and after document filing.*

(d) *Rule 144A Depository Receipts (Privately placed for QIBs and cannot be bought on the public exchanges or over the counter.)*



2. Global Depository Receipts

GDRs have access usually to Euro market and US market.

GDRs are often launched for capital raising purposes, so the US element is generally either through Rule 144(a) ADR or a Level III ADR, depending on whether the issuer aims to tap the private placement or public US markets.

The US portion of GDRs to be listed on US exchanges to comply with SEC requirements and the European portion are to be complied with EU directive.

(a) *Listing of Global Depository Receipts*

Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York

Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange etc.

International investors are interested in diversifying their portfolio across their national borders either through direct investment or through investment in depositary receipts from the exchanges of their home country. Investment in depositary receipts is an easier route for a small/medium investor. Through listing of depositary receipts in foreign exchanges, foreign investors gain benefits of diversification of portfolio while trading in their market under their own settlement and clearance process.

(b) Sponsored GDRs Vs GDRs through fresh issue of shares

GDR issue can be through sponsored GDR programme or through fresh issue of shares.

Through Sponsored GDRs the existing holders of shares in Indian Companies can sell their shares in the overseas market. It is a process of disinvestment by Indian shareholders of their holding in overseas market. The concerned Company sponsors the GDRs against the shares offered for disinvestment. These shares are converted into GDRs and sold to foreign investors. The proceeds realized are distributed to the shareholders in proportion to the shares sold by them.

For the benefit of Indian shareholders, RBI has amended Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 ('the Scheme'), to enable such shareholders to sell their shares in overseas markets, by way of Sponsored ADRs/GDRs.

Scheme of Sponsored ADRs/GDRs

Paragraph 4B of the Scheme provides that—

- (i) An Indian company may sponsor an issue of ADRs/GDRs with an overseas depository against shares held by its shareholders at a price to be determined by the Lead Manager.
- (ii) The proceeds of the issue shall be repatriated to India within a period of one month.
- (iii) The sponsoring company shall comply with the provisions of the Scheme and guidelines issued in this regard by the Central Government from time to time.
- (iv) The sponsoring company shall furnish full details of such issue, in the form specified under Annexure C to the Scheme, to the Foreign Investment Division, Exchange Control Department, Reserve Bank of India, Central Office, Mumbai within 30 days from the date of closure of the issue.

In a layman's language, the Scheme of Sponsored ADRs/GDRs is a process of disinvestments by the Indian shareholders of their holdings in overseas markets. The concerned company sponsors the ADRs/GDRs against the shares offered for disinvestments. Such shares are converted into ADRs/GDRs according to a pre-fixed ratio and sold to overseas investors. The proceeds realized are distributed to the shareholders in proportion to the shares sold by them.

Example

Say, a company sponsors 1 million equity shares to be converted into 2 million GDRs (ratio of course depends on the existing market price of shares and GDRs). Shareholders, as on the record date fixed for the purpose, tender their shares in the offering. If the shares offered for sale are more than the prespecified number, in our example it is 1 million shares would be accepted pro-rata. The accepted shares are then converted into GDRs and sold to overseas investors. The sale proceeds, after meeting with the issue expenses, are distributed to the shareholders proportionately.

(c) Two-way Fungibility of GDRs

A limited Two-way Fungibility scheme has been put in place by the Government of India for ADRs/GDRs.

Under this scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the Indian market.

3. Foreign Currency Convertible Bonds

Foreign Currency Convertible Bond (FCCB) means a bond issued by an Indian company expressed in foreign currency, the principal and interest of which is payable in foreign currency. FCCBs are issued in accordance with the Foreign Currency Convertible Bonds and ordinary shares (through depository receipt mechanism) Scheme 1993 and subscribed by a non-resident entity in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part.

III. BROAD REGULATORY FRAMEWORK WITHIN AND OUTSIDE INDIA ON ISSUE OF DEPOSITARY RECEIPTS

1. Indian Regulatory Framework in respect of issue of GDR

(a) *Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003.*

Global Depository Receipts in India are made under Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time. The important features of the amended scheme are as under

- Companies issuing GDRs do not require approval of Ministry of Finance
- GDR issue shall not exceed the sectoral cap of FDI policy. If so FIPB approval is to be obtained.
- Indian companies restrained by SEBI from raising capital, is not eligible to issue GDRs
- Indian companies issuing GDRs has to comply with the specified pricing norms.
- Unlisted companies floating GDRs has to get its shares simultaneously listed in Indian exchange/s.
- The proceeds of the issue cannot be used for investing in the stock market or real estate.
- The issue expenses shall not exceed the specified limit.
- The company has to comply with the reporting requirements of RBI.

(b) *Listing Agreement*

As FCCB and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003 requires unlisted companies floating GDRs, to get its shares simultaneously listed in Indian exchanges, with respect to underlying shares of the company issuing GDRs, all provisions on listing agreement and other filings with the stock exchanges in India has to be complied with.

(c) *Companies Act, 1956*

- The necessary compliances with respect to Board/share holder approval under Section 94 with respect to increase of authorised capital.
- Special resolution under Section 81(1A) for issuing Depository receipts.
- Special resolution under Section 31 for alteration of a capital clause referred in the Articles of Association.

- The underlying shares are to be offered to more than 50 people, as it is a public offer [Section 67(3)]
- Filing of Prospectus with ROC (Section 60).

(d) SEBI (ICDR) Regulations 2009

Though it is not applicable to GDRs as such, simultaneous listing of shares of unlisted companies floating GDRs, are to comply with SEBI (ICDR) Regulations 2009.

(e) SEBI (SAST) Regulations 2011 (Take over Regulations).

The take over regulations are to be complied with

- (a) when the GDR holders become entitled to exercise voting rights, in any manner whatsoever on the underlying shares or
- (b) exchange such depository Receipts with underlying shares carrying voting rights.

2. Regulatory framework outside India

(a) SEC requirements for issue of Global Depositary Receipts in America

As discussed earlier, Global Depositary Receipts may be listed either at exchanges based at Europe or at America. Accordingly American Depositary Receipts and Global Depositary Receipts issued/proposed to be listed at US-exchanges are required to comply with SEC requirements.

A non-US company (say an Indian Company) to be able to sell its' DRs representing its shares into the United States, it must either be a "reporting company" under the United States Exchange Act of 1934 or be exempt from such reporting requirements.

An exemption from the reporting requirements of the is provided for under Rule 12g3(2)-b of the Act to level I ADRs (i.e. unlisted, OTC Trade Depositary Receipts) and rule 144A depositary receipts (i.e. depositary receipts through private placement). In order to obtain the exemption, the company must apply to the United States Securities and Exchange Commission, through an application which has to provide information about the number of holders of each class of equity securities who are U.S. residents, the amount and percentage of each such class that U.S. residents hold and the circumstances in which they acquired such securities etc

The following are the important compliance requirements with SEC, based on the type of depositary Receipts.

Form F-6 – Registration of depositary shares evidenced by GDRs/ADRs

Form F-6 is used for the registration of depositary shares as evidenced by DRs that are issued by a depositary bank against the deposit of securities of an Indian Company. The information is prepared by the company under the guidance of the depositary bank at the inception of either an unsponsored or sponsored program. This has to be signed by both Issuer and depositary and to be declared as effective before issuance of DRS. The depositary agreement is to be filed as an exhibit along with these document.

Form 6K

Form 6k is to be filed with securities exchange commission by a foreign private issuer, pursuant to rule 13a-16 or 15d-16 under the securities exchange act of 1934 to provide information that is required to be made public in the country of its domicile.

Form 20-F – Report on material business activities

A Form 20-F is a comprehensive Annual report of all material business activities and financial results and

must comply with US GAAP. It has four distinct parts.

Part I requires a full description of the issuer's business, details of its property, any outstanding legal proceedings, taxation and any exchange controls that might affect security holders.

Part II requires a description of any securities to be registered, the name of the depository bank for the GDRs and all fees to be charged to the holders of GDRs.

Part III requires information on any defaults upon securities, and

Part IV requires various financial statements to be submitted.

This reporting requirement is essential when the company desires to list its securities in the US exchange through sponsored program or fresh issue.

Form F-1 – Filing of information to be included in the prospectus

Indian Companies planning a public offering in the US and wants to get its securities on US exchange has to register its securities in Form F-1. This form requires certain information to be included in the prospectus such as use of proceeds, summary information, risk factors and ratio of earnings to fixed charges, determination of offering price, dilution, plan of distribution, description of securities to be registered, name of legal counsel and disclosure of commissions etc.

<i>Particulars</i>	<i>Level I ADR</i>	<i>Level II ADR</i>	<i>Level III ADR</i>	<i>Private Placement</i>
Listing	Unlisted programme/OTC traded (called Pink Sheets)	Listed on US exchange	Shares offered and listed on US exchange	Issued to QIBs (i.e. Rule 144A)
SEC compliance	Registration under form F-6 and exempted from reporting requirements	Registration in form 6 and to comply with reporting requirements in form 20-F	Registration under form F-6, Reporting under form 20-F and registration of securities offered in form F-1	None

(b) Compliance under EU directive in respect of issue of Global Depository Receipts

For issue of GDRs being listed in European exchanges has to comply with Prospectus directive, Transparency obligations directive and Market Abuse Directive issued by EU and also country specific laws.

Prospectus directive

The Prospectus Regulations 2005, implementing the EU Prospectus Directive 2003/71/EC, were made on 26 May 2005.

The Prospectus Directive (PD) sets out the initial disclosure obligations for issuers of securities that are offered to the public or admitted to trading on a regulated market in the EU. It provides a passport for issuers that enable them to raise capital across the EU on the basis of a single prospectus.

Transparency obligations directive

It requires issuers to make certain periodic disclosures including annual, half yearly reports etc.

Market Abuse Directive

The Market Abuse Directive aims at tackling insider dealing and market manipulation in the EU and the proper disclosure of information to the market. It requires immediate disclosure of price-sensitive information by issuers of securities which are admitted to an EU market

IV. PARTIES, APPROVALS, DOCUMENTATION AND PROCESS INVOLVED IN THE ISSUE OF GDRs**1. Parties involved**

The following agencies are normally involved in the Euro issue:

(i) Lead Manager (ii) Co-Lead/Co-Manager (iii) Overseas Depositary Bank (iv) Domestic Custodian Banks (v) Listing Agent (vi) Legal Advisors (vii) Printers (viii) Auditors (ix) Underwriter

(a) Lead Manager

The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee as a percent of the issue. The issues related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.

(b) Co-Lead/Co-Manager

In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of the Euro issue

(c) Overseas Depositary Bank

It is the bank which is authorised by the issuing company to issue Depositary Receipts against issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

(d) Domestic Custodian Bank

This is a banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian company, which are issued by it. The domestic custodian bank functions in co-ordination with the depositary bank. When the shares are issued by a company the same are registered in the name of depositary and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

(e) Listing Agent

One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.

(f) Legal Advisors

The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depositary agreement, indemnity agreement and subscription agreement.

(g) Printers

The issuing company should appoint printers of international repute for printing Offer Circular.

(h) Auditors

The role of issuer company's auditors is to prepare the auditors report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company's accounts between Indian GAAP/UK GAAP/US-GAAP and significant differences between Indian GAAP/UK GAAP/US.

(i) Underwriters

It is desirable to get the Euro issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully

2. Approvals involved*(a) Approval of Board of Directors*

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

(b) Approval of Shareholders

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders.

A special resolution under Section 81(1A) of the Companies Act, 1956 is required to be passed at a duly convened general meeting of the shareholders of the company. Approvals under Sections 94, 16 and 31 of the Companies Act, 1956 may also be obtained, if required. Form No. 23 along with requisite filing fee is to be filed with ROC of the State in which the registered office of the company is situated.

(c) Approval of Ministry of Corporate Affairs

Approval as to compliance of Section 187C, non-applicability of provisions relating to prospectus and Section 108 for transfer of shares is also sought for.

(d) Post facto Approval of Reserve Bank of India

The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time.

RBI vide its press release dated January 20, 2000 granted general permissions to make an international offering of rupee denominated equity shares of the company by way of issue of ADR/GDR.

(e) In-principle consent of Stock Exchanges for listing of underlying shares

The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares

(f) In-principle consent of Financial Institutions

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be obtained. The company

must obtain in-principle consent on the broad terms of the proposed issue.

(g) Approval of FIPB in certain cases

As GDR is considered as Foreign Direct Investments, the GDR issue exceeding the limits specified under FDI policy, requires approval of FIPB.

3. Documentation involved

The following principal documents are involved in the issue of GDRs:

- (i) Subscription Agreement
- (ii) Depositary Agreement
- (iii) Custodian Agreement
- (vi) Listing Agreement
- (vii) Information Memorandum
- (viii) SEC Registration/Reporting and Exemptions

(a) Subscription Agreement

Subscription agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

(b) Depositary Agreement

Depositary agreement lays down the detailed arrangements entered into by the company with the Depositary, the forms and terms of the depositary receipts which are represented by the deposited shares.

(c) Custodian Agreement

Custodian works in co-ordination with the depositary and has to observe all obligations imposed on it including those mentioned in the depositary agreement. The custodian is responsible solely to the depositary. In the case of the depositary and the custodian being same legal entity, references to them separately in the depositary agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company.

Listing Agreement

Listing agreement is an agreement with the concern stock exchange in which the company has proposed to list its GDRs.

SEC Registration/Exemption

It covers registration documents in form F-6, form for registration of securities in form F-1 and F-6 for registration and

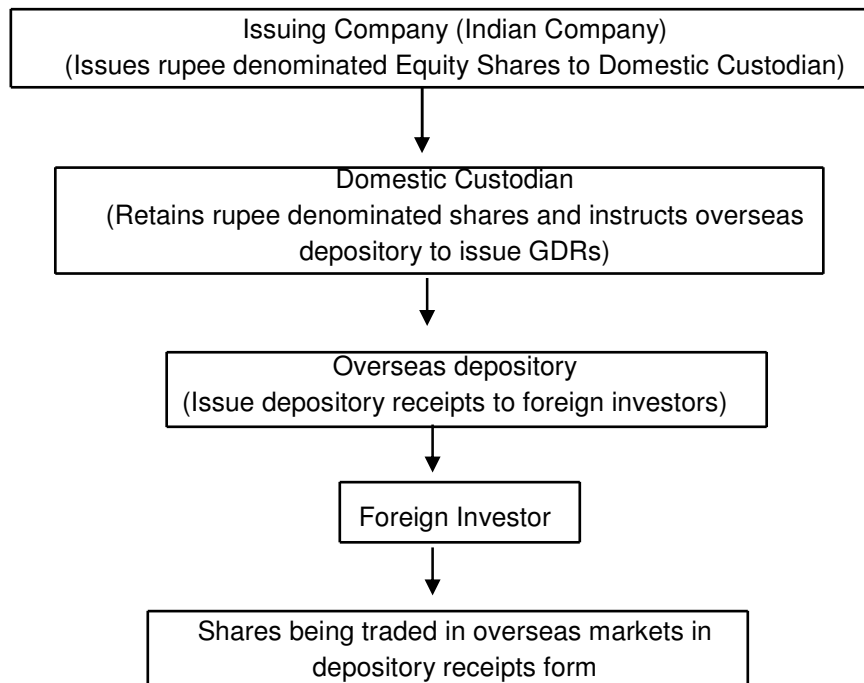
4. Process involved in the issue of GDRs

Following are the broad steps involved in GDR issue

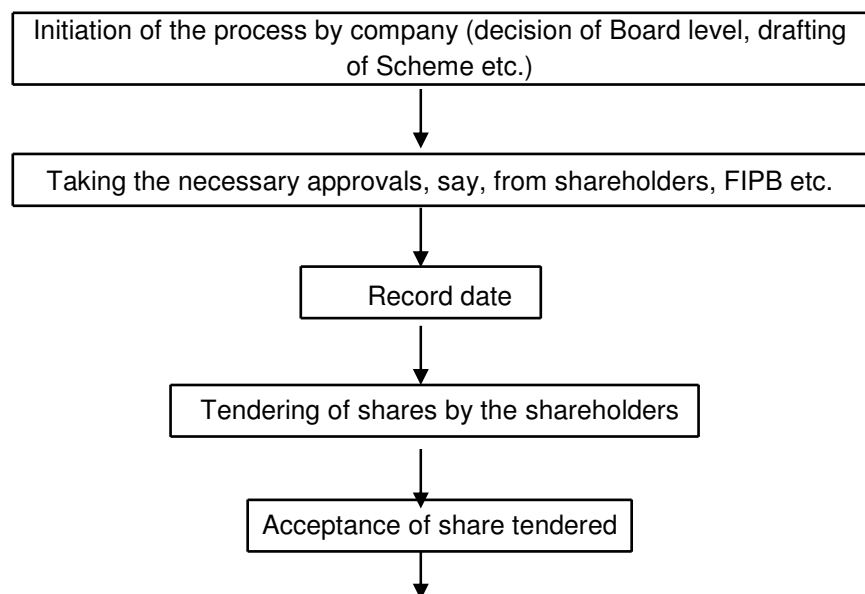
1. Indian company would issue rupee denominated shares to a depositary outside India, where the GDRs are proposed to be issued.

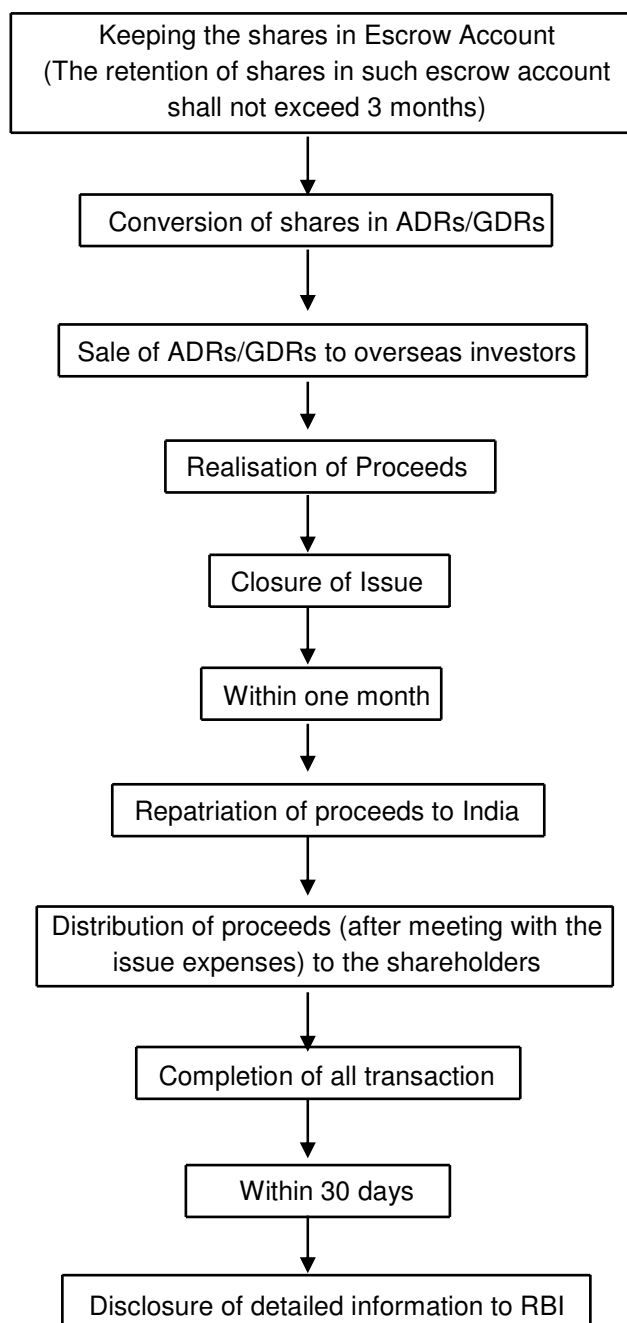
2. Indian custodian would keep these securities in his custody.
3. The investment banker would organize road shows for marketing the issue.
4. The foreign Depository would issue dollar denominated GDRs to foreign investors.
5. Listing of GDRs in American and European Stock Exchanges would take place.
6. Indian company has to comply with various requirements of EU directives and SEC requirements.

The following flowchart explains the issue of GDRs:



In case of sponsored GDRs, the process involved would be as follows.





V. CHECK-LIST IN RESPECT OF DUE DILIGENCE OF ISSUE OF GLOBAL DEPOSITARY RECEIPTS

1. Eligibility of issuer

Check whether the company is eligible to access the capital market and not been restrained by SEBI from accessing capital market.

It may be noted that an Indian Company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) will not be eligible to issue (i) Foreign Currency Convertible Bonds and (ii)

Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

2. Eligibility of subscriber

Check whether any erstwhile Overseas Corporate Bodies (OCBs) who are not eligible to invest in India through the portfolio route and entities prohibited to buy, sell or deal in securities by SEBI, have not subscribed.

It may be noted that erstwhile Overseas Corporate Bodies (OCBs) who are not eligible to invest in India through the portfolio route and entities prohibited to buy, sell or deal in securities by SEBI will not be eligible to subscribe to (i) Foreign Currency Convertible Bonds and (ii) Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

3. Limits of foreign investment in the issuing company

The ordinary shares and FCCBs issued against the GDRs shall be treated as FDI and the aggregate of the foreign investment made either directly or indirectly (through Depository Receipts Mechanism) shall not exceed 51% of the issued and subscribed capital of the issuing company. However, the investments made through offshore funds or by FII will not form part of the said limits.

4. Simultaneous listing in India

- (i) Check whether the unlisted company issuing GDR has simultaneously listed its securities in India.
- (ii) Check whether the company has complied with rule 19(2)(b) of Securities Contracts (Regulation) Rules, 1957 regarding requirement of minimum public offering.
- (iii) Check whether the company has complied with the SEBI (ICDR) Regulations in respect of public offer made for the purpose of domestic listing

It may be noted that unlisted companies, which have not yet accessed the Global Depository Receipt/ Foreign Currency Convertible Bond route for raising capital in the international market would require prior or simultaneous listing in the domestic market, while seeking to issue (i) Foreign Currency Convertible Bonds and (ii) Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

5. Pricing

Listed Companies

Check whether the pricing of Global Depository Receipt is made at a price not less than the higher of the following two averages:

- (i) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;
- (ii) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

The "relevant date" means the date thirty days prior to the date on which the meeting of the general body of shareholders is held, in terms of section 81 (IA) of the Companies Act, 1956, to consider the proposed issue.

Unlisted Companies

Check whether the price is arrived at in consultation with the Lead Manager to the issue, in case where the GDR issue is on public offer basis

Check whether the price is not less than the fair valuation of shares done by a Chartered Accountant as per the guidelines issued by the Erstwhile Controller of Capital issues.

6. Issue Expenses

Check whether the issue related expenses (including legal expenses, lead manager charges, underwriting commission etc) has not exceeded 4% in case of non-listed GDRs and 7% in case of GDRs listed on US exchange.

7. Companies Act requirements

Check whether the company has passed a special resolution under Section 81(1A) of the Companies Act, 1956 at a duly convened general meeting of the shareholders of the company in respect of GDR issue.

Check whether the company has altered Capital clause of Memorandum of Association and filed necessary forms with Registrar of Companies, if the authorized capital of the company is likely to be increased after GDR issue

Check whether the company has passed necessary special resolution, if the GDR issue has resulted in alteration of Articles of Association

8. FEMA requirements

Check whether the GDRs issued are within the limits specified in the FDI policy? If not check whether FIPB approval has been obtained?

9. SEC Registration/Exemption/reporting requirements

Check whether the company has filed Registration under form F-6, Reporting under form 20-F and registration of securities proposed to be offered in form F-1 with the Securities and Exchange Commission.

10. EU Directives in respect of issue of GDRs

Check whether the company has complied with Prospectus directive, Transparency obligations directive and Market Abuse Directive issued by EU.

11. RBI Reporting

Check whether the company has reported the necessary information such as number/amount of GDRs, number of underlying Indian security, amount of foreign capital on account of GDRs etc within 30 day of completion of GDR issue.

12. Disinvestment in case of Sponsored GDRs

- (a) Check whether the company has passed special resolution for disinvestment of existing shares in GDR market
- (b) Check whether the GDRs issued against disinvestment of existing shares would come within the purview of SEBI Takeover code.
- (c) Check whether the approval of FIPB is obtained if required?

- (d) Check the shares earmarked for the sponsored GDR was kept in an escrow account and such retention in escrow account has not exceeded 3 months.
- (e) Check whether the proceeds of GDR issue raised abroad is repatriated to India within one month of the closure of the issue.
- (f) Check the necessary information such as amount and number of GDRs, Percentage of foreign capital after disinvestment, details of repatriation etc is furnished to the exchange control department of RBI, Mumbai within 30 days of completion of such transaction.

13. Transfer and redemption

- (a) Check whether necessary RBI permission has been obtained in respect of transfer of depository receipts to a resident as underlying shares.
- (b) Check whether re-issue of redeemed GDRs have complied with FEM (Transfer or Issue of Security by a person Resident Outside India) Regulations, 2000.

Issue of Foreign Currency Convertible Bonds (FCCBs) ((Automatic Route)

1. The FCCBs to be issued will have to conform to the Foreign Direct Investment Policy (including Sectoral Cap and Sectors where FDI is permissible) of the Government of India as announced from time to time and the Reserve Bank's Regulations/directions issued from time to time.
2. The issue of FCCBs shall be subject to a ceiling of US \$500 million in any one financial year.
3. Public issue of FCCBs shall be only through reputed lead managers in the international market. In case of private placement, the placement shall be with banks, or with multilateral and bilateral financial institutions, or foreign collaborators, or foreign equity holder having a minimum holding of 5% of the paid-up equity capital of the issuing company. Private placement with unrecognized sources is prohibited.
4. The maturity of the FCCB shall not be less than 5 years. The call and put option, if any, shall not be exercisable prior to 5 years.
5. Issue of FCCBs with attached warrants is not permitted.
6. The "all in cost" will be on par with those prescribed for External Commercial Borrowings (ECB) Schemes specified in the Schedule to Notification No. FEMA. 3/2000-RB dated 3rd May, 2000 as amended from time to time. The "all in cost" shall include the issue related expenses such as legal fees, lead managers fees, and out of pocket expenses.
7. The FCCB proceeds shall not be used for investment in Stock Market, and may be used for such purposes for which ECB proceeds are permitted to be utilized under the ECB scheme.
8. FCCBs are allowed for corporate investments in industrial sector especially infrastructure sector. Funds raised through the mechanism may be parked abroad unless actually required.
9. FCCBs for meeting rupee expenditure under automatic route to be hedged unless there is a natural hedge in the form of uncovered foreign exchange receivables, which will be ensured by Authorized Dealers.
10. Financial intermediaries (viz. a bank, DFI or NBFC) shall not be allowed access to FCCBs, except those Banks and financial intermediaries that have participated in the Textile or Steel Sector restructuring package of the Government/RBI subject to the limit of their investment in the package.

11. Banks, FIs, NBFCs shall not provide guarantee/letter of comfort etc. for the FCCB issue.
12. The issue related expenses shall not exceed 4% of issue size and in case of private placement, shall not exceed 2% of the issue size.
13. The issuing entity shall, within 30 days from the date of completion of the issue, furnish a report to the concerned Regional Office of the Reserve Bank of India through a designated branch of an Authorized Dealer giving the details and documents as under:
 - (a) The total amount of the FCCBs issued
 - (b) Names of investors resident outside India and number of FCCBs issued to each of them.

INDIAN DEPOSITORY RECEIPTS

I. INTRODUCTION

Investment in Indian Depository Receipts (IDRs) is an interesting opportunity for the Indian Investors who are looking for investing their funds in foreign equity. Just like American Depository Receipts or Global Depository Receipts, which are instruments used by Indian Companies to raise money abroad, IDRs are meant for foreign companies looking to raise capital in India.

Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company which is located outside India. The Indian IDR holders would thus indirectly own the equity shares of overseas issuer company. IDRs are to be listed and denominated in Indian Currency. An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI.

The parties involved in the issue of Indian Depository Receipts are:

- (a) Issuing Company (Foreign Company)
- (b) Overseas Custodian (custodian located at the same country where issuing company is located).
- (c) Domestic Depository (Depository located in India)
- (d) Indian Investors who has invested in IDR issue

Accordingly to Companies (Issue of Indian Depository Receipts) Rules, 2004,

“Issuing company” means a company incorporated outside India, making an issue of IDRs through a domestic depository;

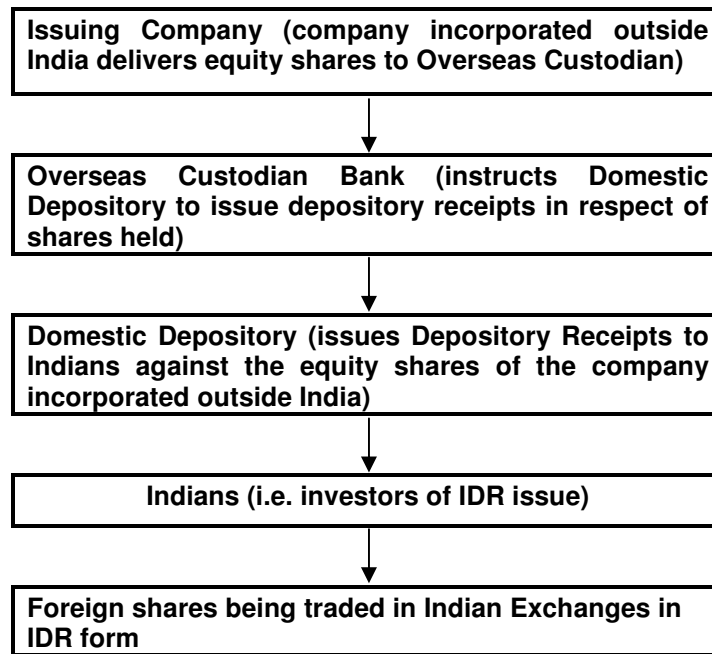
“Overseas Custodian Bank” means a banking company which is established in a country outside India and which acts as custodian for the equity shares of Issuing Company, against which IDRs are proposed to be issued by having a custodian arrangement or agreement with the Domestic Depository or by establishing a place of business in India.

Overseas Custodian bank can act as a custodian by

- having a custodial arrangement or
- agreement with the Domestic Depository or
- establishing a place of business in India.

“Domestic Depository” means custodian of securities registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts.

The following flow chart explains the IDR process



FAQs on IDRs

The following are the answers of some FAQs regarding the accessing the Indian market for raising funds by Foreign companies.

Q. Can a foreign company access Indian securities market for raising funds?

A. Yes, a foreign company can access Indian securities market for raising funds through issue of Indian Depository Receipts (IDRs)

Q. What are an Indian Depository Receipts (IDRs)?

A. An IDR is an instrument

- denominated in Indian Rupees
- in the form of a depository receipt
- created by a Domestic Depository (custodian of securities registered with the Securities and Exchange Board of India)
- against the underlying equity of issuing foreign company.

Q. Who is eligible to issue IDRs?

- A.** — Pre-issue paid-up capital and free reserves of at least US\$ 50 million and have a minimum average market capitalization (during the last 3 years) in its parent country of at least US\$ 100 million;
- A continuous trading record or history on a stock exchange in its parent country for at least three immediately preceding years;

- A track record of distributable profits for at least three out of immediately preceding five years;
- Listed in its home country and not been prohibited to issue securities by any Regulatory Body and has a good track record with respect to compliance with securities market regulations.

The size of an IDR issue shall not be less than ₹ 50 crores

Q. Whether the draft prospectus for IDRs has to be filed with SEBI as in case of domestic issues?

A. Yes. Foreign issuer is required to file the draft prospectus with SEBI. Any changes specified by SEBI shall be incorporated in the final prospectus to be filed with Registrar of Companies.

Q. Can IDRs be converted into underlying equity shares?

A. IDRs can be converted into the underlying equity shares only after the expiry of one year from the date of the issue of the IDR, subject to the compliance of the related provisions of Foreign Exchange Management Act and Regulations issued thereunder by RBI in this regard.

Q. Who can purchase IDRs?

A. IDRs can be purchased by any person who is resident in India as defined under FEMA Act, 1999

Q. What is the minimum application amount for IDRs?

A. Minimum application amount in an IDR issue shall be ₹20,000.

II. BROAD REGULATORY FRAMEWORK IN RESPECT OF ISSUE OF IDRS

Issue of Indian Depository Receipts are mainly regulated by

(a) Companies (Issue of Indian Depository Receipts) Rules, 2004.

The Central Government vide its powers conferred by clause (a) of sub-section (1) of section 642 read with section 605A of the Companies Act, 1956, notified Companies (Issue of Indian Depository Receipts) Rules, 2004. These rules are applicable only to those companies incorporated outside India, whether they have or have not established any place of business in India.

Salient Features of these rules are:

- It prescribes eligibility of an issuing company with respect to paid-up capital, free reserves, profits, debt-equity ratio etc.
- It specifies broad procedure for an issue of IDRs with respect of filing of documents with SEBI, listing permission with stock exchanges etc.
- It imposes certain condition for issue of IDRs such as maximum percentage of IDRs permissible on paid up capital & reserves, repatriation of proceeds out of redemption of IDRs, issue of prospectus and application etc.
- It describes the procedure for registration of document with SEBI and ROC by Merchant Banker.
- It has clauses relating to disclosure requirements, distribution of corporate benefits etc.
- It prescribes procedure for transfer or redemption of IDRs
- It requires issuing company to make quarterly disclosures on utilization of funds raised through issue of IDRs. This disclosure has to be made to Overseas Custodian Bank and Domestic Depository and has also to be published in one English newspaper having wide circulation in India.

- It has a schedule with respect to matters to be specified in the prospectus.

(b) Chapter VIII of SEBI(ICDR) Regulations 2009

Chapter VIII of SEBI(ICDR) Regulations 2009 deal with issue of Indian Depository Receipts. The Regulations given in this Chapter are in addition to the provisions of the Companies (Issue of Indian Depository Receipts) Rules, 2004. It also contains clauses pertaining to eligibility of issuer, minimum application amount, investment limits for investors, minimum subscription, prospectus disclosures etc.

(c) Listing agreement for IDRs

Every issuer of an IDR has to comply with the conditions stipulated in the listing agreement for IDRs issued by SEBI. The highlights of the same are enumerated in the table which is enclosed as Annexure A.

III. CHECKLIST IN RESPECT OF ISSUE OF INDIAN DEPOSITORY RECEIPTS

(a) Checklist under Companies (Issue of Indian Depository Receipts) Rules, 2004

1. Eligibility for issue of IDRs

- Check whether pre-issue paid-up capital and free reserves are at least US\$ 50 million and it has a minimum average market capitalization (during the last 3 years) in its parent country of at least US\$ 100 million;
- Check whether it has a continuous trading record or history on a stock exchange in its parent country for at least three immediately preceding years;
- Check whether it has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least three out of immediately preceding five years;
- Check whether it fulfills such other eligibility criteria as may be laid down by Securities and Exchange Board of India (SEBI) from time to time in this behalf.

2. Procedural matters

- Check whether the issuing company has obtained prior permission from the SEBI for issuing IDRs.
- Check whether the application seeking an issue of IDR has been made to the SEBI at least 90 days prior to the opening date of the issue along with non-refundable fee of US\$ 10000
- Check whether the issuing company has obtained the necessary approvals or exemption from the appropriate authorities from the country of its incorporation under the relevant laws relating to issue of capital, where required.
- Check whether the issuing company has appointed an overseas custodian bank, a domestic depository and a merchant banker for the purpose of issue of IDRs.
- Check whether the issuing company has delivered the underlying equity shares or cause them to be delivered to an Overseas Custodian Bank and the said bank has authorized the domestic depository to issue IDRs.
- Check whether the issuing company has filed through a merchant banker or the domestic depository a due diligence report with the Registrar and with SEBI in the form specified.
- Check whether the draft prospectus has been filed with SEBI, through the merchant banker, at least 21 days prior to the filing a prospectus/letter of offer.

- (h) Check whether the issuing company has through a merchant Banker filed a prospectus certified by two authorized signatories of the issuing company, one of whom shall be a whole-time director and other the Chief Accounts Officer, stating the particulars of the resolution of the Board by which it was approved, with the SEBI and Registrar of Companies, New Delhi, before such issue.
- (i) Whether the company has obtained in principle listing permission from one or more stock exchanges having nation wide trading terminals in India.
- (j) Check whether the issuing company has appointed underwriters registered with SEBI to underwrite the issue of IDRs.

3. Limits

Check the IDRs issued in any financial year has not exceeded 25 per cent of its post issue number of equity shares of the company.

4. Registration of documents

- (a) Check whether the Merchant banker to the issue of IDRs has delivered for registration the following documents or information to the SEBI and Registrar of Companies Act, New Delhi, namely:
 - instrument constituting or defining the constitution of the issuing company;
 - the enactments or provisions having the force of law by or under which the incorporation of the issuing company was effected, a copy of such provisions attested by an officer of the company be annexed;
 - if the issuing company has established place of business in India, address of its principal office in India;
 - if the issuing company does not establish principal place of business in India, an address in India where the said instrument, enactments or provision or copies thereof are available for public inspection, and if these are not in English, a translation thereof certified by a responsible officer of the issuing company shall be kept for public inspection;
 - a certified copy of the certificate of incorporation of the issuing company in the country in which it is incorporated;
 - copies of the agreements entered into between the issuing company, the overseas custodian bank, the domestic depository, which shall inter alia specify the rights to be passed on to the IDR holders;
 - if any document or any portion thereof required to be filed with the SEBI/ Registrar of Companies is not in English language, a translation of that document or portion thereof in English, certified by a responsible officer of the company to be correct and attested by an authorised officer of the Embassy or Consulate of that country in India, shall be attached to each copy of the document.
- (b) Check whether the prospectus filed with the SEBI and Registrar is containing the particulars as prescribed in Schedule to these rules and has been signed by all the whole-time directors of the issuing company and by the Chief Accounts Officer.

5. Condition for issue of prospectus and application

- (a) Check whether the application form is accompanied by a memorandum containing the salient

features of prospectus in specified form. However, in case of invitation to enter into an underwriting agreement with respect to IDRs, such memorandum need not accompany the application.

- (b) Check whether the prospectus for subscription of IDRs of the issuing company includes a statement purporting to be made by an expert? If so Check whether the expert has given his written consent to the issue thereof and has not withdrawn such consent before the delivery of a copy of the prospectus to the SEBI and Registrar of Companies, New Delhi, appears on the prospectus.
- (c) Check whether the person(s) responsible for issue of the prospectus has not incurred any liability by reason of any non-compliance with or contravention of any provision of this rule, if—
 - (i) as regards any matter not disclosed he proves that he had no knowledge thereof; or
 - (ii) the contravention arose in respect of such matters which in the opinion of the Central Government were not material.

6. Listing of Indian Depository Receipt

IDRs issued has to be listed on the recognized Stock Exchange(s) in India having nationwide terminals.

7. Procedure for transfer and redemption

1. A holder of IDRs may transfer IDRs, may ask the domestic depository to redeem them or any person may seek re issuance of IDRs by conversion of underlying Equity Shares, subject to FEMA Act and SEBI Act or rules regulations made under these Acts or other law for the time being in force.
2. In case of redemption, Domestic depository shall request the overseas custodian Bank to get the corresponding underlying Equity shares released in favor of the holder of IDRS for being sold directly on behalf of holder of IDRS or being transferred in the books of issuing company in the name of holder of IDRs and a copy of such request shall be sent to the issuing company for information.

8. Continuous Disclosure Requirements

- (a) Check whether the issuing company has furnished to the Overseas Custodian Bank and Domestic Depository, a certificate obtained by it from the statutory auditor of the company or a Chartered Accountant about utilization of funds and its variation from the projections of utilization of funds made in the prospectus, if any, in quarterly intervals and shall also publish it or cause to be published in one of the English language newspapers having wide circulation in India.
- (b) Check whether the quarterly audited financial results has been prepared and published in newspapers in the manner specified by the listing conditions.

9. Distribution of corporate benefits

Check whether, on the receipt of dividend or other corporate action on the IDRs as specified in the agreements between the issuing company and the Domestic Depository, the Domestic Depository has distributed them to the IDR holders in proportion to their holdings of IDRs.

10. Penalty

If a company or any other person contravenes any provision of these rules for which no punishment is provided in the Act, the company and every officer of the company who is in default or such other person shall be punishable with the fine which may extend to twice the amount of the IDR issue and where the contravention is a continuing one, with a further fine which may extend to five thousand rupees for every day, during which the contravention continues.

(b) SEBI (ICDR) Regulations 2009

(Check list under Chapter VIII SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 for issue of Indian Depository Receipts)

Eligibility

Ensure that

- (a) the issuing company is listed in its home country;
- (b) the issuing company is not prohibited to issue securities by any regulatory body;
- (c) the issuing company has track record of compliance with securities market regulations in its home country.

Explanation : For the purpose of this regulation, the term “home country” means the country where the issuing company is incorporated and listed.

Conditions for issue of IDR

Ensure that the following conditions are satisfied

- (a) issue size shall not be less than fifty crore rupees;
- (b) procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus;
- (c) minimum application amount shall be twenty thousand rupees;
- (d) at least fifty per cent. of the IDR issued shall be allotted to qualified institutional buyers on proportionate basis as per illustration given in Part C of Schedule XI;
- (e) the balance fifty per cent. may be allocated among the categories of noninstitutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be on proportionate basis:

It may be noted that atleast thirty per cent. of the said fifty per cent. IDR issued shall be allocated to retail individual investors and in case of under-subscription in retail individual investor category, spill over to the extent of under-subscription shall be permitted to other categories.

- (f) At any given time, there shall be only one denomination of IDR of the issuing company.

Minimum subscription

For non-underwritten issues

- (a) If the issuing company does not receive the minimum subscription of ninety percent of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
- (b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

For underwritten issues

If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

Filing of draft prospectus, due diligence certificates, payment of fees and issue advertisement for IDR

The issuing company making an issue of IDR shall enter into an agreement with a merchant banker on the lines of format of agreement specified. If the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter-alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the prospectus on the lines of format as specified in the Schedule.

The issuing company shall file a draft prospectus with the Board through a merchant banker along with the requisite fee, as prescribed in Companies (Issue of Indian Depository Receipts) Rules, 2004.

The prospectus filed with the Board under this regulation shall also be furnished to the Board in a soft copy on the lines specified in the Schedule.

(5) The lead merchant bankers shall:

- (a) Submit a due diligence certificate as per specified format to the Board along with the draft prospectus.
- (b) Certify that all amendments, suggestions or observations made by the Board have been incorporated in the prospectus.
- (c) Submit a fresh due diligence certificate as per format specified, at the time of filing the prospectus with the Registrar of the Companies.
- (d) Furnish a certificate as per specified format, immediately before the opening of the issue, certifying that no corrective action is required on its part.
- (e) Furnish a certificate as per specified format, after the issue has opened but before it closes for subscription.

(6) The issuing company shall make arrangements for specified mandatory collection centres.

(7) The issuing company shall issue an advertisement in one English national daily newspaper with wide circulation and one Hindi national daily newspaper with wide circulation, soon after receiving final observations, if any, on the publicly filed draft prospectus with the Board, which shall be on the lines of the format and contain the minimum disclosures as required.

Display of bid data

The stock exchanges offering online bidding system for the book building process shall display on their website, the data pertaining to book built IDR issue, in the format specified, from the date of opening of the bids till at least three days after closure of bids.

Disclosures in prospectus and abridged prospectus

The prospectus shall contain all material disclosures which are true, correct and adequate so as to enable the applicants to take an informed investment decision.

The prospectus shall contain:

- (a) the disclosures specified in Schedule to Companies (Issue of Indian Depository Receipts) Rules, 2004; and
- (b) the specified disclosures.

(3) The abridged prospectus for issue of Indian Depository Receipts shall contain the specified disclosures.

Post-issue reports

The merchant banker shall submit post-issue reports to the Board as follows:

- (a) initial post issue report, within three days of closure of the issue;
- (b) final post issue report, within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue.

Undersubscribed issue

In case of undersubscribed issue of IDR, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board on the lines of the format specified.

Finalisation of basis of allotment

The executive director or managing director of the stock exchange, where the IDR are proposed to be listed, along with the post issue lead merchant bankers and registrars to the issueshall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the specified allotment procedure.

Rights Issue Of Indian Depository Receipts-Salient Features

Eligibility.

No issuer shall make a rights issue of IDRs:

- (a) if at the time of undertaking the rights issue, the issuer is in breach of ongoing material obligations under the IDR Listing Agreement as may be applicable to such issuer or material obligations under the deposit agreement entered into between the domestic depository and the issuer at the time of initial offering of IDRs; and
- (b) unless it has made an application to all the recognised stock exchanges in India, where its IDRs are already listed, for listing of the IDRs to be issued by way of rights and has chosen one of them as the designated stock exchange.

Record Date

A listed issuer making a rights issue of IDRs shall in accordance with provisions of the listing agreement, announce a record date for the purpose of determining the shareholders eligible to apply for IDRs in the proposed rights issue.

Disclosures in the offer document and the addendum for the rights offering

The offer document for the rights offering shall contain disclosures as required under the home country regulations of the issuer.

Apart from the disclosures as required under the home country regulations, an additional wrap (addendum to

offer document) shall be attached to the offer document to be circulated in India containing information as specified in Part A of Schedule XXI and other instructions as to the procedures and process to be followed with respect to rights issue of IDRs in India.

Filing of draft offer document and the addendum for rights offering

(1) The issuer shall appoint one or more merchant bankers, one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.

(2) The issuer shall, through the lead merchant banker, file the draft offer document prepared in accordance with the home country requirements along with an addendum containing disclosures as specified in Part A of Schedule XXI with the SEBI, as a confidential filing accompanied with fees as specified in Part A of Schedule IV.

(3) The Board may specify changes or issue observations, if any, on the draft offer document and the addendum within thirty days or from the following dates, whichever is later:

- (a) the date of receipt of the draft offer document prepared in accordance with the home country requirements along with an addendum under sub-regulation (2); or
- (b) the date of receipt of satisfactory reply from the lead merchant bankers, where SEBI has sought any clarification or additional information from them; or
- (c) the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency; or
- (d) the date of receipt of a copy of in-principle approval letter issued by the recognized stock exchanges.

(4) If SEBI specifies changes or issues observations on the draft offer document and the addendum under sub-regulation(3), the issuer and the merchant banker shall file the revised draft offer document and the updated addendum after incorporating the changes suggested or specified by the SEBI.

(5) The issuer shall also submit an undertaking from the Overseas Custodian and Domestic Depository addressed to the issuer, to comply with their obligations with respect to the said rights issue under their respective agreements entered into between them, along with the offer document.

(6) The issuer shall ensure that the Compliance Officer, in charge of ensuring compliance with the obligations under this Chapter, functions from within the territorial limits of India.

(c) Listing Agreement for Indian Depository Receipts (IDRs)

1. Board Meeting

- Check whether the Company has notified stock exchange at least 7 days in advance of the date of the meeting of its Board of Directors at which the recommendation or declaration of a dividend or a rights issue or convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend were considered
- Check whether the Company has within 15 minutes of Board Meeting, intimated to the Stock Exchange, by phone, fax, telegram, e-mail, the details on all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment, short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by issue of rights shares, or in any other manner; short particulars of the reissues of forfeited shares or

securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe thereto; short particulars of any other alterations of capital, including calls; or any other information necessary to enable the holders of the IDRs to appraise the issuer's position and to avoid the establishment of a false market.

2. Intimation/filing/submissions to stock exchange/s

- Check whether the Company has notified the stock exchange at least twenty-one days in advance of the date on and from which the dividend on shares will be payable .
- Check whether the Company has submitted to the exchange documents such as Copy of SEBI observation letter on draft prospectus, due diligence report from depository, merchant bankers certificate reporting positive compliance
- Check whether the issuer, in case of granting any options, has notified Stock Exchange number of shares covered by such options, of the terms thereof and of the time within which they may be exercised and any subsequent changes or cancellation or exercise of such options.
- Check whether the company has notified any change in the rights attaching to any class of equity shares into which the IDRs are exchangeable.
- Check whether the company has notified change in the constitution of Board, Managing Director, Auditor, Compliance officer, domestic depository, overseas custodian etc
- Check whether the Company has forwarded to stock exchange promptly the following:
 - copies of the Annual Reports, which shall include the Balance Sheet and Profit & Loss Account, Directors' Report and the Auditors' Report and of all periodical and special reports as soon as they are issued;
 - copies of all notices, resolutions and circulars relating to new issue of capital prior to their dispatch to the equity shareholders or IDR holders;
 - copies of all the notices, call letters or any other circulars including notices of meetings at the same time as they are sent to the equity shareholders, IDR holders, debenture holders or creditors or any class of them or as they are advertised in the Press.
 - copy of the proceedings at all Annual and Extraordinary General Meetings of the Issuer;
 - copy of the deposit agreement as soon as it is executed.
 - copies of all notices, circulars, etc., issued or advertised in the press either by the Issuer, or by any other body corporate which the Issuer proposes to absorb or with which the Issuer proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the press in regard to meetings of equity shareholders, IDR holders or any class of them and copies of the proceedings at all such meetings.
- Check whether the company has filed with the Exchange the shareholding pattern on a quarterly basis within 15 days of end of the quarter in the prescribed form
- Check Issuer has intimated to the Stock Exchanges, immediately of events such as strikes, lock outs, closure on account of power cuts, etc. and all events which will have a bearing on the performance/operations of the company as well as price sensitive information both at the time of occurrence of the event and subsequently after the cessation of the event.
- Check whether the company has informed stock exchange about material events such as Change

in the general character or nature of business, Disruption of operations due to natural calamity, Commencement of Commercial Production/Commercial Operations, Developments with respect to pricing/realisation arising out of change in the regulatory framework, Litigation/dispute with a material impact, Revision in Ratings etc

- Check whether the company has furnished on a quarterly basis a statement to the stock exchange indicating the variations between projected utilisation of funds and/or projected profitability statement made by it in its prospectus or letter of offer and the actual utilisation of funds and/or actual profitability.
- Check whether the company has furnished a copy of agreement or MOU entered into with overseas custodian bank, domestic depository, merchant banker and RTA to the stock exchange.

3. Issuance of further IDRs

- Check whether the company has obtained 'in-principle' approval and made application for listing, in respect of further issue of IDRs if any,
- Check whether the Company has complied with all legal and regulatory requirements before issuing any prospectus/offer document/letter of offer for public subscription of any IDRs.
- Check whether the company has made the allotment of IDRs offered to the public within 30 days of the closure of the public issue and has paid interest @ 15% per annum if the allotment has not been made and or refund orders have not been dispatched to the investors within 30 days from the date of the closure of the issue.
- Check whether the underlying shares of IDRs ranks pari passu with the existing shares of the same class and the fact of having different classes of shares based on different criteria, if any, has been disclosed by the company in every offer document issued in India and in the annual report.

4. Corporate Governance

Composition of Board

- Check whether the Board of the company has optimum combination of executive/non-executive director and with prescribed minimum Percentage of Independent Directors
- Check whether all fees/compensation, if any paid to non-executive directors, including independent directors, has been fixed by the Board of Directors and with previous approval of shareholders in general meeting.
- Check whether the Board has met at least four times a year, with a maximum time gap of four months between any two meetings.
- Check whether no director is a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director.
- Check whether the Board periodically reviews compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.
- Check whether the Board has laid down a code of conduct for all Board members and senior management of the company and the same is posted on the website of the company.
- Check whether all Board members and senior management personnel affirms compliance with the code on an annual basis.
- Check whether the Annual Report of the company contains a declaration to this effect signed by the CEO.

Audit Committee

- Check whether a qualified and independent Audit Committee has been set up, with minimum three directors as members and Two-thirds of them being independent.
- Check whether all members of Audit Committee are financially literate and at least one member has accounting or related financial management expertise.
- Check whether the Chairman of the Audit Committee is an independent director and was present at Annual General Meeting to answer shareholder queries.
- Check whether the Audit Committee has met at least four times in a year and not more than four months elapsed between two meetings.
- Check whether the Audit Committee has reviewed the following information:
 1. Management discussion and analysis of financial condition and results of operations;
 2. Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
 3. Management letters/letters of internal control weaknesses issued by the statutory auditors;
 4. Internal audit reports relating to internal control weaknesses; and
 5. The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee.

Subsidiary Companies

- Check whether at least one independent director on the Board of Directors of the holding company is a director on the Board of Directors of a material non-listed Indian subsidiary company.
- Check whether the Audit Committee of the listed holding company review the financial statements, in particular, the investments made by the unlisted subsidiary company.
- Check whether the minutes of the Board meetings of the unlisted subsidiary company was placed at the Board meeting of the listed holding company.

Disclosures

- Check whether the company has disclosed related party transactions if any to the audit committee.
- Check whether the company has disclosed to the Audit Committee about accounting treatment which is different from prescribed accounting standard.
- Check whether the company has laid down procedures to inform Board members about the risk assessment and minimization procedures.
- Check whether the company has disclosed to the Audit Committee the uses and applications of funds arising out of an IPO.

Remuneration of Directors

- Check whether all pecuniary relationship or transactions of the non-executive directors vis-à-vis the company has been disclosed in the Annual Report.
- Check whether the following disclosures on the remuneration of directors has been made in the section on the corporate governance of the Annual Report:
 - (a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
 - (b) Details of fixed component and performance linked incentives, along with the performance

criteria.

- (c) Service contracts, notice period, severance fees.
- (d) Stock option details, if any - and whether issued at a discount as well as the period over which accrued and over which exercisable.
- Check whether the company has published its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.
- Check whether the company has disclosed the number of shares and convertible instruments held by non-executive directors in the annual report.

Management

- Check whether, as part of the directors' report or as an addition thereto, a Management Discussion and Analysis report is forming part of the Annual Report to the shareholders with specified information.
- Check whether Senior management has made disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.).

Shareholders

- Check, in case of the appointment of a new director or re-appointment of a director the shareholders has been provided with the following information:
 - A brief resume of the director;
 - Nature of his expertise in specific functional areas;
 - Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
 - Shareholding of non-executive directors as stated in clause 24 (IV)(E)(v) above.
- Check whether Quarterly results and presentations made by the company to analysts has been put on company's website, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own website.
- Check whether a board committee under the chairmanship of a non-executive director has been formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc.

CEO/CFO certification

Check whether the CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function has certified to the Board that :

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - (ii) these statements together present a true and fair view of the company's affairs and are in

compliance with existing accounting standards, applicable laws and regulations.

- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit Committee
 - (i) significant changes in internal control over financial reporting during the year;
 - (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
 - (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

Report on Corporate Governance

- Check whether there is a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance.
- Check whether the company has submitted a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the specified format.

Compliance

Check whether the company has obtained a certificate from either the auditors or practising company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company and has been sent to the Stock Exchanges along with the annual report filed by the company.

5. Actions/investigations initiated

Check whether the issuer has intimated any action/investigations initiated by any statutory/regulatory authority along with the purpose of the same.

6. Information/submissions to IDR holders

Check whether the issuer has sent a copy of Annual Report containing Boards Report, Profit & Loss Account, Balance Sheet, Cash flow statement, Auditors report etc within four months of the end of financial year.

Check whether the company has disclosed the pre and post arrangement capital structure and shareholding pattern to the IDR holders in case of corporate restructuring like mergers/amalgamations and other schemes in advance.

7. Annual Report/publications etc

- Check whether the Issuer has sent to its IDR holders and the stock exchange a copy of the annual report within four months of the end of the financial year. The annual report shall contain the Board's report, Balance Sheet, Profit and Loss Account, Cash Flow Statement and the auditor's report thereon.

- Check whether the company has complied either with Indian GAAP (including all Accounting Standards issued by the Institute of Chartered Accountants of India) or with the International Financial Reporting Standards (IFRS) [including the International Accounting Standards (IAS)] or with US GAAP in the preparation and disclosure of its financial results.
- In case the Company opts to prepare and disclose its financial results as per IFRS/US GAAP, Check whether it has complied with the requirements of clauses 35 and 36 of listing agreement for IDRs.
- In case the Company opts to prepare and disclose its financial results as per Indian GAAP, Check whether the company has complied with, as far as may be, with clauses 37 and 38 of the listing agreement for IDRs and with the provisions of the Companies Act, 1956 relating to authentication and presentation of annual accounts as far as may be practicable.

8. Audit Qualifications

Check whether there are any qualifications in the Audit report? If so check whether it is published along with audited financial statements.

9. Appointment of Company Secretary

Check whether the company has appointed the Company Secretary as Compliance Officer who will directly liaise with the authorities such as SEBI, Stock Exchanges, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter.

10. Undertaking of Due diligence

Check whether the company has undertaken a due diligence survey to ascertain whether the RTA is sufficiently equipped with infrastructure facilities such as adequate manpower, computer hardware and software, office space, documents handling facility etc., to serve the IDR holders.

11. Equivalent Information

Check whether the Company has provided any information simultaneously, that was furnished to international exchanges

12. Miscellaneous

Check whether any scheme of arrangement/amalgamation/merger/ reconstruction/reduction of capital, etc., presented by the Company to any Court or Tribunal has not violated in any way violate, override or circumscribe the provisions of securities laws or the stock exchange requirements

Check whether the issuer has complied with the rules/regulations/laws of the country of origin.

IV. PENAL PROVISIONS RELATING TO IDRs UNDER VARIOUS LEGISLATIONS

(a) Companies Act, 1956

Section 606, 607 and 608 of the Act prescribe the penalty for non-compliance of any of the provisions relating to IDR which is reproduced below:

606. Penalty for contravention of Sections 603, 604, 605 and 605A

Any person who is knowingly responsible—

- (a) for the issue, circulation or distribution of a prospectus; or

(b) for the issue of a form of application for shares, debentures or Indian Depository Receipts;

in contravention of any of the provisions of Sections 603, 604, 405 and 405A, shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to fifty thousand rupees, or with both.

607. Civil liability for misstatements in prospectus

Section 62 shall extend to every prospectus offering for subscription shares in or debentures of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, with the substitution for references in Section 62 to Section 60 of this Act, of references to Section 604 thereof.

608. Interpretation of provisions as to prospectus

(1) Where any document by which any shares in, or debentures of, a company incorporated outside India are offered for sale to the public, would, if the company concerned had been a company within the meaning of this Act, have been deemed by virtue of Section 64, to be a prospectus issued by the company, that document shall be deemed, for the purposes of this Part, to be a prospectus issued by the company offering such shares or debentures for subscription.

(2) An offer of shares or debentures for subscription or sale to any person whose ordinary business it is to buy or sell shares or debentures, whether as principal or as agent, shall not be deemed to be an offer to the public for the purposes of this Part.

(3) In this Part, the expressions “prospectus”, “shares” and “debentures” have the same meanings as when used in relation to a company incorporated under this Act.

(b) Companies (Issue of Indian Depository Receipts) Rules, 2004 (Rule 13)

As per the Rules, if a company or any other person contravenes any provision of these rules for which no punishment is provided in the Act, the company and every officer of the company who is in default or such other person shall be punishable with the fine which may extend to twice the amount of the IDR issue and where the contravention is a continuing one, with a further fine which may extend to five thousand rupees for every day, during which the contravention continues.

As per Rule 8(iv), the person(s) responsible for issue of the prospectus shall not incur any liability by reason of any non-compliance with or contravention of any provision of this rule, if—

- (a) as regards any matter not disclosed, he proves that he had no knowledge thereof; or
- (b) the contravention arose in respect of such matters which in the opinion of the Central Government were not material.

(c) Securities Contracts Regulation Act, 1956

Apart from the above, non-compliance of the conditions of the listing agreement attracts the provisions of Section 23(2) and 23E of the SCRA which is given hereunder:

- Section 23(2) – imprisonment of 10 years or fine of ₹25 crores or both for non-compliance of conditions of listing.
- Section 23E of SCRA, 1956 – failure to comply with conditions of listing or delisting or committing a breach thereof – ₹25 crores fine.

(d) Foreign Exchange Management Act, 1999

Non-compliance of FEMA provisions attracts the following:

- (1) If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorization is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.
- (2) Any Adjudicating Authority adjudging any contravention under sub-section (1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

Explanation: For the purposes of this sub-section, “property” in respect of which contravention has taken place, shall include:

- (a) deposits in a bank, where the said property is converted into such deposits;
- (b) Indian currency, where the said property is converted into that currency; and
- (c) any other property which has resulted out of the conversion of that property.

LESSON ROUND UP

- Global Depository Receipts means any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company
- Domestic Custodian Bank means a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian Company which are issued by it against global Depository receipts or certificates
- Overseas Depository Bank means a bank authorised by the issuing company to issue global Depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company
- GDR issue can be through sponsored GDR programme or through fresh issue of shares.
- Through Sponsored GDRs the existing holders of shares in Indian Companies can sell their shares in the overseas market. It is a process of disinvestment by Indian shareholders of their holding in overseas market.
- A limited Two-way Fungibility scheme has been put in place by the Government of India for ADRs/GDRs. Under this scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/ GDRs which have been redeemed into underlying shares and sold in the Indian market.
- Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange etc.

- Indian Companies issuing GDRs in America and Europe has to comply with SEC requirements and EU directives.
- Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company.
- Domestic Depository is custodian of securities registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts.
- Overseas Custodian Bank means a banking company which is established in a country outside India and has a place of business in India and acts as custodian for the equity shares of issuing company against which IDRs are proposed to be issued after having obtained permission from Ministry of Finance for doing such business in India.
- Issue of IDRs are regulated by Chapter VI A of SEBI (DIP) Guidelines, 2000 Companies (Issue of Indian Depository Receipts) Rules, 2004 and Listing Agreement for IDRs
- The IDRs issued should be listed on the recognized Stock Exchange(s) in India as specified and such IDRs may be purchased, possessed and freely transferred by a person resident in India.
- Issuer of an IDR has to comply with the listing conditions stated in the listing agreement for IDRs

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What are the various options for a company issuing Global Depository Receipts?
2. Describe the SEC requirements in respect of GDRs proposed to be listed in US exchanges?
3. Write short notes on
 - Pink Sheets
 - Domestic Custodian Bank
 - Overseas Depository
4. What are the provisions relating to transfer/redemption of GDRs?
5. Describe the working mechanism of GDRs?
6. What are the check list in respect of due diligence of GDR issue?
7. What do you mean by Indian Depository Receipts. Briefly explain the salient features of Companies (Issue of Indian Depository Receipts) Rules, 2004.
8. What are the procedures for making an issue of Indian Depository Receipts?
9. Explain the procedure for carrying out due diligence of IDR issue.

Lesson 7

DUE DILIGENCE –MERGERS AND AMALGAMATIONS

LESSON OUTLINE

- Introduction
- Due diligence process in M&A strategy
- Business Financial and Legal Due diligence
- Data Room Management
- Cultural Due diligence
- Corporate Governance Due diligence
- Due diligence on takeovers
- Impact of Due diligence on valuation

LEARNING OBJECTIVES

The decision to merge or amalgamate has to be based on rational analysis, which can be formed only after evaluation of information and records available. Due Dilligence is the assessment process to judge the benefits vis-à-vis the threats that are likely in post merger scenario. In fact there are several factors financial/non financial/ open/hidden factors that influence the ultimate choice of strategy. The process of analysis of strategic choices on various aspects for merger is done through due diligence process. This involves analysis of business, financial, legal, cultural, governance aspects. After reading this lesson you will be able to understand broadly the aspects to be analyzed during M&A due diligence process.

INTRODUCTION

A company may decide to accelerate its growth by developing into new business areas, which may or may not be connected with its traditional business areas, or by exploiting some competitive advantage that it may have. Once a company has decided to enter into a new business area, it has to explore various alternatives to achieve its aims.

Basically, there can be three alternatives available to it:

- (i) the formation of a new company;
- (ii) the acquisition of an existing company;
- (iii) merger with an existing company.

The decision as to which of these three options are to be accepted, will depend on the company's assessment of various factors including in particular:

- (i) the cost that it is prepared to incur;
- (ii) the likelihood of success that is expected;
- (iii) the degree of managerial control that it requires to retain.

For a firm desiring immediate growth and quick returns, mergers can offer an attractive opportunity as they obviate the need to start from 'scratch' and reduce the cost of entry into an existing business. However, this will need to be weighed against the fact that unless the shareholders of the transferor company (merging company) are paid the consideration in cash, part of the ownership of the existing business remains with the former owners.

Merger with an existing company will, generally, have the same features as an acquisition of an existing company. However, identifying the right candidate for a merger or acquisition is an art, which requires sufficient care and calibre.

Once an organization has identified the various strategic possibilities, it has to make a selection amongst them. There are several factors financial/non financial/ open/hidden factors that influence the ultimate choice of strategy. The process of analysis of strategic choices on various aspects for merger is done through due diligence process.

Due Diligence Process in the M&A Strategy

Stages	For Buyer	For seller
Preparation Stage	<ul style="list-style-type: none"> ➤ M&A Strategy formulation ➤ Preparation of List of potential targets ➤ Appoint external advisor for evaluation of targets ➤ Short list targets ➤ Create Due diligence team 	<ul style="list-style-type: none"> ➤ Structure a Business plan ➤ Preparation of list of potential buyers ➤ Appoint external advisor ➤ Shortlist buyers
Pre diligence	<ul style="list-style-type: none"> ➤ Approach targets ➤ Negotiation of initial terms 	<ul style="list-style-type: none"> ➤ Approach buyers ➤ Negotiate initial terms

	<ul style="list-style-type: none"> ➤ Execute Non Disclosure Agreement ➤ Compilation of list of data required 	<ul style="list-style-type: none"> ➤ Execution of Non-Disclosure agreement ➤ Creation of Data room
Due diligence	<ul style="list-style-type: none"> ➤ Inspection of Data room ➤ Analysis of private documents ➤ Evaluation of risk and return ➤ Structure the terms and conditions 	<ul style="list-style-type: none"> ➤ Assistance in data room ➤ Setting deadlines for offer
Negotiations	<ul style="list-style-type: none"> ➤ Make final offer ➤ Negotiate and agree on terms 	<ul style="list-style-type: none"> ➤ Compile final offers ➤ select best offer ➤ negotiations
Post diligence	<ul style="list-style-type: none"> ➤ Post merger integration and cultural adjustments 	<ul style="list-style-type: none"> ➤ Termination of data room and ownership exchange

ACTIVITY SCHEDULE FOR PLANNING A MERGER

Sl.	Activity	Action to be taken for completion of activity
(1)	(2)	(3)
1.	Objects clause to be examined	Check the object clause of the transferor and transferee company with regard to the power of amalgamation.
		Check the object clause of the transferee company regarding power to carry on the business of the transferor company; if not, it is necessary to amend the Objects Clause.
		Check if authorised capital of the transferee company is sufficient; if not it is to be amended.
2.	Preparation of Scheme of Amalgamation	Aspects of Business Valuation, calculation of Swap ratio etc. are being carried out during this process.
3.	Board meeting of both the transferor and transferee companies to be held.	<p>Notice, Agenda of the Board Meeting to be sent.</p> <p>Board Meeting to be held.</p> <p>Agenda for Board Meeting will include the following items: Effective date to be announced:</p> <p>Approval of the scheme of amalgamation</p> <p>Approval of Ratio</p> <p>Directors/Officers to be empowered to make application to appropriate High Courts and to take necessary action.</p>
4.	Stock Exchange	Immediately after the board meeting approving the scheme/ exchange ratio, both companies will have to inform the respective stock exchanges.
5.	Press Release	The news may be released to the press for information and others.

6.	Financial Institutions/ Banks/Trustees to Debentureholders, if any, to be formally advised their consent sought.	Financial institutions/trustees to Debentureholders, if any to be formally advised and their consent sought.
7.	<p>Application to the High Court</p> <p>If the transferee/ transferor company is a potentially sick company, the provisions of SICA to be borne in mind.</p> <p>If there are any calls in arrears of transferor company, the High Court direction to be sought specifically.</p> <p>In case of a merger of a potentially sick company with a healthy company, the possibility of reducing the share capital of the sick company to the extent of losses to be considered and procedure for reduction to be undertaken. This would have an effect on the EPS of the merged company.</p>	<p>An application to the High Court concerned both to the transferor and transferee companies will have to be made under Companies (Court) Rules, 1959, for summons for direction to convene the meeting in Form No. 33 of the Companies (Court) Rules, 1959.</p> <p>Affidavit in support of summons will be in Form 34 of the Companies (Court) Rules, 1959.</p> <p>Appointing chairman of the meeting.</p> <p>Fix quorum of the meeting.</p> <p>An order by judge in summons convening meeting of the members of the transferor and transferee companies to approve the scheme and for approval. This will be in Form No. 35 of Companies (Court) Rules, 1959.</p>
8.	Notices of Extra Ordinary General Meeting.	<p>Notices and Statements under Section 393 of the Act will have to be printed. It will be in Form No. 36 of Companies (Court) Rules, 1959.</p> <p>Take approval of the draft of notice from Registrar of High Court.</p> <p>Proxy Forms in Form No. 37 will have to be sent along with the notice.</p> <p>Notices will be in Form No. 36 and will be sent to individual members in the name of the Chairman of the meeting concerned, as required by Rule 73.</p> <p>Notice should be accompanied with:</p> <ul style="list-style-type: none"> — the statement. — a copy of the scheme

		<p>— form of proxy</p> <p>The Notice will be advertised in the newspapers in such manner as the court may direct not less than 21 clear days before the meeting. The advertisement will be in Form No. 38.</p>
9.	Meetings of Members	<p>The meetings will be held as scheduled. The management will answer the queries of the members, permitted by the Chair.</p> <p>The decision of the meeting will be ascertained by poll only (Rule 77).</p> <p>Approval is required of a majority in number of persons present and voting representing three-fourths in value of the members.</p> <p>Chairman of each meeting will within the time fixed by the Judge (or within 7 days of the meeting) submit a report in Form No. 39.</p>
10	Petition to Court	<p>Where the scheme is approved by members, the companies will within 7 days of filing of the report by the Chairman present a petition to the Court for confirmation of the scheme. The petition will be in Form No. 40.</p> <p>A copy of the petition will be served on the Regional Director, Company Law Board and others as directed by the Court.</p>
11	Directions on the Petition.	<p>The Court will fix a date for the hearing of the petition.</p> <p>The Court will also direct official liquidator to scrutinize the books of the transferor company and submit a report thereon in terms of Section 394 of the Companies Act.</p>
12	Notice of the hearing	<p>Notice of the hearing will be advertised in the same papers as the Court may direct not less than 10 days before the date fixed for the hearing.</p>
13	Official Liquidator's Report.	<p>The Official liquidator upon directions of the Court will be required to inspect the books of the transferor company and report that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest.</p> <p>The official liquidator may nominate a chartered accountant from his panel to conduct the inspection and report to him. He may direct that inspection should cover 3-5 years. The fees payable will also be fixed.</p> <p>The official liquidator's representative will visit the company's office and particulars required will be furnished to him.</p> <p>On the basis of the reports of the representatives, the official liquidator will submit his report to the court.</p> <p>Thereupon the Court will order dissolution.</p>
14.	Hearing and Order.	<p>Any person interested including creditors and employees may appear before the Court and make submissions.</p> <p>The order of the Court may include such directions with regard to any matter and such modifications in the scheme as the Judge may think fit to make for the proper working of the Scheme.</p> <p>The order will direct that a certified copy of the same should be filed</p>

		<p>with the Registrar of companies within 14 days from the date of the order or such other time as may be fixed by the Court.</p> <p>The order will be in Form 41 with such variations as may be necessary.</p> <p>The order may include order for dissolution of the transferor company if the Official Liquidator has submitted the report.</p> <p>The Court may make any provision for any person who dissents from the scheme.</p> <p>The order will not have any effect till a certified copy is filed with the Registrar.</p>
15.	Filing/Annexing	<p>Within 30 days of the making of the order, a certified copy thereof will be filed with the Registrar of Companies.</p> <p>In computing the period of 30 days the time taken in obtaining certified copy has to be excluded.</p> <p>A copy of the Court's order will be annexed to every copy of the memorandum and articles of association of the transferee company.</p>
16	FEMA	Approval of Reserve Bank of India will be obtained for allotment of shares to non-residents under FEMA, wherever required.
17	Effective Date	As soon as the scheme has become effective, particulars will be intimated through press and to the government authorities, banks, creditors, customers and others. Certified copy of the Court order will be given where necessary.

PREPARATION OF SCHEME OF AMALGAMATION

The scheme of amalgamation to be prepared by the company should contain *inter-alia* the following information:

1. Definitions of transferor and transferee as well as the definition of the undertaking of the transferor company.
2. Authorised, issued and subscribed capital of transferor and transferee companies.
3. Basis of scheme should be explained briefly on the recommendation of valuation report, covering transfer of assets/liabilities, specified date, reduction or consolidation of capital, application to financial institutions as lead institution for permission, etc.
4. Change of name, object and accounting year.
5. Protection of employment.
6. Dividend position and prospects.
7. Management structure, indicating the number of directors of the transferee company and the transferor company.
8. Applications under Sections 391 and 394 of the Companies Act, 1956 to obtain approval from the High Court.
9. Expenses of amalgamation.

10. Conditions of the scheme to become effective and operative and the effective date of amalgamation.

The basis of the scheme should be framed on the reports of valuers, auditors and chartered accountants of assets of both the merger partner companies. The underlying idea is to ensure that the scheme is just and equitable to the shareholders and employees of each of the amalgamating companies and to the public at large. It should be ensured that common yardstick is adopted for valuation of shares of each of the amalgamating company for fixing rate of exchange of shares on merger.

A. Information Required by the Advocates Generally

Cross holding of the Directors of the Transferee and Transferor Companies.

1. Relationship between the directors of the transferee and transferor companies under the Companies Act, 1956.
2. Names of the officers of both the transferee and transferor companies who are to be authorised to sign the Application, Affidavit and Petition. (The companies concerned can authorise any one person to act on behalf of them, who may be from either of the companies).
3. Names of the English and regional language newspapers in which notices are to be published.
4. Names in preferential order as to the chairmen of the meetings of the transferee and transferor companies. (The chairman in this case need not be a director on the board of directors of the company concerned or even a member of the company).
5. List of creditors and their dues. List of individual cases to be given, as well as categorisation in various slabs.

B. Information/Documents that may be Required by the Regional Director, Ministry of Corporate Affairs, in Connection With Amalgamation.

1. Balance sheets for last five years of the transferee company.
2. Balance sheets for last five years of the transferor company.
3. Two copies of the valuation report of the chartered accountants.
4. List of top fifty shareholders of the transferee company.
5. List of top fifty shareholders of the transferor company.
6. List of directors of the transferor company and their other directorships.
7. List of directors of the transferee company and their other directorships.
8. Number and percentage of NRI and foreign holding in the transferee and transferor companies.
9. Rights/Bonus/Debentures Issues made by the transferee and the transferor companies in the last five years.

C. The Following Information is Required to be Furnished to the Auditors Appointed by the Official Liquidator.

From the transferor company

1. Certified true copy of the scheme of amalgamation alongwith the petition.
2. Certified true copy of the Memorandum and Articles of Association of the company.

3. List of shareholders of the company with their shareholding. Any changes during the last five years to be indicated.
4. Accounts of the company made upto the appointed day of amalgamation.
5. Address of the registered office of the company.
6. Present authorised and paid-up share capital of the company.
7. Changes in the Board of directors during the last five years alongwith list of present Board of directors.
8. List of associated concern in which directors are interested.
9. List of various appeals pending under Income-tax, Sale Tax, Excise Duty, Custom Duty, FEMA, etc.
10. Details of loans and advances given to the associated concern/companies under the same management during the last five years.
11. Details of revaluation of assets.
12. Details of any allegations and/or complaints against the company.
13. Details of amount paid to the managing director, directors or any relative of the directors during the last five years.
14. Comparative statement of profit and loss account and balance sheet for the last five years.
15. Details of bad debts written off during the last five years.
16. List of all charges registered with the Registrar of Companies and the amount secured against the same.
17. Copy of the latest annual return filed with the Registrar of Companies alongwith Annexures.
18. Details of all the subsidiary companies as under:
 - (a) Authorised and paid-up share capital of the company.
 - (b) List of present shareholders alongwith details of changes in the shareholding patterns during the last five years.

The following information of the transferee company is required by the auditor :

1. Names of the existing directors of the company.
2. List of common shareholders of the companies involved in the amalgamation with individual shareholding.
3. Authorised and paid up capital of the company.
4. Copy of latest audited balance sheet.

The auditors may also require the following records of the transferor company for examination :

1. Books of accounts and relevant records for the last five years.
2. Minutes book of Board and General Meetings.

The students may note that the business financial and other legal aspects of due diligence are dealt under Chapter 9 and 4
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IMPACT OF DUE DILIGENCE ON VALUATION

To arrive at a value of the target company we need to analyze aspects viz. how much should we pay for the target company, how much is the target worth, how does this compare to the current market value of the target company, etc.

Senior management at the acquiring company will delegate the M&A process to a special team of experts responsible for assessing the value of the target company. The composition of the buyer's team is likely different from that of the seller's team because of the buyer's motivation, depending on whether the buyer is strategic or financial. After inspecting the relevant documents, the functional due diligence team provides a summary of findings regarding his or her area of expertise. These summaries are then collected and incorporated into a diligence synthesis and a technical and financial analysis of the target. Expert recommendations are then summarized into an integration recommendation.

As we are aware that the due diligence process helps in identifying the hidden risks/ litigations etc, it helps in arriving at a right price after valuation process, by discounting for the risks identified and vice versa. The techniques of valuations are dealt under Lesson 14, 15 and 16 of Corporate Restructuring, Valuations and Insolvency.

DATA ROOM MANAGEMENT IN STRATEGIC DECISIONS

As regards data room management, security is a critical issue in managing the data room, as sensitive information should not be leaked to the people not covered by nondisclosure or confidentiality agreements executed between the parties. Such information leaks can have detrimental effects on the entire transaction process, and may adversely affect the consideration being paid by a buyer, or the consideration being exchanged in a merger, if either party senses a process damaged or tainted by leaks. A person is generally employed as a coordinator for this purpose and is assigned to manage the operation of the data room by minimizing security and information leaks, recording data room attendance, and searching briefcases and other bags as attendees leave the data room.

The process of collecting the necessary data room documents and information is extensive and time consuming. Data must be compiled, indexed and properly organized and this process takes up valuable resources. Function-wise contact persons are assigned to manage the data room information from their areas. They ensure that their operational area provides the information needed, indexes the relevant documents and information, coordinates with management regarding documents that may be copied, and verifies that information that cannot be copied. Similarly under virtual data room copying or printing of documents may be delayed.

HR AND CULTURAL DUE DILIGENCE IN BUSINESS TRANSACTIONS

Culture is a complex system with a multitude of interrelated processes and mechanisms based on which the organisation functions. It includes vision/mission of the organisation, work flow process, communication mechanism, formal procedures, informal practices, strategy setting mechanism and so on.

Corporate Culture is embedded deeply in the organization and in the behavior of the people there. It is not necessarily equal to the image the company gives itself in brochures and on the website. Therefore, it is difficult to determine an organization's culture from the outside. Especially in pre-merger negotiations – when time and confidentiality are critical factors while trust still needs to be established – it can be a challenging task to find out if the cultures of the potential partners fit together.

The issues of cultural integration and the issues of human behaviour need to be addressed simultaneously if not well before the issues of financial and legal integration are considered. Implementation of structural

nature may be financially and legally successful. But if cultural issues are ignored, the success may only be transient.

According to KPMG Study 83% of all mergers and acquisitions failed to produce any benefit for the shareholders and over half actually destroyed value. It revealed that the overwhelming cause for failure is the people and cultural difference. Difficulties encountered in M & As are amplified in cross-cultural situations, when the companies involved are from two or more countries.

Culture of an organization means the sum total of things the people do and the things the people do not do. Behavioral patterns get set because of the culture. These patterns create mental blocks for the people in the organization. Pre-merger survey and summarization of varying cultures of different companies merging, needs to be carried out. People belonging to the each defined culture need to be acquainted with other cultures of other merging companies. They need to be mentally prepared to adopt the good points of other cultures and shed the blockades of their own cultures. Such an open approach will make the fusion of cultures and ethos easy and effective.

The successful merger demands that strategic planners are sensitive to the human issues of the organisations. For the purpose, following checks have to be made constantly to ensure that:

- sensitive areas of the company are pinpointed and personnel in these sections carefully monitored;
- serious efforts are made to retain key people;
- a replacement policy is ready to cope with inevitable personnel loss;
- records are kept of everyone who leaves, when, why and to where;
- employees are informed of what is going on, even bad news is systematically delivered. Uncertainty is more dangerous than the clear, logical presentation of unpleasant facts;
- training department is fully geared to provide short, medium and long term training strategy for both production and managerial staff;
- likely union reaction be assessed in advance;
- estimate cost of redundancy payments, early pensions and the like assets;
- comprehensive policies and procedures be maintained up for employee related issues such as office procedures, new reporting, compensation, recruitment and selection, performance, termination, disciplinary action etc.;
- new policies to be clearly communicated to the employees specially employees at the level of managers, supervisors and line manager to be briefed about the new responsibilities of those reporting to them;
- family gatherings and picnics be organised for the employees and their families of merging companies during the transition period to allow them to get off their inhibitions and breed familiarity.

Why is corporate culture that important?

Corporate culture influences the performance of an organization, since it determines

- Style of tackling problems
- Method or style of communication
- Adaptability of employees
- Organization commitment to strategies and ultimately to vision and mission etc

A perfect integration would develop a new culture from both former cultures of the partners. Ideally, this new culture should include the best elements from both organizations.

Corporate culture influences the performance of an organization, since it determines:

1. Style of organizational functioning
2. Adaptability of people to changes
3. The way people interact with each other
4. The way the organization interacts with stakeholders
5. Level of commitment

Types of Cultural differences

There are three types of cultural differences:

1. Cross-national differences (especially in cross-border mergers),
2. Cross-organizational differences,
3. Cross-functional differences.

Areas of differences in cultural aspects:

- Organizational values
- Management culture and leadership styles
- Organizational myths and stories
- Organizational taboos, rituals
- Cultural symbols

Ideally, this new culture should include the best elements from both organizations.

Survey by Accenture and Economist Intelligence Unit

Accenture and the Economist Intelligence Unit in the first half of 2006, surveyed senior executives in North America, Europe and Asia on their mergers and acquisitions (M&A) activities and their experience in integrating companies. Similar survey was also administered to 156 executives based in India during the fourth quarter of 2006.

Of the total respondents in India, 40% were senior-level. About 64% were from companies that had global annual revenues of US\$100m or more and 36% had revenues of US\$1bn or more. 45% executive mainly played roles in strategy and business development and 42% in general management. Their companies were from a wide range of industries, including financial services (25%), IT and technology (21%) and professional services (13%).

The Key findings of the Survey

Human and Cultural Factors

Accenture Survey points out that for integrating a cross border company, 43%, respondents found addressing cultural issues as critical. The real challenge, after an acquisition is, therefore, the integration of the two companies. That is why the integration should be given a focused attention. There should be a focus on aligning the acquired company's processes through the business excellence model.

Human Factor

Studies on post-acquisition performance have primarily been a centre of interest of researchers in strategy, economics and finance. The identified factors of performance variations have usually ranged from the industry match (complementary of assets, similarities of markets and products, synergies in production, strategic orientation, etc.), pricing policy, financing and size of the operation and type of the transaction, bidding conditions, etc.

By contrast to quantitative measurements from finance and economics, the research, which has focused on the organizational and human side of M & As, has mostly dealt with identifying factors that might have played a role in the integration process of the merging entities and led to successful outcomes. Despite the absence of a direct causal correlation, several dimensions have been identified as having an important impact on M&A performance, these include psychological, cultural and managerial factors, knowing that the human factor covers at the same time employees and managers of the companies.

Psychological Factors

A large part of the existing research has looked at the psychological effects of M&A on employees. Scholars have pointed out that strong impact that the operations could have on employees, in particular the resulting increase in stress and anxiety due to changes in work practices and tasks, managerial routines, colleagues environment, the hierarchy, etc. Further, merger and acquisitions often introduce an environment of uncertainty among employees about job losses and future career development. It has been pointed out that stress and insecurity may lead to employee resistance to change, absenteeism and lack of commitment to work and the organisation. Employee resistance prevents the building up of a well functioning organisation and constructive cooperative environment. Lack of work commitments have a negative impact on individual and organizational performance measured in terms of productivity, quality, and service. Moreover, a relationship between organizational and financial performance has also been identified which may have consequences for the market value of company.

On the other hand, it has been argued that satisfied employees are presumed to work harder, better, and longer with higher productivity records. Even though a direct relationship between job satisfaction and corporate performance remains to be established with certainty, it appears that lower job satisfaction is a cause of higher absenteeism, which, in turn is shown to have a negative influence on organizational performance.

Cultural factors

Cultural differences look like playing both ways. Although distant cultural environments make the integration process harder, the lack of culture-fit or cultural compatibility has often been used to explain M&A failure. Cultural differences have also been considered a source of lower commitment to work, making co-operation more difficult, particularly from employees of the acquired company. In this regard, scholars have largely given account of the lack of co-operation momentum stemming from a “we” versus “them” attitude, resulting in hostility among employees.

It is, therefore, no surprise that strong cultural differences are usually associated with a negative impact on M&A performance, since the integration process is less easy and deals with higher employee resistance, communication problems, and lower interest in co-operation. Noticeably, cultural clashes are likely to be more prominent in cross-national than domestic acquisitions, since such mergers bring together not only two companies that have different organizational cultures but also organizational cultures rooted in national diversity. The scholars have identified building up of a common culture as essential for the success of merger and acquisitions. Researchers have found that high levels of employees' social identification with the

organization's identity results in increased work effort, higher performance, reduced staff turnover and more frequent involvement in positive organizational citizenship.

Cultural Due Diligence

Cultural Due Diligence (CDD) is the process of identifying, assessing, investigating, evaluating and defining the cultures of two or more distinct corporates through a cultural analysis so that the similarities and differences that impact the merged organization are identified and remedial actions are taken well in advance. It should be carried along with M&A due diligence stage itself. The findings of cultural due diligence would be the base for post integration strategies.

Scope of Cultural Due diligence

The Cultural Due Diligence process covers

1. Leadership, Strategies and Governing principles: It covers vision, mission, values, business strategy development, leadership effectiveness, ethics, board room practices, role of independent directors etc.,
2. Relationships and behaviors: It covers trust, inter/intra group relationships, community and customers
3. Communication: feedback, information sharing, employee trust in information
4. Infrastructure: formal procedures, processes, systems, policies, structure and teams
5. Involvement & Decision Making: authority levels, accountability, expectations and the decision making process
6. Change Management: creativity, innovation, recognition, continuous learning and diversity
7. Communication platforms
8. Finance: perception of financial health and the role of the employee and the level of financial comprehension and impact on the business

Cultural Due Diligence is the process which analyzes the cultural aspects which includes:

- leadership vision
- management practices,
- governing principles,
- policies and procedures
- informal practices,
- relationship management,
- employee satisfaction,
- customer satisfaction,
- key business drivers,
- organizational characteristics,
- organizational perceptions
- communication mechanism etc.

Questions being analysed in Cultural Due Diligence

The following questions are being analysed for determining the different corporate culture.

1. What are the primary issues driving the business strategy?

2. What are the levels of relationship with the board and the senior management?
3. What is the nature of the relationship between groups and units in the organization?
4. What formal and informal systems are in place and what part do they play in the daily life of doing the work?
5. How do people dress and address each other?
6. How do the office ambience differ?
7. What are the working hours?
8. What are the variations in utilization of technology in daily routine?
9. How actual work is performed?
10. How authority and responsibility is allocated?
11. How the performance evaluation is done and reward is granted?
12. What are the reporting relationships in the organization?
13. What are the supervisory practices in the organization?

The above questions indicate that the corporate culture is basically focused on:

1. Leadership style and management practices.
2. Manner of organizational functioning.
3. Employees.

How to address Cultural Differences during merger?

1. Formation of strategies for cultural integration.
2. Analyzing the existing cultures.
3. Identifying common aspects and differences.
4. Decide if you want to go on with one of the existing cultures or if you prefer an integration culture.
5. Establish 'bridges' between both companies.
6. Establish a basis and mechanisms for the new culture.
7. Extensive interaction with people.

The following mechanism may help in resolving cultural differences:

1. Newsletters and hotlines.
2. Workshops.
3. Surveys, questionnaires and feedback analysis.
4. Synergy teams.
5. Continuous interactions.

CORPORATE GOVERNANCE DUE DILIGENCE

FACTORS INFLUENCING QUALITY OF CORPORATE GOVERNANCE

Quality of governance primarily depends on following factors:

- (i) Integrity of the management;

- (ii) Ability of the Board;
- (iii) Adequacy of the processes;
- (iv) Commitment level of individual Board members;
- (v) Quality of corporate reporting;
- (vi) Participation of stakeholders in the management.

While corporate governance is an important element affecting the long-term financial health of companies, it is only part of the larger economic context in which companies operate. The corporate governance framework depends on the legal, regulatory and institutional environment, business ethics and awareness of the environmental and societal interests of the constituencies in which it operates.

The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for taking key investment decisions. International flow of capital enable companies to seek financing from a larger pool of investors. If companies are to reap the full benefits of the global capital market, capture efficiency gains, benefit by the economies of scale and attract long term capital, adoption of corporate governance standards must be credible, consistent, coherent and inspiring.

As the final analysis the factors which add greater value through Good Governance, may be summarized as follows:

- Adoption of good governance practices provides stability and growth to the enterprise.
- Good governance system, demonstrated by adoption of good corporate governance practices, builds confidence amongst stakeholders as well as prospective stakeholders.
- Investors pay higher price to the corporates demonstrating strict adherence to internationally accepted norms of corporate governance.
- Effective governance reduces perceived risks, consequently reduces cost of capital and enables Board of directors to take quick and better decisions which ultimately improves bottom line of the corporates.
- Adoption of good corporate governance practices provides long-term sustainability and strengthens stakeholders' relationship.
- A good corporate citizen becomes an icon and enjoys a position of respect.
- Potential stakeholders aspire to enter into relationships with enterprises whose governance credentials are exemplary.

ASPECTS TO BE ANALYSED DURING CG DUE DILIGENCE

The following aspects are to be analysed during corporate governance due diligence. This is not an exhaustive list.

I. BOARD INDEPENDENCE & GOVERNANCE

Board Composition

- (i) Is the Chairperson an Executive Chairperson?
- (ii) If Chairperson is Executive, does 50% or more of the Board consist of Independent directors?
- (iii) If the non-executive Chairperson is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, does 50% or more of the Board consist of Independent directors?

- (iv) If the non-executive Chairperson is not a promoter of the company or is not related to any promoter or person occupying management positions at the Board level or at one level below the Board, does 1/3rd or more of the Board consist of Independent directors?
- 3. The proportion of Independent Directors to total number of Directors.
- 4. Senior/lead independent director if any, if the offices of Chairperson and Chief Executive Officer are not held by different persons.
- 5. written policy/ procedure if any for induction of Independent Directors.
 - 1. Disclosure if any in the Annual Report the basis on which independent directors are nominated on the Board
 - 2. Letter of appointment of non-executive directors.
 - 3. Maximum tenure of independent directors if any specified.
 - 4. Details of Separate meetings of independent directors.
 - 5. Details of Orientation programme/training of directors.
 - 6. Details of D&O insurance if any provided.
 - 7. Gap between resignation and appointment of independent directors.
 - 8. Details of affirmative statement from each of the independent directors that they meet the criteria of independence(Annual and at the time of appointment).

II. BOARD SYSTEMS AND PROCEDURES

- 1. Details of Circulation of Agenda.
- 2. Details of Board meetings.
- 3. Attendance in Board Meeting.
- 4. Details of meeting through video conferencing.
- 5. List of applicable laws if any maintained by the company.
- 6. Information/Certificate to the Board on statutory compliances.
- 7. Communication of Board decisions to various departments.
- 8. Details of written Code of Conduct for Directors, Senior Management and other Employees.
- 9. Policy on succession planning at senior management level (just one level below the Board),
- 10. Policy on Action Taken Report.
- 11. Policy on reviewing the effectiveness of Board and its members.
- 12. Share dealings by Directors and his relatives.

III. BOARD COMMITTEES

- 1. Names of Board committees, its terms of reference, composition and meetings.
- 2. Details of chairperson of Board committees.
- 3. Proportion of independent directors in Audit Committee.
- 4. Risk assessment process by Audit Committee.
- 5. Process of reviewing the related party transactions by the Audit Committee.
- 6. Details of financial experts in the Audit Committee.
- 7. Communication mechanism between internal auditor, Audit Committee and CFO.

8. Details of rotation of Auditors/audit partners.
9. Details of pending investor grievances.

IV. TRANSPARENCY AND DISCLOSURE COMPLIANCES

Disclosures in the Annual Report

1. Details of disclosures in the Annual Report.
2. Disclosure on the details of remuneration paid to Board members.
3. Disclosure on related party transaction.
4. Disclosure on material cases pending against the company.
5. Details of directors appointed or proposed to be appointed.
6. Means of communication.
7. Details of filings with corp filing portal.
8. Disclosures on insider trading.
9. Disclosure of CEO/CFO on compliance under Clause 49.
10. Compliance of Secretarial Standards issued by ICSI.
11. Compliance of Accounting Standard/Cost Accounting Standard (if applicable).
12. Details of Secretarial Audit if any.
13. Adverse remarks in Audit Report, Cost Audit Report, Secretarial Audit Report.
14. Disclosure of directors relationship inter-se.
15. Details of corporate disclosure policy.

V CONSISTENT SHAREHOLDER VALUE ENHANCEMENT

1. Growth in network.
2. Details of dividend paid.
3. Dividend policy, if any.
4. EPS
5. Details of public shareholdings.
6. Details of investor satisfaction survey, if any.

VI. OTHER STAKEHOLDERS VALUE ENHANCEMENT

1. Details of Vendor/Supplier/Customer Satisfaction surveys.
2. Personnel policy.
3. Policy on employee participation in management.
4. Policy on ESOPs
5. Policy on prevention of sexual harassment.
6. Vendor Development policy.

VII. CORPORATE SOCIAL RESPONSIBILITY

1. Policy on CSR, if any.

2. CSR/Sustainability Report, if any.
3. Energy conservation initiatives.
4. Water/waste management initiatives.
5. Budget for CSR activities.

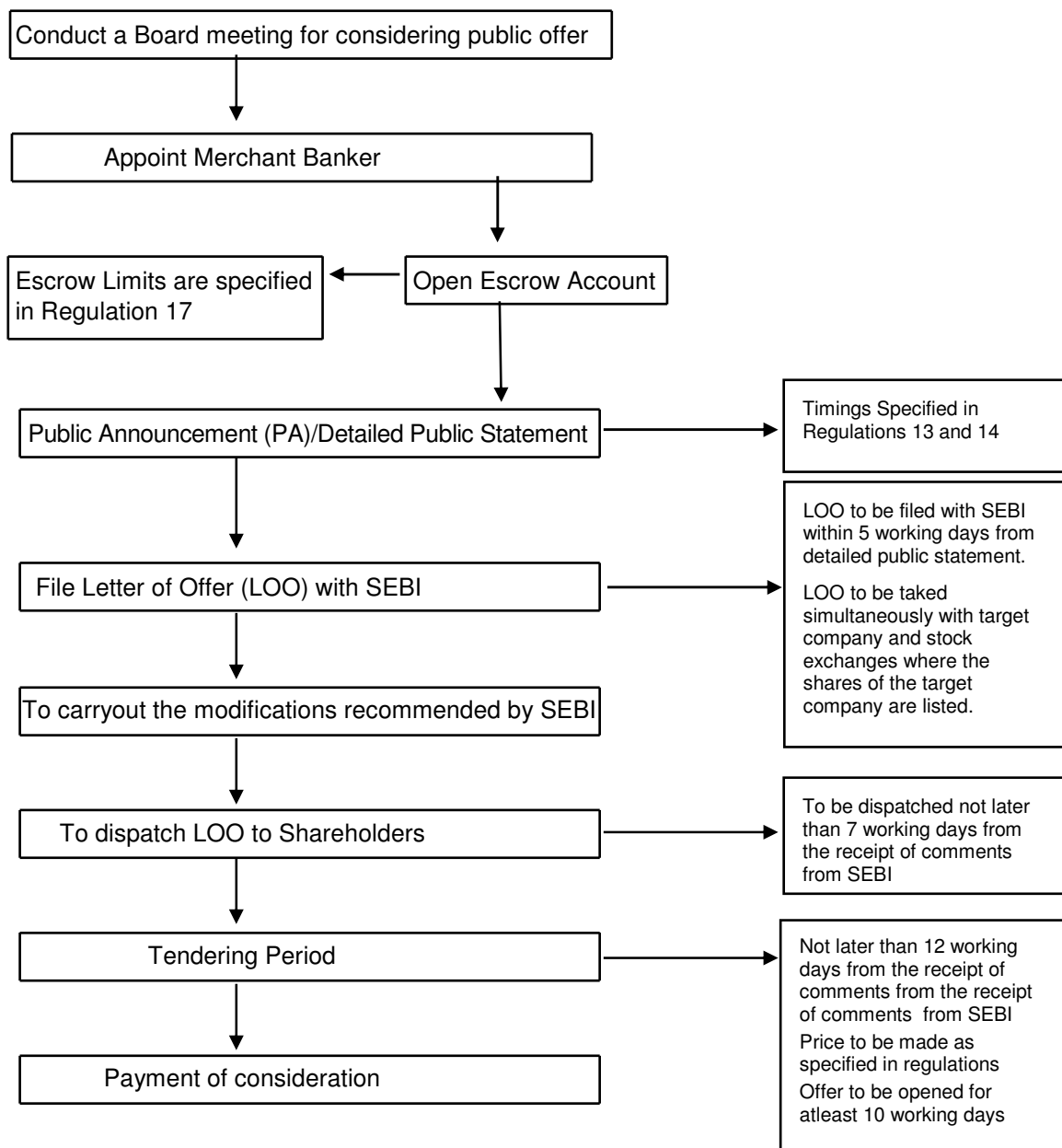
TAKEOVERS DUE DILIGENCE

Takeover process under SEBI (SAST) Regulation 2011 – An Overview

The compliances relating to takeovers include disclosure requirements (event based/continuous disclosures), take over process etc., are dealt in SEBI (Substantial Acquisition of Shares and Take overs) Regulations, 2011.

Students are advised to refer to Lesson 9 of Corporate Restructuring, Insolvency and Valuations Paper for Introductory Framework and disclosure requirement. The process being followed are dealt below:

The following chart gives an overview of takeover process in India, when there is no competitive bid.



CHECKLISTS ON TAKEOVERS

A. Checklist for Acquirer

Preliminary Examination of a target company:

The acquirer has to undertake a preliminary study on the target company, before taking any action for taking over a company. He may consider the following points.

It may be noted that this list is not an exhaustive checklist and it varies depends on size of the company nature of industry

- (a) Information has to be collected on Target Company and to be analysed on financial and legal angle.
- (b) Register of members to be examined to verify the profile of the shareholders.
- (c) Title of the target company with respect to immovable properties may be verified.
- (d) Financial statements of Target Company have to be examined.
- (e) Examination of Articles and Memorandum of Association of the Company.
- (f) Examination of charges created by the Company
- (g) Applicability of FEMA provisions if any relating to FDI has to be looked into.
- (h) Import and Export of technology if any
- (i) Business prospects etc.

A merchant Banker of Category I have to be appointed. It has to be ensured that the merchant banker is not an associate of or group of acquirer or the target company

Escrow Account:

- (i) An escrow account has to be opened and the following sum has to be deposited.
- (ii) The escrow amount shall be calculated in the following manner, as specified in regulation 17,—

For consideration payable under the public offer,—

On the first 500 crores	25 per cent; of the consideration
On the balance consideration	an additional amount equal to 10% of balance consideration.

If, an open offer is made conditional upon minimum level of acceptance, hundred percent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, shall be deposited in cash in the escrow account.

(2) The consideration payable under the open offer shall be computed as provided for in sub-regulation (2) of regulation 16 and in the event of an upward revision of the offer price or of the offer size, the value of the escrow amount shall be computed on the revised consideration calculated at such revised offer price, and the additional amount shall be brought into the escrow account prior to effecting such revision.

(3) The escrow account referred to in sub-regulation (1) may be in the form of,—

- (a) cash deposited with any scheduled commercial bank;

- (b) bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or
- (c) deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin:

Provided that securities sought to be provided towards escrow account under clause (c) shall be required to conform to the requirements set out in sub-regulation (2) of regulation 9.

Regulation 9(2) specifies the following requirements.

- (a) such class of shares are listed on a stock exchange and frequently traded at the time of the public announcement;
- (b) such class of shares have been listed for a period of at least two years preceding the date of the public announcement;
- (c) the issuer of such class of shares has redressed at least ninety five per cent. of the complaints received from investors by the end of the calendar quarter immediately preceding the calendar month in which the public announcement is made;
- (d) the issuer of such class of shares has been in material compliance with the listing agreement for a period of at least two years immediately preceding the date of the public announcement:

Provided that in case where the Board is of the view that a company has not been materially compliant with the provisions of the listing agreement, the offer price shall be paid in cash only;

- (e) the impact of auditors' qualifications, if any, on the audited accounts of the issuer of such shares for three immediately preceding financial years does not exceed five per cent. of the net profit or loss after tax of such issuer for the respective years; and
- (f) the Board has not issued any direction against the issuer of such shares not to access the capital market or to issue fresh shares.

(4) In the event of the escrow account being created by way of a bank guarantee or by deposit of securities, the acquirer shall also ensure that at least one per cent of the total consideration payable is deposited in cash with a scheduled commercial bank as a part of the escrow account.

(5) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the acquirer shall while opening the account, empower the manager to the open offer to instruct the bank to issue a banker's cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account, in accordance with requirements under these regulations.

(6) For such part of the escrow account as is in the form of a bank guarantee, such bank guarantee shall be in favour of the manager to the open offer and shall be kept valid throughout the offer period and for an additional period of thirty days after completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer.

(7) For such part of the escrow account as is in the form of securities, the acquirer shall empower the manager to the open offer to realise the value of such escrow account by sale or otherwise, and in the event there is any shortfall in the amount required to be maintained in the escrow account, the manager to the open offer shall be liable to make good such shortfall.

(8) The manager to the open offer shall not release the escrow account until the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of

the open offer, save and except for transfer of funds to the special escrow account as required under regulation 21.

(9) In the event of non-fulfillment of obligations under these regulations by the acquirer the Board may direct the manager to the open offer to forfeit the escrow account or any amounts lying in the special escrow account, either in full or in part.

(10) The escrow account deposited with the bank in cash shall be released only in the following manner,—

- (a) the entire amount to the acquirer upon withdrawal of offer in terms of regulation 23 as certified by the manager to the open offer:

Provided that in the event the withdrawal is pursuant to clause (c) of sub-regulation (1) of regulation 23, the manager to the open offer shall release the escrow account upon receipt of confirmation of such release from the Board;

- (b) for transfer of an amount not exceeding ninety per cent of the escrow account, to the special escrow account in accordance with regulation 21;
- (c) to the acquirer, the balance of the escrow account after transfer of cash to the special escrow account, on the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer;
- (d) the entire amount to the acquirer upon the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, upon certification by the manager to the open offer, where the open offer is for exchange of shares or other secured instruments;
- (e) the entire amount to the manager to the open offer, in the event of forfeiture for non-fulfillment of any of the obligations under these regulations, for distribution in the following manner, after deduction of expenses, if any, of registered market intermediaries associated with the open offer,—
 - (i) one third of the escrow account to the target company;
 - (ii) one third of the escrow account to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009; and
 - (iii) one third of the escrow account to be distributed pro-rata among the shareholders who have accepted the open offer.

Undertakings/Authorisation:

Ensure to obtain following undertakings/authorization.

1. A letter duly authorizing Target Company to realize the value of escrow account in terms of Takeover Regulations.
2. An undertaking to Target Company that none of the Acquirer/Persons Acting in Concert have been prohibited by SEBI from dealing in securities, in terms of direction issued under Section 11B of SEBI Act.
3. An undertaking from the sellers, promoters, directors of the Target Company that they have not been prohibited by SEBI from dealing in securities, in terms of direction issued under Section 11B of SEBI Act.
4. An undertaking from the Target Company that it has complied with the provisions of Listing

Agreement, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.

5. An undertaking from the Target Company that it has complied with the provisions of SEBI (SAST) Regulations, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.

Public announcement (PA):

1. Public announcement.

SEBI (SAST) Regulation, 2011 provides that whenever Acquirer acquires the shares or voting rights of the Target Company in excess of the limits prescribed under Regulation 3 and 4, than Acquirer is required to give a Public Announcement of an Open Offer to the shareholder of the Target Company. During the process of making the Public Announcement of an Open Offer, the Acquirer is required to give Public Announcement and publish Detailed Public Statement. The regulations have prescribed the separate timeline for Public Announcement as well as for Detailed Public Statement.

- (i) Public Announcement
- (ii) Detailed Public Statement

Timing of Public Announcement

The Public Announcement shall be sent to all the stock exchanges on which the shares of the target company are listed. Further, a copy of the same shall also be sent to the Board and to the target company at its registered office within one working day of the date of the public announcement. The time within which the Public Announcement is required to be made to the Stock Exchanges under different circumstances is tabulated below:

Applicable Regulation	Particulars	Time of making Public Announcement to Stock Exchange
13(1)	Agreement to Acquirer Shares or Voting Rights or Control Over The Target Company	On the same day of entering into agreement to acquire share, voting rights or control over the Target Company.
13(2)(a)	Market Purchase of shares	Prior to the placement of purchase order with the stock broker.
13(2)(b)	Acquisition pursuant to conversion of Convertible Securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares	On the same day when the option to convert such securities into shares is exercised.
13(2)(c)	Acquiring shares or voting rights or control pursuant to conversion of Convertible Securities with a fixed date of conversion	On the second working day preceding the scheduled date of conversion of such securities into shares.
13(2)(d)	In case of disinvestment	On the date of execution of agreement for acquisition of shares or voting rights or control over the Target Company.

13(2)(e)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are not met	Within four working days of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(f)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are met	On the same day of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(g)	Acquisition of shares, voting rights or control over the Target Company pursuant to Preferential Issue	On the date when the Special Resolution is passed for allotment of shares under Section 81(1A) of Companies Act 1956.
13(2)(h)	Increase in voting rights pursuant to a buy-back not qualifying for exemption under Regulation 10	Not later than 90th day from the date of increase in voting rights.
13(2)(i)	Acquisition of shares, voting rights or control over the Target Company where the such acquisition is beyond the control of acquirer	Not later than two working days from the date of receipt of such intimation.
13(3)	Voluntary Offer	On the same day when the Acquirer decides to make Voluntary Offer.

Timing of Detailed Public Statement

In terms of Regulation 13(4) of SEBI (SAST) Regulations, 2011, a Detailed Public Statement shall be published by the acquirer through the Manager to the Open Offer within maximum 5 working days from the date of Public Announcement.

However in case of Indirect Acquisition where none of condition specified in Regulation 5(2) are satisfied, the Detailed Public Statement shall be published not later than five working days of the completion of the primary acquisition of shares or voting rights in or control over the company or entity holding shares or voting rights in, or control over the target company.

Publication of Public Announcement and Detailed Public Statement

Regulation 14 of SEBI (SAST) Regulation, 2011 provides the requirements relating to publication of Public

Announcement and Detailed Public Statement which are tabulated below:

Regulation	Particulars	Time	To whom
14(1)	Public Announcement	On the same day	All the stock exchanges on which the shares of the target company are listed. The stock exchanges shall forthwith disseminate such information to the public.
14(2)	Public Announcement	One working day of the date of the public announcement	Board and to the target company at its registered office
14(3)	Detailed Public Statement	5 working days from the date of Public Announcement.	Publication in the following newspaper: (a) One Hindi national language daily with wide circulation (b) One English national language daily with wide circulation (c) One regional national language daily with wide circulation language at a place where registered office of the company is situated. (d) One regional language daily with wide circulation at the place of the stock exchange where the maximum volume of trading in the shares of the target company is recorded during the sixty trading days preceding the date of the public announcement.
14(4)	Detailed Public Statement		A copy of 'Detailed Public Statement shall be sent to followings: (a) Board (b) All the stock exchanges in which the shares of the target company are listed (c) The target company at its registered office

Contents of Public announcement (Regulation 15)

The public announcement shall contain such information as may be specified, including the following,—

- (a) name and identity of the acquirer and persons acting in concert with him;

- (b) name and identity of the sellers, if any;
- (c) nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;
- (d) the consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;
- (e) the offer price, and mode of payment of consideration; and
- (f) offer size, and conditions as to minimum level of acceptances, if any.

(2) The detailed public statement pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.

(3) The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations shall not omit any relevant information, or contain any misleading information.

Filing Draft Letter of offer

Within 5 working days of publication Detailed Public Statement, the acquirer through the manager to the offer is required to file a draft letter of offer with SEBI for its observations.

The Board shall give its comments on the draft letter of offer as expeditiously as possible but not later than fifteen working days of the receipt of the draft letter of offer and in the event of no comments being issued by the Board within such period, it shall be deemed that the Board does not have comments to offer:

Provided that in the event the Board has sought clarifications or additional information from the manager to the open offer, the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

Provided further that in the event the Board specifies any changes, the manager to the open offer and the acquirer shall carry out such changes in the letter of offer before it is dispatched to the shareholders.

Offer price

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

If the target company's shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- Volume weighted average market price for sixty trading days preceding the PA.

If the target company's shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples, and such other parameters that are customary for valuation of shares of such companies.

It may be noted that the Board may at the expense of the acquirer, require valuation of shares by an independent merchant banker other than the manager to the offer or any independent chartered accountant in practice having a minimum experience of 10 years.

The shares of the target company will be deemed to be frequently traded if the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month, in which the PA is made, is at least 10% of the total number of shares of the target company. If the said turnover is less than 10%, it will be deemed to be infrequently traded.

Minimum size:

It has to be ensured that minimum of 26% of voting capital of the company is being offered subject to minimum public holding requirements.

Date of opening of offer:

The date of opening of offer has to be not later than the 12 working days from the date of receipt of recommendation from SEBI.

Period of offer:

The offer to acquire should remain open for a period of minimum 10 days.

Competitive Bid and Revision:

Ensure to revise the offer price in consultation with merchant bankers in case of competitive bid if any.

Payment of consideration (Regulation 21)

For the amount of consideration payable in cash, the acquirer shall open a special escrow account with a banker to an issue registered with the Board and deposit therein, such sum as would, together with cash transferred under clause (b) of sub-regulation (10) of regulation 17, make up the entire sum due and payable to the shareholders as consideration payable under the open offer, and empower the manager to the offer to operate the special escrow account on behalf of the acquirer for the purposes under these regulations.

(2) Subject to provisos to sub-regulation (11) of regulation 18, the acquirer shall complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange or transfer of

securities, to all shareholders who have tendered shares in acceptance of the open offer, within ten working days of the expiry of the tendering period.

(3) Unclaimed balances, if any, lying to the credit of the special escrow account referred to in sub-regulation (1) at the end of seven years from the date of deposit thereof, shall be transferred to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.

Directors of the target company (Regulation 24)

(1) During the offer period, no person representing the acquirer or any person acting in concert with him shall be appointed as director on the board of directors of the target company, whether as an additional director or in a casual vacancy:

Provided that after an initial period of fifteen working days from the date of detailed public statement, appointment of persons representing the acquirer or persons acting in concert with him on the board of directors may be effected in the event the acquirer deposits in cash in the escrow account referred to in regulation 17, one hundred per cent of the consideration payable under the open offer:

Provided further that where the acquirer has specified conditions to which the open offer is subject in terms of clause (c) of sub-regulation (1) of regulation 23, no director representing the acquirer may be appointed to the board of directors of the target company during the offer period unless the acquirer has waived or attained such conditions and complies with the requirement of depositing cash in the escrow account.

(2) Where an open offer is made conditional upon minimum level of acceptances, the acquirer and persons acting in concert shall, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to regulation 17, not be entitled to appoint any director representing the acquirer or any person acting in concert with him on the board of directors of the target company during the offer period.

(3) During the pendency of competing offers, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to in regulation 17, by any acquirer or person acting in concert with him, there shall be no induction of any new director to the board of directors of the target company:

Provided that in the event of death or incapacitation of any director, the vacancy arising therefrom may be filled by any person subject to approval of such appointment by shareholders of the target company by way of a postal ballot.

(4) In the event the acquirer or any person acting in concert is already represented by a director on the board of the target company, such director shall participate in any deliberations of the board of directors of the target company or vote on any matter in relation to the open offer.

Obligation of target company

Once a Public Announcement is made, the board of directors of the Target Company is expected to ensure that the business of the target company is conducted in the ordinary course. Alienation of material assets, material borrowings, issue of any authorized securities, announcement of a buyback offer etc. is not permitted, unless authorized by shareholders by way of a special resolution by postal ballot.

- The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders and a list of persons whose applications, if any, for registration of transfer of shares, in case of physical shares, are pending with the target company.

- After closure of the open offer, the target company is required to provide assistance to the acquirer in verification of the shares tendered for acceptance under the open offer, in case of physical shares.
- Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations and such committee shall be entitled to seek external professional advice at the expense of the target company. The recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer. The recommendation will also be sent to SEBI, Stock Exchanges and the Manager to the offer.

Obligations of the acquirer

(1) Prior to making the public announcement of an open offer for acquiring shares under these regulations, the acquirer shall ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

(2) In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company or of any of its subsidiaries whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period:

Provided that in the event the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall inter alia contain reasons as to why such alienation is necessary.

(3) The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.

(4) The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.

(5) The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under these regulations

Obligations of the manager to the open offer

27.(1) Prior to public announcement being made, the manager to the open offer shall ensure that,—

- (a) the acquirer is able to implement the open offer; and
- (b) firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

(2) The manager to the open offer shall ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post offer advertisement are true, fair and adequate in all

material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under these regulations.

(3) The manager to the open offer shall furnish to the Board a due diligence certificate along with the draft letter of offer filed under Regulation 16.

(4) The manager to the open offer shall ensure that market intermediaries engaged for the purposes of the open offer are registered with the Board.

(5) The manager to the open offer shall exercise diligence, care and professional judgment to ensure compliance with these regulations.

(6) The manager to the open offer shall not deal on his own account in the shares of the target company during the offer period.

(7) The manager to the open offer shall file a report with the Board within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements.

Consequences of Violation of obligations SEBI (SAST) Regulations, 2011

SAST Regulations, 2011 have laid down the general obligations of acquirer, Target Company and the manager to the open offer. For failure to carry out these obligations as well as for failure / non-compliance of other provisions of these Regulations, penalties have been laid down there under. These penalties include:

- directing the divestment of shares acquired;
- directing the transfer of the shares / proceeds of a directed sale of shares to the investor protection fund;
- directing the target company / any depository not to give effect to any transfer of shares;
- directing the acquirer not to exercise any voting or other rights attached to shares acquired;
- debarring person(s) from accessing the capital market or dealing in securities;
- directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
- directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;
- directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;
- directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the open offer consideration;
- directing the acquirer to pay interest of for delayed payment of the open offer consideration;
- directing any person to cease and desist from exercising control acquired over any target company;
- directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

LESSON ROUND UP

- M&A Due Diligence involves preparation stage, Pre diligence, diligence, negotiations, post diligence.
- Due diligence impacts valuation in Mergers
- Business, legal, financial, HR/Cultural and corporate governance aspects are analysed in M&A due diligence process.
- Data room management is an important function in due diligence process.
- Data security is crucial in data room management.
- Many mergers and acquisitions fail due to cultural mismatch.
- SEBI (SAST) Regulations, 2011 regulate takeovers covering open offer requirements, disclosure mandates etc.

SELF TEST QUESTIONS

1. What are the stages of M&A due diligence?
2. Prepare a check list for M&A due diligence
3. How does due diligence impact valuations?
4. Describe corporate governance due diligence?
5. How HR/Cultural issues are addressed in mergers?
6. What is the process involved in takeover?

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Lesson 8

COMPETITION LAW DUE DILIGENCE

LESSON OUTLINE

- Introduction
- Competition Act, 2002- An overview
- Need to comply with competition law
- Due diligence of competition law relating to:
 - various agreements(both existing and proposed)
 - dominance and its likely abuse if any,(existing)
 - Combinations(i.e effect of proposed mergers & Acquisition)
- Competition Compliance Programme

LEARNING OBJECTIVES

Ensuring compliance with competition law, rules etc. is crucial, during strategic business decisions, as the consequences of non-compliance may be serious for concerned companies in terms of investigation by Competition Commission of India(CCI), hefty financial penalties, agreements being unenforceable and void, adverse publicity, damages, possibility of being sued for damages by those harmed by unlawful behaviour and what not.

Due diligence of competition law involves examination of the current/proposed operations and practices of an enterprise to determine the extent of its compliance with the competition law and to identify potential risks and liabilities, and assessment of the adherence to and effectiveness of the company's competition law compliance programme. This process includes examination of business/trade agreements, analysis of proposed mergers/combination, check into the dominance of an organization so that the same is not abused etc.,

After reading this chapter you will be able to understand the broad aspects of due diligence relating to competition law including anti-competitive agreement, abuse of dominance, regulation of combinations, and the relevant checklists, importance of competition compliance programme etc.

I. INTRODUCTION

In the light of international economic development, there was a need felt to shift the focus from curbing monopolies to promoting competition. Further, in the wake of economic reforms in 1991 in tune with international environment, a high level committee on competition law and policy was constituted under the chairmanship of Shri S.V.S. Raghavan to examine the provisions of MRTP Act, and to propose modern competition law in view of liberalization of economy. The Committee brought out its report on May 22, 2000 and the Central Government after a detailed consultative process with Chamber of Commerce, trade associations, professional bodies and general public, enacted the Competition Act, 2002 which received the president's assent on January 13, 2003.

The Competition Act seeks to ensure fair competition by providing for

- (a) Prohibition of Anti-Competitive Agreements;
- (b) Prohibition of Abuse of Dominance;
- (c) Regulation of combinations, acquisitions, mergers etc.,
- (d) Competition Advocacy.

To fulfill the objectives of the Act, government established Competition Commission of India with effect from October 14, 2003. This has replaced the MRTP Commission, which has been dissolved with effect from October 14, 2009.

Need for compliance of Competition Law

The basic purpose of the competition law is to ensure that markets remain competitive, to the benefit of both business and consumers. The compliance by the market participants of competition law, rules and directions issued by competition authorities, is a precondition in achieving the purpose of law.

Why Comply?

Business community needs to be fully aware that while anti competitive business practices may bring about short-term profits to individual corporations, in the long run they in fact become less competitive. Genuine business competitiveness is demonstrated through fierce competition in individual markets, and only competitiveness that survives market competition can sustain itself in the long term.

All businesses have a duty to act lawfully, but there are more practical reasons why compliance with competition law is particularly important. On a broad level, the main aim of competition law is to ensure that markets remain competitive. Compliance ensures that this aim is achieved to the benefit of both business and consumers. At an individual level, businesses that comply with the law could avoid the various consequences of non-compliance.

Further, compliance with competition law is more than just good corporate governance, as it reduces the risk of the company being subject to an investigation by the Competition authorities. In the event of violation of competition law, business can face significant financial penalties, third party actions and loss of reputation and goodwill.

In an era of global competition, voluntary compliance with competition law is becoming a global standard led by the world's most prominent international corporations. This is due to the growing recognition that breach of competition law brings about managerial burdens rather than market benefits to individual companies. Corporations are thus obliged to firmly build up a business philosophy of abiding by established rules of fair market competition. In recognition of these facts, it becomes essential that all companies strive for voluntary observance of fair market discipline, and in the process help lay a cornerstone for a mature culture of corporate compliance.

COMPETITION ACT, 2002 – A BIRD'S EYE VIEW

Anti-competitive agreements (Section 3)

What are Anti Competitive Agreements?

These are agreements between enterprises or association of enterprises in respect of production, supply, distribution, storage, acquisition or control of goods or provisions of services, which cause or likely to cause an appreciable adverse effect on competition within India.

How to determine appreciable adverse effect?

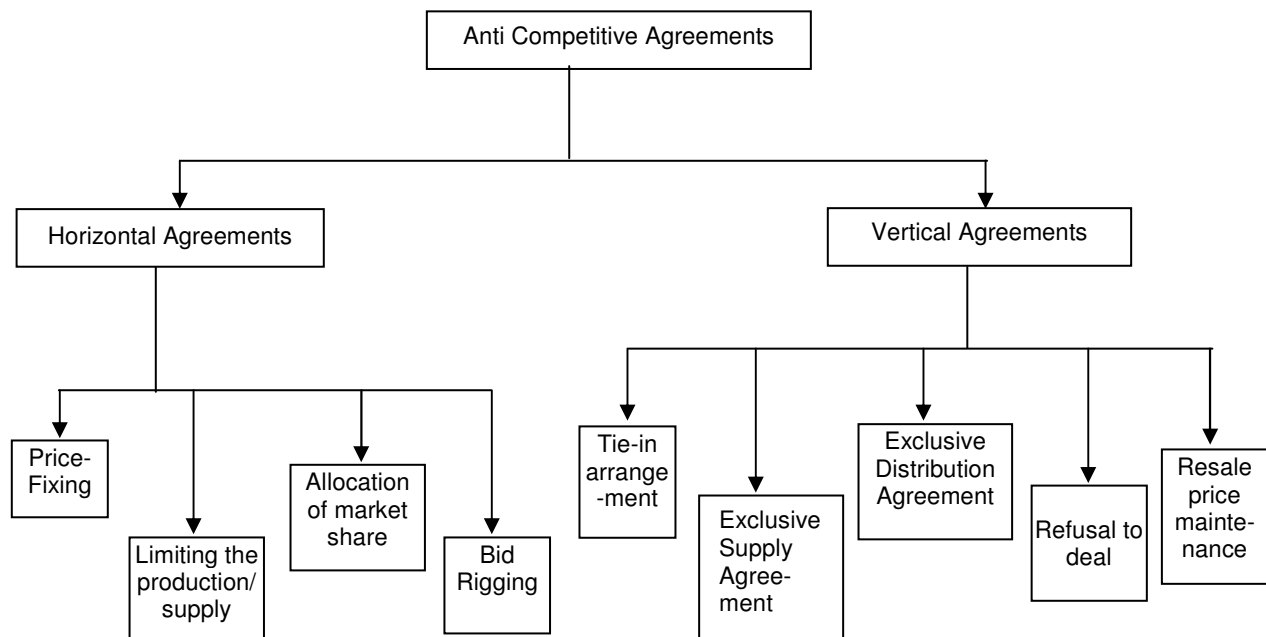
The Commission has been put under obligation, while determining whether an agreement has an appreciable adverse effect on competition under section 3, to have due regard to all or any of the following factors, namely:—

- (a) creation of barriers to new entrants in the market;
- (b) driving existing competitors out of the market;
- (c) foreclosure of competition by hindering entry into the market;
- (d) accrual of benefits to consumers
- (e) improvements in production or distribution of goods or provision of services;
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

What is an Enterprise?

"Enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Anti Competitive Agreements are void (Section 3(2))



Horizontal Agreements (Section 3(3))

Price Fixing (Section 3(3)(a))

Price fixing occurs when two or more firms agree to raise or fix the prices in order to increase their profits by reducing competition. It is an attempt at forming a collective monopoly.

Limiting the Production or supply (Section 3(3)(b))

The object of these agreements or arrangements is to eliminate the competition by limiting the quantity.

Allocation of Market Share (Section 3(3)(c))

It means agreement among enterprises that will have exclusive or preferential rights in a designated area for sale, production or provision of services or otherwise.

Bid Rigging (Section 3(3)(d))

An agreement, between enterprises or persons engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding. Bid rigging is a particular form of collusive price-fixing behaviour by which firms coordinate their bids.

Vertical Agreements (Section 3(4))

These are agreement between enterprises that are at different stages or levels of production chain and therefore in different markets. These agreements are not considered anti-competitive per se as in the case of horizontal agreements and have to be judged by the rule of reason.

Tie in arrangement (Section 3(4)(a))

It an agreement requiring a purchaser of goods as a condition of such purchase, to purchase some other goods.

Exclusive Supply agreement (Section 3(4)(b))

Exclusive supply agreement or exclusive dealings means an arrangement or practice whereby a manufacturer or supplier requires his dealers to deal exclusively in his products and not in the products of his competitors.

Exclusive Distribution Agreement (Section 3(4)(c))

Exclusive distribution agreement or exclusive territory includes agreement between enterprises that will have exclusive or preferential rights in a designated area for sales production, performance of services.

Refusal to Deal (Section 3(4)(d))

The practice of restricting persons or class of persons to whom the goods are sold or from whom the goods are bought.

Resale price Maintenance (Section 3(4)(e))

It is a situation in which the supplier forces the distributor/retail seller to sell the good to the customer at prices stipulated by the supplier.

A case Study on Anti-Competitive Agreement.

Competition Commission of India (CCI) finds cement companies guilty of anti-competitive agreements-cartelization, collusive price, dispatch and supplies parallelism, creating artificial scarcity by limiting output to raise prices

Facts

Information was filed under section 19 of the Competition Act, 2002 by the Builders' Association of India ('the informant') against the Cement Manufacturers' Association (CMA) 11 cement manufacturing companies for alleged violation of section 3 (Anti-competitive agreements) and section 4 (Abuse of dominant position) of the Competition Act, 2002.

Held

- Mere examination of data belonging to period prior to 20-5-2009 cannot be construed to mean that provisions of the Act have been applied retrospectively. Moreover, if the effects of an act/conduct, prior to 20-5-2009 continue post notification of the date of coming into force of provisions relating to anti-competitive agreements, the CCI has the necessary jurisdiction to look into such conduct.
- Section 3(3)(a) deals with any agreement which directly or indirectly determines the purchase or sale prices, section 3(3)(b) deals with any agreement which limits or controls production, supply, markets, technical development, investment or provision of services.
- The word 'agreement' used in section 3(3) has been defined in section 2(b). The definition is inclusive and inter-alia includes any arrangement, understanding or action in concert irrespective of whether it is written/formal or otherwise or intended to be legally enforceable. Thus, there is no need for an explicit agreement. The same can be inferred from the intention or conduct of the parties.
- Parties to an anti-competitive agreement will not come out in open and reveal their identity to be punished by the competition agencies. This is also the reason why the legislature in its wisdom has made the definition of 'agreement' wide and inclusive and not restricted it to a documented written agreement between parties.

- In cases of conspiracy or existence of any anti-competitive agreement, proof of formal agreement may not be available and may be established by circumstantial evidence alone.
- In addition to the exchange of information on prices and production using CMA as platform, there were other 'plus' or 'facilitating' factors over and above the existence of price parallelism which indicated collusive behaviour among the cement companies. One of the 'plus' factors that suggested a concerted action among the cement companies is the finding by the Director General (DG) as regards the overall low capacity utilisation and lower supply of cement. The overall capacity utilisation of cement companies dropped from 83% in 2009-10 to 73% during 2011-12. The companies were not able to substantiate their low capacity utilisation even during the period as per their version.
- The act of these Cement Companies in limiting and controlling supplies in the market and determining prices through an anti-competitive agreement is not only detrimental to the cause of the consumers but also to the whole economy since cement is a crucial input in construction and infrastructure industry vital for economic development of the country.
- The Cement Manufacturers were directed to deposit the penalty of ₹6,300 crores (Approx) within 90 days. They were also directed to 'cease and desist' from indulging in any activity relating to agreement, understanding or arrangement on prices, production and supply of cement in the market.
- CMA was directed to disengage and disassociate itself from collecting wholesale and retail prices through the member cement companies and also from circulating the details on production and dispatches of cement companies to its members.

Abuse of Dominance (Section 4)

As regards Competition Act, 2002, the following points are significant to understand the concept of 'Abuse of Dominance'

1. What is Dominance?

Explanation to Section 4(2) of the Competition Act 2002 defines dominant position (dominance) in terms of a position of strength enjoyed by an enterprise, in the relevant market in India, which enables it to:

- (a) operate independently of the competitive forces prevailing in the relevant market; or
- (b) affect its competitors or consumers or the relevant market in its favour.

2. What is relevant market?

The definition of the term 'Dominant Position' contains the term 'Relevant Market' which is very significant to identify whether an enterprise is in a dominant position or not.

The Competition Act, 2002 defines the term 'Relevant Market' also.

"relevant market" means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;

"relevant geographic market" means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas;

"relevant product market" means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use;

Dominance as such is not bad

Dominance of market as such is not bad under Competition Act, but its' abuse is prohibited under the Act.

The Act gives an exhaustive list of practices that constitute abuse of dominant position and, therefore, are prohibited. Such practices shall constitute abuse only when adopted by an enterprise enjoying dominant position in the relevant market in India.

When Dominance gets abused?

Abuse of dominance is judged in terms of the specified types of acts committed by a dominant enterprise alone or in concert. Such acts are prohibited under the law. Section 4 (2) of the Act specifies the following practices by a dominant enterprises or group of enterprises as abuse of dominant position:

- directly or indirectly imposing unfair or discriminatory condition in purchase or sale of goods or service;
- directly or indirectly imposing unfair or discriminatory price in purchase or sale (including predatory price) of goods or service;
- limiting or restricting production of goods or provision of services or market;
- limiting or restricting technical or scientific development to the prejudice of consumers;
- denying market access in any manner;
- making conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts;
- Using its dominant position in one relevant market to enter into, or protect, other relevant market.

A Case Study - Intel

The European Commission imposed a fine of €1.06 Billion on Intel Corporation for violating EC Treaty antitrust rules on the abuse of a dominant market position by engaging in anti-competitive practices and for excluding competitors from the market for computer chips called x86 central processing units (CPUs).

Facts of the case

Throughout the period October 2002-December 2007, Intel had a dominant position in the worldwide x86 CPU market (at least 70% market share).

The Commission found that Intel engaged in two specific forms of illegal practice.

- First, Intel gave wholly or partially hidden rebates to computer manufacturers on condition that they bought all, or almost all, their x86 CPUs from Intel. Intel also made direct payments to a major retailer on condition to stock only computers with Intel x86 CPUs. Such rebates and payments effectively prevented customers - and ultimately consumers - from choosing alternative products.
- Second, Intel made direct payments to computer manufacturers to halt or delay the launch of specific products containing competitors' x86 CPUs and to limit the sales channels available to these products.

The Commission found that these practices constituted abuse by Intel of its' dominant position on the x86 CPU market that harmed consumers throughout the European Economic Area. By undermining its competitors' ability to compete on the merits of their products, Intel's actions undermined competition and innovation.

The Commission has also ordered Intel to cease ongoing abusive practices immediately.

A brief Analysis of Intel case under Competition Act, 2002

- In the above mentioned case the relevant market is 'Relevant Product Market', and to be more specific, 'Computer Chip Market'
- The dominance is abused on the grounds of 'Denial of Market Access' which is listed as one of the grounds of abuse of dominance, under Section 4(2)(c) of Competition Act, 2002

Regulation of Combinations. (Section 5)

Combination under Competition Act, 2002

Combination means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The thresholds are unambiguously specified in the Act in terms of assets or turnover in India and abroad. Entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India is prohibited and such combination would be void.

Sections 5 and 6 of the Competition Act, 2002 came into force with effect from 1 June 2011

Combinations – Thresholds

The current thresholds for the combined assets/turnover of the combining parties are as follows:

- **Individuals:** Either the combined assets of the enterprises are more than ₹1,500 crore in India or the combined turnover of the enterprise is more than ₹4,500 crore in India. In case either or both of the enterprises have assets/turnover outside India also, then the combined assets of the enterprises are more than US \$750 million, including at least ₹750 crore in India, or turnover is more than US\$ 2,250 million, including at least ₹2.250 crore in India.
- **Group:** The group to which the enterprise whose control, shares assets or voting rights are being acquired would belong after the acquisition or the group to which the enterprise remaining the merger or amalgamation would belong has either than ₹6,000 crore in India or turnover more than ₹18,000 crore in India. Where the group has presence in India as well as outside India then the group has assets more than US \$ 3 billion including at least ₹750 crore in India or turnover more than US\$ 9 billion including at least ₹2,250 crore in India.
- In term Group has been explained in the Act. Two enterprises belong to a "Group" if one is in position to exercise at least 26 percent voting rights or appoint at least 50 per cent of the directors or controls the management or affairs in the other. Vide notification S.O. 481 (E) dated 4 March, 2011met has exempted "Group" exercising less than fifty per cent of voting rights in other enterprise from the provisions of section 5 of the Act for a period of five years.
- In exercise of the powers conferred by clause (a) of section 54 of the Competition Act, 2002, the Central Government, in public interest, hereby exempts an enterprise, whose control, shares, voting rights or assets are being acquired has either assets of the value of not more than ₹250 crore in India or turnover of not more than ₹750 crore in India from the provisions of section 5 of the said Act for a period of five years.

- The above thresholds are presented in the form of a table below:

In India	Applicable to	Assets		Turnover	
	Individual	₹ 1,500 Cr.		₹ 4,500 Cr.	
	Group	₹ 6,000 Cr.		₹ 18,000 Cr.	
In India an outside	Applicable to	Assets		Turnover	
		Total	Minimum Indian Component	Total	Minimum Indian Component out of Total
	Individual parties	\$ 750 m	₹ 750 cr.	\$ 2,250 m	₹ 2,250 cr.
	Group	\$ 3 bn.	₹ 750 cr.	\$ 9 bn.	₹ 2,250 cr.

1 Crore = 10 million

The turnover shall be determined by taking into account the values of sale of goods or services. The value of assets shall be determined by taking the book value of the assets as shown in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed combination falls, as reduced by any depreciation. The value of assets shall also include the brand value, value of goodwill, or intellectual Property Rights etc. referred to in explanation (c) to section 5 of the Act.

Regulation of combinations

Section 6 of the Competition Act, 2002 prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be void.

DUE DILIGENCE OF COMPETITION LAW ASPECTS

Due diligence on competition law aspects is an examination of the actual operations and practices of an enterprise to determine the extent of its compliance with the competition law and to identify potential risks and liabilities, and assess the adherence to and effectiveness of the company's competition law compliance policy and training program.

Primary components of Competition Law due diligence are:

- An examination of selected company documents.
- Interviews with selected company personnel.
- Identify specific business activities that potentially could create antitrust exposure for the company.
- The results of the due diligence may suggest an enterprise to have an effective competition law compliance programme.
- The results of the due diligence may result in variation of deal value, withdrawal of deal and also make suggestions to structure a compliance program.

How to go about the process of due diligence of competition law?

Due diligence of competition law may be made under the following heads:

- (a) Due diligence of various agreements(both existing and proposed)
- (b) Due diligence on dominance and its likely abuse if any,(existing)
- (c) Due diligence on combinations (i.e. effect of proposed mergers & Acquisition)
- (d) Competition law compliance programme of an enterprise

Due Diligence of various agreements include

- agreements relating to production, supply and distribution of goods or services.
- agreement if any with competitor relating to production, marketing or bidding, price etc.
- agreements with customers and distributors.
- purchase agreements.
- non-compete covenants.
- technology transfer/technical know-how agreements.
- Concession agreements

Due diligence on abuse of dominance if any includes

- Examination as to the existence of dominance
- Examination of relevant market, whether product or geographical
- Cases of abuse if any.,

Due diligence on regulation of combinations

The following aspects are to be analysed during due diligence process:

- What is the nature of combination? Whether it is acquisition of share, voting rights, assets or control or merger/amalgamation etc?
- Examination of total value of Assets or Turnover and the valuation methodology.
- Status of merger notification to be filed with CCI
- Status of dominance after merger.

DUE DILIGENCE CHECKLIST FOR COMPLIANCE WITH COMPETITION ACT, 2002**I CHECKLIST FOR ANTI COMPETITIVE AGREEMENTS**

Section 3 of the Competition Act, 2002 dealing with anti-competitive agreements prohibits such agreements or practices, or decision taken which causes or is likely to cause an appreciable adverse effect on competition within India.

An enterprise might enter into horizontal¹ or vertical² agreements during the ordinary course of business. However, when agreements are entered to prevent the competition, such agreements are not in accordance with the principles of fair play in the market, hence anti-competitive.

In this context, it is important to note that the term Agreement³ would include any arrangement or understanding or action in concert whether or not it is formal or in writing; or it is intended to be enforceable by legal proceedings. This definition is an inclusive one and covers not only an agreement as understood in the conventional sense under the Indian Contract Act, but any arrangement or understanding or action in concert. In other words, the form of agreement is of no importance. Not only written agreements are deemed to come within the scope of competition law but also verbal agreements or so-called co-ordinated policies, i.e. deliberate and intended collaboration between individual companies for the purpose of eliminating or restricting competition in a certain market.

The following general principles/checklist should be considered in connection with Horizontal and Vertical Agreements under Section 3.

DO NOT

- jointly determine selling or purchase prices
- jointly determine price increases
- jointly fix specific minimum or maximum prices or price ranges
- jointly agree on rebates, discounts
- agree to adhere to published price lists
- quote a price without consulting potential competitors
- not to charge less than any other price in the market
- grant discounts or special deals on a published list price or ruling price
- hold prices firm
- adopt a standard formula for computing prices or to the formulae by which prices or ancillary terms are to be calculated.
- maintain certain price differentials between different types, sizes, or quantities of products
- adhere to a minimum fee or price schedule
- fix credit terms, discounts or allowances to be granted, transport charges, payments for additional services, credit terms or the terms of guarantees
- not to advertise prices
- accept recommendations of a trade association in relation to price
- indulge in collective price-fixing or price co-ordination of any product⁴
- fix/exchange any price related conditions including discussions related to aspects of pricing with competitors
- share information about prices, discounts, profit margins, cost structures, during meetings of a trade

1 Horizontal agreements mean agreements between companies acting on the same marketing stage, e.g. agreements with competing manufacturers.

2 Vertical agreements mean agreements between companies acting on different marketing stages, e.g. agreements with distributors and customers, licensees, suppliers or licensors.

3 Section 2 (b) of The Competition Act, 2002

4 Regardless of the form it takes for instance, decision that requires members to post their prices at the association's premises or on the association's website etc., as well as any recommendation on prices and charges, including discounts and allowances.

association⁵

- mutually agree not to supply certain customers or not to purchase from certain suppliers
- agree with competitors to make the supply or purchase of goods subject to certain mutually agreed conditions.
- share or allocate markets between competitors in respect of specific territories, products, customers or sources of supply.
- fix production, buying and selling quotas between competitors.
- submit an offer, which is not capable of being successfully honoured/performed.
- brings multiple bids to a bid opening and submits its bid only after coming to know as to who else is bidding.
- make a statement indicating advance knowledge of the offers of the competitors.
- make a statement that a bid is a 'complementary', 'token 'or' cover' bid.
- make statement that the bidders have discussed prices and reached an understanding.
- give the false impression that the enterprise is a party to any anticompetitive agreement.
- discuss among competitors of such matters as need for changes in price levels, prospective production plans, allocation of markets, action aimed at hindering the prospects of competitors, or the like.
- speculate as to the legal propriety or consequences of specific conduct.
- agree in writing or in any other way on prices or pricing policy.
- exchange specific and recent information with competitors on individual purchasing prices, cost price structure, sales quantities or other trading conditions.
- restrict the liberty of competitors to promote and sell products at independently determined prices and conditions.
- restrict the possibilities of competitors to use a common quality label.
- enter into standardisation agreements with competitors that might make entry for new entrant in the market more difficult.
- fix prices other than maximum or recommended prices.
- restrict import or export or the type of customers.
- in case of exclusive distribution: do not restrict passive sales.
- in case of selective distribution: do not restrict sales inside the system.
- restrict use of spare parts that are obtained directly from the manufacturer.

II CHECKLIST FOR ABUSE OF DOMINANT POSITION

Competition Act, 2002 does not prohibit the mere possession of dominant position, but only its abuse, thus

⁵ Joining a trade association where competitors meet is not prohibited, however, any meetings or other activities that involve sharing of information among horizontal competitors can raise competition issues. Accordingly, enterprise participation in such associations must be monitored carefully.

recognizing that a dominant position may have been achieved through superior economic performance. Once it is determined that an enterprise is in dominant position, then the next question that arises is whether there has been an abuse of dominant position. In particular Section 4(2) states that there shall be an abuse of dominant position if an enterprise indulges in any of the activities listed in the sub-section, these being :unfair or discriminatory condition or price including predatory pricing, limiting or restricting production or technical or scientific development, denying market access, imposing supplementary obligations having no connection with the subject of the contract, or using dominance in one market to enter into or protect another relevant market. Thus, the Act provides for five kinds of abuses and the list of abuses is exhaustive, and not merely illustrative.

The abuses referred under section 4(2) of the Competition Act, 2002 include exploitative abuses such as unfair or discriminatory conditions or prices as well as exclusionary abuses such as denial of market access.

DO NOT

- discriminate between different customers.
- abruptly refuse to supply.
- abruptly refuse to provide services.
- discriminate prices or rebates between similar customers.
- take more restrictive measures than are necessary to protect its business interests.
- give Unjustified rebates, discounts or sale incentives.
- discriminate in regard to granting discount, rebate or allowance to a purchaser over and above any granted to his competitors, in respect of sale of goods of like grade, quality and quantity.
- between purchasers differently located.
- provide Discriminatory differential bonus or discount based on quantity.
- provide Discriminatory discounts based on quantities.
- operate the pricing mechanism in such manner that as and when there is a rise in cost of production, the sale price should be changed proportionately.
- discriminate in relation to prices, terms of sale, or the quality or quantity of what is supplied, and may extend to refusal to sell.
- discriminate in terms and conditions in the supply or purchase of goods or services, for example, extension of discriminated credit facilities or ancillary services.
- impose discriminatory or unfair conditions to any category of users, or any other enterprise having contractual relationship with the dominant enterprise.

III CHECKLIST FOR REGULATION OF COMBINATIONS

According to the provisions of the Competition Act, 2002, combinations are discouraged, if they reduce or harm competition. Act does not provide for monitoring all kinds of combinations by the CCI, for the reason that very few Indian companies are of international size and that in the light of continuing economic reforms, opening up of trade and foreign investment, a great deal of corporate restructuring is taking place in the country and that there is a need for mergers, amalgamations etc. as part of the growing economic process

before India can be on an equal footing to compete with global giants, as long as the mergers are not prejudicial to consumer interest.

It is in this context, the provisions relating to combinations in the Act are fairly liberal, in the sense that the thresholds are relatively high, and if the Commission fails to complete the investigation and pass an order regarding the combination within the prescribed time period, the combination is deemed to have been approved.

The Competition Act, 2002 regulates those combinations which, in certain circumstances, causes or is likely to cause an appreciable adverse effect on competition within relevant market in India and renders such a combination as void.

FOLLOWING SHOULD BE AVOIDED

- the acquisition of a potential entrant;
- an acquisition, by the market leader, pre-empting the acquisition by another competitor;
- the acquisition of an existing business by a firm that would likely have entered the market in the absence of the combination;
- an acquisition that prevents expansion into new geographic markets;
- an acquisition that prevents pro-competitive effects of new capacity;
- leveraging dominant position in any market into a vertically related market by combined entity;
- restricting access to an essential input;
- raising barriers to new entry;
- evasion of access or downstream price regulation;
- price discrimination;
- price coordination.

Under the provisions of Competition Act, 2002, no documents, are exempt from disclosure. All documents may be subject to production, including agenda, minutes of the meetings, annual reports, statements relating to corporate information made, discussed at various forums. Hence, it is in the interest of the company to ensure that its employees comply with the Competition Act, 2002.

The above checklist is not to be regarded as covering all competition issues that can arise. Rather, they are intended to educate the officer or employee of the enterprise of some of the common situations in which competition issues may arise. It is pertinent to note that failure to comply with Competition Act, 2002 has serious consequences for the enterprise, its officers, and employees.

NEED FOR COMPETITION COMPLIANCE PROGRAMME

It goes without saying that prevention is always better than cure. When businesses fail to have a compliance program, or when it is ineffective, they are essentially relying on others to bring that failure to their attention. It is far better when companies discover a breach first and act to rectify the problem, rather than the competition authorities bringing the breach to the company's attention. Given today's rigorous competitive environment, a robust competition compliance programme is an absolute must for enterprises.

As every business is unique, so each company requires different steps to ensure compliance with competition law. These depend on a range of factors, including the size and nature of the business, and the

frequency of contact of employees with their competitors. Businesses which are able to significantly affect the market in which they are operating or which have large market shares, may be more vulnerable to allegations of abuse of their strong position in the market. Their agreements may be more likely to have an appreciable adverse effect on competition in the market. Employees or directors of a business who have regular contact with competitors on a business or social basis may run a higher risk of colluding.

A compliance programme therefore provides a formal internal framework for ensuring that businesses, i.e., the management and individual employees, comply with competition law. It may include such elements as training to raise awareness of law, the use of checklists to ensure compliance by individual staff with company policies, recording systems to document any permitted contacts that employees have with competitors and independent reviews of agreements, behavior and staff to monitor ongoing compliance. It can also help identify actual or potential infringements at an early stage, enabling the company to take appropriate remedial action.

When considering whether it is necessary to implement a compliance programme, companies should bear in mind that if they do commit an infringement, the competition authorities may take a lenient view where they can show that they have taken adequate steps to achieve compliance. The larger the business and the greater the risk of infringement, the more likely it is that adequate steps will include the introduction of a compliance programme. As a starting point it is helpful to assess the extent to which competition law will affect the business and the risk of committing an infringement. In case the risk of infringement is high, more elaborate measures may be required to ensure compliance.

Further, if employees understand competition law, they will also be able to recognize when the business is a victim of anti-competitive agreements or conduct, and be better-placed to protect the business' interests by making a reasoned complaint to the Competition Commission.

Compliance programmes have following three main purposes:

- (i) they strive to prevent violation of law,
- (ii) promote a culture of compliance, and
- (iii) encourage good corporate citizenship.

As the consequences of infringement can be serious a compliance programme must be capable of meeting the changing requirements of business and must make efforts as part of the regular evaluation process to ensure that the compliance programme continues to be relevant.

Competition Compliance programme help reduce legal costs in the short run by enabling the enterprise to avoid violation of competition laws, while in the long run, they increase corporate competitiveness by raising the value of an enterprise. The prescription of behavioral standards under the compliance programme not only prevents officers and employees of an enterprise from unconsciously violating the competition laws, but at the same time, relieve the employees of the fear that accompanies breach of such laws. The enterprises also save time and money by securing the following benefits from compliance programme:

- Corporate officers and employees being well aware of the requirements of competition law may maintain legal transparency.
- Corporate officers have advance perception concerning the activity of employees that might violate competition laws.
- Corporate officers and employees can avoid civil and criminal liability resulting from violation of competition laws.

The costs of legal counseling and litigation incurred from investigation and prosecution of acts of violation, as well as penalties, negative publicity, and disruptions in normal corporate operation, can be reduced.

An effective compliance programme equips the enterprise with the capacity to demonstrate due diligence to the competition authorities. This is a benefit that can make the cost and effort in putting in place a compliance program seem the best possible investment by company. This is because the amount of time the corporate professionals, who have encountered regulatory action, have had to devote in dealing with enforcement action, when they could be better focussed on more constructive activities of the company. This is not to ignore the cost involved in employing lawyers or paying fines or damages, and the negative impact on the business brand if found to be in breach of the law. There is evidence to suggest a strong link between effective compliance programme and maintaining the reputation of an enterprise and its brands.

Compliance embodied by a well-managed and adequately resourced corporate governance system, is aimed at a business enabler. In a paper presented at an Australian compliance forum, the author summarises that the importance of a good governance system, a holistic approach to compliance, can not be over emphasised: in an increasingly responsive stakeholder environment managing regulatory risk and being committed to the principles of good governance is vital to overall strategic management⁶.

One of the greatest potential benefits of a vigorous compliance program is the ability to protect the company from being a victim of waste, fraud and abuse. The very same techniques that help prevent a company from harming others, also helps protect the company from being victimised.

Advantages of Competition Compliance Programme

Competition Compliance programme offers various advantages to the companies during its ordinary course of business. Broadly, the advantages of Competition Compliance programme can be classified as under:

Positive Benefits to Business

An effective compliance programme that embeds a culture of compliance throughout the organisation can be a business enhancer offering positive benefits to business. A superior knowledge of the risks faced by the organisation and of the measures in place to guard against those risks can provide a company with a competitive advantage. When employees are aware of their rights and obligations, customer service improves and the employees become more alert and better able to deal with unlawful conduct that the company may be subjected to. A company can obtain value from good governance and compliance, develop a better culture, sustain itself for long term and maintain its reputation, and may avoid or reduce the negative effects of litigation and regulatory intervention.

Reputation and Goodwill

Companies that contravene the competition law may suffer damage to their reputation, unraveling years of careful marketing and brand development. In the era of information age it is more difficult to escape events that in the past were consigned to fading memories and dusty library shelves. Information on past misconduct by companies can now be retrieved at the stroke of a keyboard.

Mitigation of penalties

In the event, Competition Commission institutes proceedings, the verifiable presence of a compliance programme and culture, and its successful implementation, can be scrutinised by the competition authorities/courts when the quantum of penalty is determined.

⁶ Compliance – A Business Enabler Australian Compliance Institute, 7th National Compliance Conference.

LESSON ROUND UP

- All businesses have a duty to act lawfully, but there are more practical reasons why compliance with competition law is particularly important. On a broad level, the main aim of competition law is to ensure that markets remain competitive.
- The Competition Act, 2002 was passed to encourage competition in markets in India.
- The Competition Act broadly covers anti-competitive agreements, abuse of dominance and regulation of combinations.
- During combinations, i.e mergers or takeovers, the businesses of the transferor and transferee are to be studied from the point of view of anti-trust aspects(i.e Competition aspects). This process is competition law due diligence.
- Competition law due diligence involves examination of various agreements, check into the companies dominance and its' abuse if any, checking combination thresholds, implementing competition compliance programme help reduce legal costs in the short run by enabling the enterprise to avoid violation of competition laws, while in the long run, they increase corporate competitiveness by raising the value of an enterprise.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Write briefly about the preamble of Competition Act, 2002.
2. What are the combination thresholds for domestic takeovers?
3. Write short notes on
 - (i) Anti competitive agreement
 - (ii) Relevant market
 - (iii) Abuse of dominance.
4. Why do we need to carry out competition law due diligence during strategic decisions?

[illegible]

Lesson 9

LEGAL DUE DILIGENCE

LESSON OUTLINE

- The concept, scope, objectives and process of legal due diligence
- General aspects to be looked during legal due diligence process
- Possible hurdles and Remedial actions in legal due diligence
- Role of Company Secretaries in legal due diligence

LEARNING OBJECTIVES

As we are aware that due diligence involves investigative process that identifies hidden strength and weaknesses in a business transaction, which helps in evaluation of a business transaction.

Legal due diligence is investigation of legal aspects of business including regulatory compliance, contractual compliance, hidden liabilities etc., It involves detailed study of various legal documents of the company such as Memorandum & Articles of Association, Minutes of Meetings, Returns filed with regulators, notices issued by regulators if any, material contracts, Annual Reports, IPR & Patent Details, environmental clearances etc.,

Since the cost of non-compliance would negatively affect a business transaction, legal due diligence has to be carried out while evaluating the same. After reading this lesson you would be able to understand the concept, process, scope of legal due diligence, possible hurdles and remedial actions relating to legal due diligence etc.,

I. INTRODUCTION

A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters. It also improves the buyer's bargaining position and ensures that necessary precautions are taken in relation to the transaction proposed.

Due diligence is an art that requires expertise in asking gathering and reporting of sensitive information. It involves collecting information about complete details, which includes the products, marketing, financial status, legal issues, assets/liabilities, etc.

Legal due diligence is a precautionary operation through which one can know the strengths and weaknesses of the company through the maximum possible information available. This process reduces future problems and ensures safety.

II. OBJECTIVES OF LEGAL DUE DILIGENCE

The objectives of a legal due diligence exercise may vary from case to case. However some of the common objectives in most of the cases would be as follows:

1. Gathering of information from the target company.
2. Uncovering of the risks of target company through a SWOT analysis.
3. Improving the bargaining position.
4. Cost benefit analysis.
5. Assessing the risk and liability on the cost of the transaction.
6. Mapping of compliance requirements of the target company and the actual status.

III. SCOPE OF LEGAL DUE DILIGENCE

The scope of legal due diligence depends on the purpose and objectives which may vary from case to case. The scope of due diligence by a large institutional investor will vary from the scope of due diligence by the company which proposes to acquire a target company. Thus it is not possible to define the scope of due diligence specifically. However, certain mandatory issues that should be covered in any type of legal due diligence are as follows

1. *Regulatory compliance*

It would include compliance requirements of the company under various applicable laws such as Companies Act, Income Tax Act, SEBI Act rules and regulations, employee related laws, other business related laws such as pollution control laws, patent laws, applicable laws in the country where the target company is situated.

2. *Contractual compliance*

It would include the compliance by the company under various material contracts by the company with suppliers, customers, employees etc. and to verify whether the company has complied with the terms and conditions of different contracts.

3. *Compliance under intra-corporate aspects*

It would include the compliance by the company under the intra company documents such as Memorandum and Articles of Association, Corporate policies, procedures, code of conduct etc.

4. *Financial aspects*

It includes thorough reading of the balance sheet to identify the financial obligations of the company, penalties paid for violations of laws in the past etc.

5. *Non financial aspects*

It includes analysis/examination of aspects such as reputation and goodwill of the company.

6. *Cultural aspects*

Especially in case of cross border transactions, compatiability and adaptability of corporate cultures are to be analysed to eliminate the problems that may arise out of cultural differences.

The following are the various important aspects covered as scope of due diligence in general. However, the list provided herein is not an exhaustive list and the scope would vary according to the nature of business decision.

Under Companies Act

- Compliance with provision of Articles of Association
- Related parties transaction
- Appointment of and remuneration to Directors
- Contracts with director
- Loans to Director
- Borrowings by the Company and securities covered
- Matters such as disclosure, prospectus, minimum subscription compliance with listing agreement etc. in case of listed company.
- Fixed deposits accepted and its repayments
- Distribution of dividend
- Maintenance of statutory registers, minutes books etc.
- Filing of necessary returns

Under Tax Laws

- Status of tax assessments
- Identification of potential tax liabilities
- Pending notices and demands
- Impact of business agreements on potential tax demands
- Aspects relating to double-taxation.

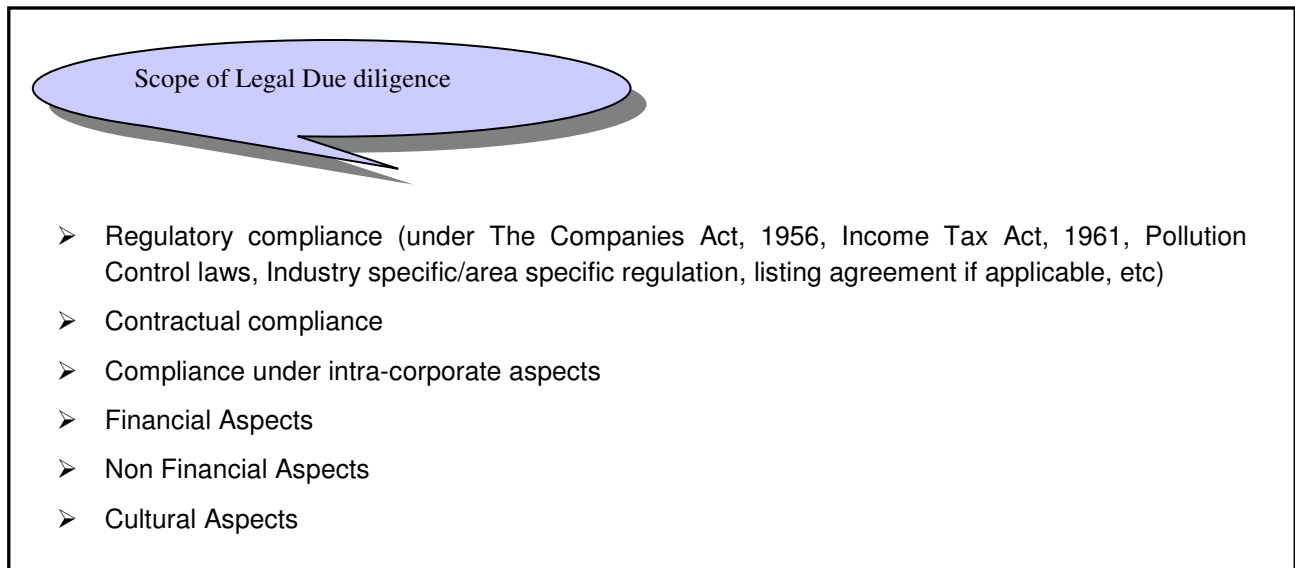
Under other business laws

- Registrations and approvals from various authorities and risks on non-compliance
- Compliance under pollution control laws
- IPR related matters

- Issues relating to immovable properties, title deeds etc.
- Compliance under FEMA, insurance laws etc.

The investigation or inspection also would cover aspects such as Compliance with local laws, assessment of feasibility of pursuing litigation, reputation and goodwill of the organization, cross-border and cultural issues, employee litigation etc.

IV. NEED OF LEGAL DUE DILIGENCE



Legal Due Diligence provides complete picture of a company through a methodical investigative process. Due Diligence investigations are good at finding liabilities in a company and to uncover the hidden risks. These investigations can help to negotiate a lower price in a business transaction negotiation.

Legal Due Diligence is an art of managing a risk of undertaking a major business transaction. It involves maintaining a methodical system for organizing and analyzing the documents, data, and information provided by the information provider, and then quantitatively assessing the risks associated with any issues or problems discovered during the process. Only a careful and thorough Legal Due Diligence process will help to avoid legal difficulties, unintended transfer of legal property and other drawbacks.

Legal Due Diligence investigations allow getting the current information that is needed to make good business and financial decisions. These investigations help to avoid costly mistakes and can also help to avoid lawsuits caused by a bad business partnership. Investigations such as these can also be crucial in negotiations – by helping cut through business claims to the actual facts about a corporation, they help to get the proof needed to negotiate better terms.

The need for legal due diligence may occur in the following occasions

- Mergers/Acquisitions
- Corporate Restructuring
- Corporate Governance related matters
- IPOs/FPOs

- Private Equity
- General Compliance requirement.
- Commercial agreements
- Leveraged buy-outs
- Joint Ventures etc

V. LEGAL DUE DILIGENCE PROCESS

There is no definitive process of a legal due diligence. The investigative aspects as well as Legal Due Diligence process varies depending upon the scope of work dictated by the client, the focus, special areas of weakness, the type of business, etc. In general, the following process involved in legal due diligence.

- Entering of Memorandum of Understanding between the transacting parties along with confidentiality agreement
- Determination of scope of Legal Due Diligence
- Calculation of time frame
- Drafting of various questionnaire and checklists
- Obtaining of access to records and data room agreement
- Interaction with management and key managerial persons with the questionnaires and checklists and for other material information
- Interaction with regulatory authorities for independent check
- Checking of regulatory and contractual compliance
- Analysis of financial and non financial information
- Collation with financial due diligence for confirmation of representations, warranties and liabilities
- Investigation of material issues
- Drafting of preliminary report
- Discussions with the management of the target company
- Finalisation of the Report
- Determination of strategy

VI. GENERAL DOCUMENTS/ASPECTS TO BE COVERED

The following aspects would give a rough figure on the aspects/documents to be looked into in the process of legal due diligence. However, this is not an exhaustive list.

1. Organizational and internal Aspects

- Memorandum and Articles of Association of the Company
- Minutes of all meetings
- Organisational chart
- Statutory Registers

- Returns filed with Ministry of Corporate Affairs and other regulatory authorities.
- Search/status report if any.
- Details of branches and subsidiaries
- Registrations documents under various laws
- Documents/reports filed with stock exchanges on shareholding pattern and other material information.

2. Financial Aspects

- Financial Statements for the last five years
- Auditors Qualifications if any
- Recent unaudited financial statements
- Details of various financial reports published under listed agreement
- Capital Budgets and projections
- Details of fixed and variable expenses
- Internal Audit Report if any
- Strategic plans
- Details of internal control procedures.
- Unrecorded liabilities
- Commitments, contingencies
- Accounting policies
- Relationship between profit and operating cash flows
- Reliance on debt funds and usage of debt
- Debt repayment and potential debt trap
- Working capital lock up

3. IPR/Patent/R&D Details

- Schedule of trade marks/copyrights
- Details of Indian and international patents with the company
- Details of pending patent applications
- A schedule and copies of all consulting agreements, agreements regarding inventions, licenses, or assignments of intellectual property to or from the Company
- Details of threatened claims if any etc.

4. Human Resource Aspects

- List of employees, their positions and salaries
- Details of options given/vested under ESOP scheme
- Bio-data of key managerial personnel
- Employee litigations
- Employee harassment reports if any.
- Cultural issues in case of cross border transactions.

5. Environmental aspects

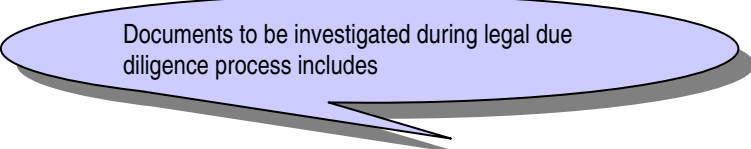
- Environmental audits reports if any
- Details of environmental permits and licenses
- Hazardous substances used in the Company's operations
- Copies of all correspondence with environment authorities
- Litigation or investigations if any on environmental issues
- Contingent environmental liabilities or continuing indemnification obligations if any

6. Material Contracts

- A schedule of all subsidiary, partnership, or joint venture relationships and obligations, with copies of all related agreements
- Copies of all contracts between the Company and employees, shareholders and other affiliates
- Loan agreements, letter of credit, or promissory notes etc
- Security agreements, mortgages etc to which the Company is a party
- Any distribution agreements, sales representative agreements, marketing agreements etc.
- All nondisclosure or non competition agreements
- Other material contracts

7. Other aspects

- Copies of any governmental licenses, permits, or consents
- Any correspondence or documents relating to any proceedings of any regulatory agency
- A list of all existing products or services and products or services under development
- Company's purchase policy/credit policy
- Details of largest customers
- Details of company's competitors
- Press releases relating to the Company.



Documents to be investigated during legal due diligence process includes

- Organisational/internal aspects (MOA/AOA/Minutes/Statutory Registers documents filed with Regulatory Authorities etc)
- Financial aspects(financial statements, audit qualifications, internal audit report business projections etc)
- IPR/Patents/R&D Details etc
- HR Aspects
- Environmental Aspects
- Material contracts
- Other relevant aspects as may be covered

VII. POSSIBLE HURDLES IN CARRYING OUT A LEGAL DUE DILIGENCE AND REMEDIAL ACTIONS

1. Non availability of information:

In many occasions, when a person carries out due diligence, the required information may not be available or insufficient to derive a complete picture.

2. Unwillingness of target company's personnel in providing the complete information:

Non-co-operation of target company's personnel may also prove to be a major hurdle during due diligence process. Sometimes, the available information would be pretended as not available.

3. Providing of incorrect information:

Providing of incorrect information by the target personal also acts as a major hurdle in the due diligence process.

4. Complex tax policies and hidden liabilities:

Complex tax policies & structures may create a number of hidden tax liabilities, which may not be easy to track.

5. Multiple Regulations and its applicability:

Owing to the new and emerging legislations, it is difficult to interpret whether a specific legislation is applicable for business and getting legal opinion on the same would prove to be very costly.

6. Process in providing data:

Multiple Layers of review and scrutiny before data is provided for due diligence also hinders and delays the due diligence process.

7. Absence of proper MIS:

Due diligence process would become difficult if there is no proper MIS in the company.


Actions to break hurdles in due diligence

The following actions may break the afore said hurdles

- Focus follow up questions.
- Ask several people the same questions and utilise appropriate professional skepticism.
- Polite persistence may help to overcome this attitude.
- Independent check with regulatory authorities.

Considering this hurdles, it is advisable to insert the necessary disclaimer clauses in the due diligence report.

Breaking legal due diligence hurdles



Hurdles

1. Non availability of information:
2. Unwillingness of target company's personnel in providing the complete information:
3. Providing of incorrect information:
4. Complex tax policies and hidden liabilities:
5. Multiple Regulations and its applicability:
6. Process in providing data:
7. Absence of proper MIS:

Actions to break hurdles in due diligence

The following actions may break the aforesaid hurdles

- Focus follow up questions.
- Ask several people the same questions and utilise appropriate professional skepticism.
- Polite persistence may help to overcome this attitude.
- Independent check with regulatory authorities.

VIII. ROLE OF COMPANY SECRETARIES IN LEGAL DUE DILIGENCE

Company Secretary is a competent professional who comes in existence after exhaustive exposure provided by the Institute through compulsory coaching, examinations, rigorous training and continuing education programmes. The course curriculum includes papers on subjects such as Financial Management, Financial Accounting, Company Accounts, Cost and Management Accounting, Financial Treasury and Forex Management, Security Laws and an exclusive paper on 'Due Diligence and Corporate Compliance Management'. Company Secretary, thus, has vast theoretical knowledge base and practical experience and exposure in various laws and financial aspects. As a Compliance Management specialist, a company secretary is competent to discharge the Legal Due diligence process efficiently.

Company Secretary while carrying out due diligence has to maintain confidentiality. Certain activities

conducted during due diligence may breach confidentiality that a transaction is being contemplated. Especially while interacting with external persons such as customers, suppliers, it is better to contact them under the disguise of being prospective supplier/customer, which will help in maintaining confidentiality.

LESSON ROUND UP

- A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters.
- The objectives of a legal due diligence exercise may vary from case to case.
- Legal Due Diligence is an art of managing a risk of undertaking a major business transaction.
- The documents that is to be checked during legal due diligence may be financial information, statutory information, organizational matters, employee matters etc.
- The process of legal due diligence involves various steps such as entering of MOU, preparations of questionnaires and checklists, interview with target company's personal, interaction with regulatory authorities, preparation and discussion of preliminary report, finalization of report and arriving of decision.
- The legal due diligence covers various laws such as Companies, Act, Income Tax Act, other business laws etc.
- The company Secretary is a competent professional to conduct legal due diligence.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What do you mean by legal due diligence and why does a person need to carry out legal due diligence?
2. Draft a legal due diligence programme for a corporate acquisition.
3. What are the process involved in legal due diligence in general?
4. What are the possible hurdles that may occur during legal due diligence process?

Lesson 10

DUE DILIGENCE FOR BANKS

LESSON OUTLINE

- Introduction
- Need
- Due diligence for Banks-Format
- Pointwise compliance checklists.

LEARNING OBJECTIVES

Reserve Bank of India, with a view to facilitate industry has liberalized rules for consortium lending a little more than a decade back. Multiple banking as a concept had also started gaining ground at that time and many corporates opted for the multiple banking route presumably due to the perceived rigidity of the consortium arrangement. Unfortunately, exchange of information between banks was minimal and resultantly unscrupulous borrowers were able to take advantage of the information asymmetry that prevailed. The Central Vigilance Commission concerned at this development had attributed this phenomena to lack of effective sharing of information amongst banks. A need was felt, all along to have certification of statutory compliances by a Company through a professional such as a Company Secretary/Chartered Accountant/Cost Accountant so that the lending banks get the desired comfort. Accordingly, the Reserve Bank of India advised all the scheduled commercial Banks to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue in the specified format. The Diligence Report broadly covers many critical and relevent matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilisation/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc. The compact structure of the Diligence Report under its twenty-five paragraphs makes it obligatory for a Practicing Company Secretary to prepare the Report after critical examination of all relevent records and documents of the borrowing companies which demands a high degree of care, skill and knowledge. After reading this lesson you will be able to understand the scope, process of due diligence for banks including compliance checklist.

INTRODUCTION

The Reserve Bank of India vide its Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008 advised all the scheduled commercial Banks (excluding RRBs and LABs) to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in the aforesaid notification. Further RBI vide its Circular dated January 21, 2009 also advised all Primary Urban Co-operative Banks to obtain Diligence Report. Subsequently the RBI vide its Circulars dated December 08, 2008 and February 10, 2009 revised the format of Diligence Report for Scheduled Commercial Banks and also for Primary Urban Co-operative Banks vide its Circular dated February 12, 2009.

Background

In October 1996, various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements were withdrawn by Reserve Bank of India with a view to introducing flexibility in the credit delivery system and to facilitate smooth flow of credit. However, Central Vigilance Commission (CVC), Government of India, in the light of frauds involving consortium/multiple banking arrangements which have taken place in the recent past, expressed concerns on the working of Consortium Lending and Multiple Banking Arrangements in the banking system. The CVC attributed the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of the account of the borrowers amongst various banks.

The matter was examined by the Reserve Bank of India (RBI) in consultation with the Indian Banks Association (IBA) who were of the opinion that there is need for improving the sharing/dissemination of information among the banks about the status of the borrowers enjoying credit facilities from more than one bank.

The RBI vide its Circular No. RBI/2008-2009-313/DBOD No. B.P. BC 94/08.12.001/2008-2009 dated December 08, 2008, advised the banks to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks as under:

- (i) At the time of granting fresh facilities, banks may obtain declaration from the borrowers about the credit facilities already enjoyed by them from other banks. In the case of existing lenders, all the banks may seek a declaration from their existing borrowers availing sanctioned limits of ₹ 5.00 crore and above or wherever, it is in their knowledge that their borrowers are availing credit facilities from other banks, and introduce a system of exchange of information with other banks as indicated above.
- (ii) Subsequently, banks should exchange information about the conduct of the borrowers' accounts with other banks at least at quarterly intervals.
- (iii) Obtain regular certification by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue.
- (iv) Make greater use of credit reports available from Credit Information Bureau of India Limited (CIBIL).
- (v) The banks should incorporate suitable clauses in the loan agreements in future (at the time of next renewal in the case of existing facilities) regarding exchange of credit information so as to address confidentiality issues.

Need for Diligence Report

In order to streamline consortium/multiple banking arrangements, Reserve Bank of India has been making regulatory prescriptions from time to time regarding conduct of consortium/multiple banking. Banks have also been advised to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks by following specified criteria.

Way back in October 1996, Reserve Bank of India withdrew various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements so as to bring flexibility in the credit delivery system. With the passage of time, however, it was observed that the relaxations meant for providing flexibility to the borrowing community, may also have contributed to various types of frauds, prompting the Central Vigilance Commission to attribute the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of account of the borrowers among various banks.

Accordingly, Reserve Bank of India in consultation with the Indian Banks' Association, specified the framework to be observed by banks for improving the sharing/dissemination of information amongst the banks about the status of the borrowers enjoying credit facilities from more than one bank. Further, the banks are required to obtain regular certification of Diligence Report from a professional, preferably a Company Secretary about conformity to statutory prescriptions in vogue. Thus, the banking community in general and the Regulatory in particular have reposed enormous trust on professionals.

The Diligence Report covers many critical and relevant matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilization/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc. The compact structure of the Diligence Report under its twenty-five paragraphs makes it obligatory for a Practising Company Secretary to prepare the Report after critical examination of all relevant records and documents of the borrowing companies which demands a high degree of care, skill and knowledge.

The introduction of diligence reporting by Company Secretary in Practice is expected to lay down a strong foundation for good governance culture among borrowing corporates and correspondingly enhance the comfort level of the banks by reducing the information asymmetry prevailing currently.

Scope of Diligence Report

The Practising Company Secretary (PCS) is required to certify compliance in respect of matters specified in the RBI Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008. Para (2)(iii) of the RBI Circular specifies that the Diligence Report shall be in the format given in Annex III thereto. The format has been subsequently revised and streamlined by RBI.

Format of Diligence Report

DILIGENCE REPORT¹

To

The Manager,

_____ (Name of the Bank)

I/We have examined the registers, records, books and papers of Limited having its registered office

¹ (As contained in RBI Circular No. DBOD. No. BP.BC. 110/08.12.001/2008-09 dated February 10, 2009 read with RBI Circular No. UBD.PCB.No. 49/13.05.000/2008-09 dated February 12, 2009)

at..... as required to be maintained under the Companies Act, 1956 (the Act) and the rules made thereunder, the provisions contained in the Memorandum and Articles of Association of the Company, the provisions of various statutes, wherever applicable, as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s for the half year ended on..... . In my/our opinion and to the best of my/our information and according to the examination carried out by me/us and explanations furnished to me/us by the Company, its officers and agents. I/We report that in respect of the aforesaid period:

1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure, and the Board was duly constituted. During the period under review the following changes that took place in the Board of Directors of the Company are listed in the Annexure, and such changes were carried out in due compliance with the provisions of the Companies Act, 1956.
2. The shareholding pattern of the company as on was as detailed in Annexure During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure..... .
3. The company has altered the following provisions of
 - (i) The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.
 - (ii) The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.
4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure..... .
5. The company has advanced loans, given guarantees and provided securities amounting to ₹ to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section 295 of the Companies Act, 1956.
6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexure.... and has complied with the provisions of the Companies Act, 1956.
7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company's domestic borrowings were as detailed in Annexure
8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies.
9. The Company has created, modified or satisfied charges on the assets of the company as detailed in Annexure.... Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure
10. Principal value of the forex exposure and Overseas Borrowings of the company as on are as detailed in the Annexure under.
11. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within the

stipulated time in compliance with the provisions of the Companies Act, 1956 and other relevant statutes.

12. The Company has insured all its secured assets.
13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institutions at the time of availing any facility and also during the currency of the facility.
14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956.
15. The Company has insured fully all its assets.
16. The name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India.
17. The name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation.
18. The Company has paid all its Statutory dues and satisfactory arrangements had been made for arrears of any such dues.
19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.
20. The Company has complied with the provisions stipulated in Section 372A of the Companies Act in respect of its Inter Corporate loans and investments.
21. It has been observed from the Reports of the Directors and the Auditors that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India.
22. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends and other amounts required to be so credited.
23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and /or its directors in such cases are detailed in Annexure.....
24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement.
25. The Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

Note : The qualification, reservation or adverse remarks, if any, are explicitly stated may be stated at the relevant paragraphs above place(s).

Place:
Date

Signature :
Name of Company Secretary/Firm :
C.P. No.:

GUIDANCE ON DILIGENCE REPORTING

The following paragraphs outline the Compliance Inputs that may be relied upon by the PCS for the purpose of issue of Diligence Report. Compliance Inputs and checklist are indicative and PCS shall not exclusively rely upon that, but use that as a guide and apply his own judgement to determine what is to be checked and to what extent.

Period of Reporting

Annex. III to the RBI Notification provides that the Diligence Report shall be made on a half yearly basis.

Secretary in Whole-Time Practice

Section 2(45A) of the Company Secretaries Act, 1980 defines “secretary in whole-time practice” as a secretary who shall be deemed to be in practice within the meaning of sub-section (2) of section 2 of the Company Secretaries Act, 1980 and who is not in full-time employment. Thus, a member of the Institute of Company Secretaries of India, who is not in full-time employment can become a Secretary in whole-time practice (hereinafter referred to as PCS) after obtaining from the Council of the Institute a Certificate of Practice under section 6 of the Company Secretaries Act, 1980 and the regulations thereunder.

Right to Access Records and Methodology for Diligence Reporting

To enable the PCS to issue the Diligence Report, the Company (borrower) should provide the PCS access at all times to the books, papers, minutes books, forms and returns filed under various statutes, documents and records of the company, whether kept in pursuance of the applicable laws or otherwise and whether kept at the registered office of the company or elsewhere which he considers essential for the purposes of Diligence Reporting. The PCS shall be entitled to require from the officers or agents of the company, such information and explanations as the PCS may think necessary for the purpose of such Reporting. However, depending on the facts and circumstances he/she may obtain a letter of representation from the company in respect of matters where verification by PCS may not be practicable, for example matters like —

- (i) dis-qualification of directors;
- (ii) show cause notices received;
- (iii) persons and concerns in which directors are interested, etc.

Reporting with Qualification

The qualification, reservation or adverse remarks, if any, may be stated by the PCS at the relevant places. It is recommended that the qualifications, reservations or adverse remarks of PCS, if any, should be stated in thick type or in *italics* in the Diligence Report.

If the PCS is unable to form any opinion with regard to any specific matter, the PCS shall state clearly the fact that he is unable to form an opinion with regard to that matter and the reasons thereof.

If the scope of work required to be performed, is restricted on account of limitations imposed by the company or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the Report shall indicate such limitation.

If such limitations are so material as to render the PCS incapable of expressing any opinion, the PCS should state that:

“in the absence of necessary information and records, he is unable to report compliance(s) or otherwise by the Company”.

PCS shall have due regard to the circulars and/or clarifications issued by the Reserve Bank of India from time to time. It is recommended that a specific reference of such circulars at the relevant places in the Report shall be made, wherever possible.

Professional Responsibility and Penalty for False Diligence Report

While the RBI Notification has opened up a significant area of practice for Company Secretaries, it equally

casts immense responsibility on them and poses a greater challenge whereby they have to justify fully the faith and confidence reposed by the banking industry and measure up to their expectations. Company Secretaries must take adequate care while issuing Diligence Report.

Any failure or lapse on the part of a Practising Company Secretary (PCS) in issuing a Diligence Report may not only attract penalty for false Reporting and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his/her negligence in issuing the Diligence Report. Therefore, it becomes imperative for the PCS that he/she exercises great care and caution while issuing the Diligence Report and also adheres to the highest standards of professional ethics and excellence in providing his/her services.

While preparing the Diligence Report the PCS should ensure that no field in the report is left blank. If there is nothing to be reported or the field is not applicable to the company, then the PCS should write 'none' or 'nil' or 'not applicable' as the case may be.

The PCS should obtain a list of statutes applicable to the Company before proceeding with the assignment for issue of Diligence Report.

"1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure, and the Board was duly constituted. During the period under review the changes that took place in the Board of Directors of the Company are listed in the Annexure, and such changes were carried out in due compliance with the provisions of the Companies Act, 1956."

FORMAT FOR DISCLOSING INFORMATION ABOUT EACH DIRECTOR

(As on last date of financial year)

<i>Name of Director</i>	<i>Shri/Ms.</i>	<i>Shri/Ms.</i>	<i>Shri/Ms.</i>	<i>Shri/Ms.</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(4)</i>	<i>(5)</i>
Date of Birth				
DIN/DPIN				
PAN No.				
Present Address/Permanent Address				
Position of Director: Chairman/MD/ WTD/Manager etc.				
Category of director: Promoter/Executive/ Non executive/Independent/Nominee				
If nominee, Name of the Institution: (whether Institution is Lending or investing institution/company/body corporate)				
Academic qualifications :				
Date of joining the Company:				
Relationship with other directors:				
Total number of directorships:				
No. of committee memberships across Companies:				
Number of Committee Chairmanships across companies:				

Total No. of Directors				
<i>Promoter</i>	<i>Executive</i>	<i>Non executive</i>	<i>Independent</i>	<i>Nominee</i>

In case of promoter directors give the name and brief history of other concern(s) in which the promoters are interested.

Changes in Directors

<i>Name</i>	<i>Date of Change</i>	<i>Particulars of Change</i>	<i>Reason for Change</i>	<i>E-filing Reference</i>
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Check whether a valid board constitution remained throughout the period under review.

Composition of Board

In case of listed Company check whether the provisions of Clause 49 of the Listing Agreement have been complied with in respect of composition of the Board.

(Detailed reference in this regard is made under paragraph 24)

In case of private limited company check that the minimum no. of directors on the Board never fell below two at any point of time.

In case of an unlisted public company check that the minimum number of directors on the Board was never below three at any point of time.

Compliance Inputs

- Register of Directors maintained u/s 303 of the Companies Act, 1956.
- Minutes of the Board Nomination Committee, if any, and General Meetings to verify resolution of the Board of Directors/Company appointing, designating, varying the terms of appointment of each director and notices and explanatory statements pertaining to such matters.
- E-Form 32 filed with ROC with its paid challan.
- Minimum and maximum number of Directors on the Board as prescribed under the Articles of Association/Board resolution.

- Resolution of the Board of Directors/Company appointing, designating, varying the terms of appointment of each director and notices and explanatory statements pertaining to such matters.
- Resume of each Director.
- Disclosure of interest made by each Director u/s 299 of the Companies Act, 1956.
- Register of Directors Shareholding.
- Register of Firms/parties in which Directors are interested.
- Extract of relevant minutes.
- Declaration given by the Directors u/s 274 of the Companies Act, 1956.
- Abstract of terms of appointment of Directors, Managing/Wholetime Directors, Manager u/s 302 of the Companies Act, 1956.
- Loan Agreements with Bank(s)/financial institution(s) to verify their consent required for appointment of Managing/Wholetime Directors, Manager.

Checklist

- (a) Check if the company has the minimum number of directors - three in the case of a public company and two in the case of a private company
- (b) Check whether action was taken to bring the number to the minimum if the number had fallen below the minimum.
- (c) Check whether the first directors were appointed in accordance with the articles, if it is a new company.
- (d) Check whether the provisions of sections 255 and 256 of the Companies Act, 1956 have been duly complied with respect to retirement of directors by rotation.
- (e) Check whether persons other than retiring directors who were candidates for directorship at the general meeting had complied with the provisions of Section 257 of the Companies Act, 1956.
- (f) Check whether approval of the Central Government has been obtained, if the number of directors has been increased to more than twelve.
- (g) Check whether the appointment of additional directors was in accordance with the Articles of Association of the company.
- (h) If the board has filled up casual vacancy among directors appointed in general meeting, check whether the appointment was in accordance with the articles and was made at a meeting of the Board.
- (i) Check the authority of the Board under sections 313 and 260 of the Companies Act, 1956 respectively, if the board has approved any alternate/additional director during the period under review.
- (j) Check whether the appointment of any nominee directors during the period under review, was in consonance with the provisions of the articles of the company and the loan agreement. Also check whether the approval of the Government, under Section 259 of the Companies Act, 1956, if required, has been obtained.
- (k) Check whether each of the directors had given consent to act as director within 30 days of his appointment and the consent was filed with the Registrar in e-form no. 32.

- (l) Check the declaration under Section 274 of the Companies Act, 1956 that none of the directors suffers from any of the disqualifications.
- (m) Check with reference to Section 283 of the Companies Act, 1956 that the office of any director did not fall vacant on account of any of the disqualifications specified in the section.
- (n) Check that the provisions of Section 284 of the Companies Act, 1956 were complied with, if any director was removed before the expiry of his term of office.
- (o) Check whether the director's other directorship(s) were within the limits prescribed under Section 278 of the Companies Act, 1956.

Appointment of Managing Director, Whole-Time Director or Manager

- (a) Check with reference to Section 269 read with Schedule XIII of the Companies Act, 1956 if the appointment was in order.
- (b) Check whether
 - (i) the appointment was in accordance with the conditions specified in parts I and II of Schedule XIII;
 - (ii) return in e-form no. 25C was filed with the Registrar within ninety days of the appointment; and
 - (iii) the appointment has been approved by the members in general meeting - where the appointment has been made without the approval of the Central Government.
- (c) Check whether application in e-form no. 25A seeking the approval of the Central Government was made within ninety days of the appointment and whether the approval of the Central Government has been received - if the appointment was not under Schedule XIII and the appointment was required to be made with the approval of the Central Government.
- (d) Check whether the appointment was approved by the bank(s)/financial institution(s), wherever required.
- (e) Check that the managing director or whole-time director does not suffer from any of the disqualifications specified in Sections 274 and 267 of the Companies Act, 1956. In the case of manager, check with reference to Section 385 of the Companies Act, 1956.
- (f) Check whether remuneration paid to Directors/Managing/Whole-time Director(s) is in accordance with the provisions of the Companies Act, 1956 viz. Section 269, Schedule XIII and terms and conditions of approval.
- (g) Check if Sections 316 & 386 of the Companies Act, 1956 were applicable whether the unanimous board resolution was passed.

"2. The shareholding pattern of the company as onwas as detailed in Annexure: During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure....."

In case of listed companies the shareholding pattern as prescribed by SEBI may be followed.

Compliance Inputs

- Memorandum and Articles of Association
- Minutes of Share Transfer Committee in case of shares held and transferred in physical form
- Board Resolution approving the alteration of capital

- Approval of the Company in general meeting by an ordinary resolution for the alteration
- E-Form No. 2
- E-Form No. 5 and E-Form No. 23 (if the articles are amended), filed with the ROC
- Annual Return filed with the Registrar
- Audited Balance Sheet of the Company
- Returns/Documents filed with the Stock Exchanges in accordance to the Listing Agreement.

“3. *The company has altered the following provisions of*

- (i) *The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.*
- (ii) *The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose”*

ALTERATION IN THE MEMORANDUM OF ASSOCIATION WITH RESPECT TO CHANGE IN REGISTERED OFFICE FROM ONE STATE TO ANOTHER AND OBJECTS CLAUSE

Compliance Inputs

- Resolution, copy of altered Memorandum & Articles of Association for change in registered office of the company/alteration of objects clause/or any other clause of Memorandum & Articles of Association, e-form no. 18 filed with ROC;
- Certified true copy of the special resolution along with the certified true copy of the explanatory statement filed with the Registrar in e-form no. 23;
- Petition filed before the Regional Director, for confirmation of the alteration of Memorandum relating to change of place of the company's registered office from one State to another;
- Certified true copy of the order of the Regional Director confirming the Alteration of Memorandum in respect of registered office of the company together with the printed copy of the Memorandum as altered;
- Certificate of registration issued by the Registrar;
- Minutes of Board Meetings;
- Notice and Minutes of General Meeting;
- Copy of Form 18 filed with the Registrar required for change in registered office of the company.

Checklist

- (a) Check whether the Board of directors had passed a resolution for change in registered office of the company/alteration of object clause/alteration of other clause;
- (b) Check whether the Board had called a general meeting and necessary special resolution has been passed at the said meeting;
- (c) Check whether a certified true copy of the special resolution along with the certified true copy of the explanatory statement was filed with the Registrar in e-form no. 23, within thirty days from the date of passing of the resolution;

- (d) Check whether a petition has been filed before the Regional Director, for confirmation of the alteration of Memorandum relating to change of place of the company's registered office from one State to another;
- (e) Check whether a certified true copy of the order of the Regional Director confirming the Alteration of Memorandum in respect of registered office of the company together with the printed copy of the Memorandum as altered was filed with the ROC of each State;
- (f) Check whether the Registrar of each State registered the change (wherever the ROC has been appointed) and issued the Certificate of Registration under his hand;
- (g) Check whether every copy of the memorandum issued after the date of alteration reflects such alteration.

SHIFTING OF REGISTERED OFFICE FROM A PLACE UNDER THE JURISDICTION OF ONE ROC TO A PLACE UNDER THE JURISDICTION OF ANOTHER ROC WITHIN THE SAME STATE

Compliance Inputs

- Copy of special resolution passed in the general meeting for shifting its registered office from a place under the jurisdiction of one ROC to a place under the jurisdiction of another ROC, within the same State;
- Copy of application in e-form no. 1AD to the Regional Director for confirmation of special resolution including advertisement in newspaper(s);
- Copy of confirmation order of the resolution passed by RD;
- Report of registration issued by the ROC.

Checklist

- (a) Check whether the company has passed a special resolution in the general meeting for shifting its registered office from a place under the jurisdiction of one ROC to a place under the jurisdiction of another ROC, within the same State;
- (b) Check whether the company has made application in e-form no. 1AD to the Regional Director for confirmation of special resolution;
- (c) Check whether the RD had passed the confirmation order of the resolution within four weeks from the date of receipt of the company's application;
- (d) Check whether the company has filed with the ROC, from whose jurisdiction it proposes to shift the registered office, a copy of the confirmation order of the Regional Director along with the printed copy of the memorandum as altered within 2 months from the date of confirmation by the Regional Director;
- (e) Check whether the ROC from whose jurisdiction Registered Office has been shifted, has registered the documents and certified the registration under his hand within one month from the date of filing of such documents.

ALTERATION OF THE MEMORANDUM WITH RESPECT TO NAME CLAUSE

Compliance Inputs

- Certified true copy of the special resolution along with the relevant explanatory statement and the letter issued by the Registrar of Companies making the new name available with the company;

- Fresh Certificate of Incorporation issued by ROC incorporating the alterations consequent to change of name;
- Copy of Form 23, 1A and 1B filed with the Registrar;
- Minutes of the Board Meeting;
- Notice & Minutes of General Meeting.

Checklist

- (a) Check whether the company had obtained the availability of new name from the Registrar of Companies;
- (b) Check whether the Board of Directors had called and held the general meeting within sixty days of the date of Registrar's letter intimating the availability of name;
- (c) Check whether the company has passed the special resolution for the change of name and obtained approval of the Central Government (Registrar of Companies) in this respect;
- (d) Check whether the company has filed with the Registrar of Companies certified true copy of the special resolution along with the relevant explanatory statement in e-form 1B and the letter issued by the Registrar of Companies making the new name available with the company;
- (e) Check whether the ROC has issued a fresh Certificate of Incorporation incorporating the alterations consequent to change of name;
- (f) Check whether copies of memorandum have been duly altered;
- (g) Check whether the name has been painted/affixed/printed on the name board, business letters, bill heads, Memorandum and Articles; and
- (h) Check whether new common seal has been adopted by the Board.

ALTERATION OF MEMORANDUM WITH RESPECT TO SHARE CAPITAL

Compliance Inputs

- Memorandum and Articles of Association
- Board Resolution approving the alteration of capital
- Approval of the Company in general meeting by an ordinary resolution for the alteration
- E-Form No. 2
- E-Form No. 5 and E-Form No. 23 (if the articles are amended), filed with the ROC
- Annual Return filed with the Registrar
- Audited Balance Sheet of the Company
- Returns filed with the Stock Exchanges

Checklist

- (a) Check whether the Articles of Association authorise the alteration of share capital;
- (b) Check whether the Board of directors have passed a resolution approving the alteration of capital as above;
- (c) Check whether the company had called and held the general meeting and obtained approval of the company in general meeting by an ordinary resolution for the alteration;

- (d) Check whether the company has filed e-form no. 5 and e-form no. 23 (if the articles are amended), with the ROC;
- (e) Check whether copies of Memorandum and Articles have been altered.

ARTICLES OF ASSOCIATION

Compliance Inputs

- Board resolution approving the alteration of articles;
- Approval of the company in general meeting by a special resolution for the alteration;
- Copy of the special resolution containing the amendments to the Articles of Association along with e-form no. 23 filed with the ROC.

Checklist

- (a) Check whether the Board of Directors have passed a resolution approving the alteration of articles;
- (b) Check whether the company had called and held the general meeting and obtained approval of the company in general meeting by a special resolution for the alteration;
- (c) Check whether copy of the special resolution containing the amendments to the Articles of Association along with e-form no. 23 have been duly filed with the ROC within 30 days, and;
- (d) Check whether the alteration had been duly incorporated in the Articles.

"4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure....."

DISCLOSURE OF DIRECTOR'S INTEREST IN TRANSACTIONS WITH THE COMPANY

[illegible]

The Company/its subsidiary (names) entered on (date) into materially significant related party transaction(s), the details of which are given as under, with its promoter(s)/the director(s) (Names), (Name) officer holding the position ofin the management (Name)

.....

.....

.....

The quantum of related party transaction(s) in rupee value terms is _____.

Compliance Inputs

- Register of Particulars of Contracts in which Directors are Interested maintained under Section 301 of the Companies Act, 1956
- Disclosure in Annual Accounts relating to Related Party Transactions as per AS-18
- Minutes of Board Meeting and/or General Meeting
- Details of Sole selling agents (Section 294AA of the Companies Act, 1956)

Checklist

- (a) Check whether the register is being properly maintained by entering separately particulars as prescribed under sub-section (1) of Section 301 of the Companies Act, 1956 of all contracts or arrangements to which Section 297 or Section 299 applies;
- (b) Check whether the names of the directors voting for or against the contract or arrangement and the names of those remaining neutral are recorded;
- (c) Check whether entries have been made within 7 days from the date on which contract or arrangement was made;
- (d) If the company's paid-up share capital is rupees one crore or more, check whether the previous approval of the Central Government has been obtained for entering into contracts;
- (e) Check whether the register specifies in relation to each director the names of firms and bodies corporate of which notice has been given by him under Section 299(3) of the Companies Act, 1956;
- (f) Check whether the register has been signed by the directors present at the Board meeting following the meeting in which the contracts were considered;
- (g) Where the above contracts and/or arrangements have been approved by members in their general meeting, check whether the register is maintained and signed in accordance with the terms of the resolution thereat; and
- (h) Check whether the register is maintained at the registered office and is kept open for inspection and extracts and copies are permitted to be taken or are given to the members in the same manner and on payment of the same fee as in the case of Register of members;
- (i) Board Resolution for contracts u/s 297 of the Companies Act, 1956.

"5. The company has advanced loans, given guarantees and provided securities amounting to Rs. to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section– 295 of the Companies Act , 1956."

Loans to Directors (except housing loans)

<i>Name of Director</i>	<i>Maximum Loans advanced from the date of last reporting and (date)</i>	<i>Current Loans Advanced (₹)</i>	<i>Guarentees given (₹)</i>	<i>Securities Provided (₹)</i>
Shri/Ms....				
Shri/Ms....				
Shri/Ms....				

Loans to Relative/Firms/Companies in which Directors are interested

<i>Name of the relative(s)/firms/Companies</i>	<i>Nature of Relationship</i>	<i>Name of Director (s) Interested</i>	<i>Loans Advanced (₹)</i>	<i>Guarentees given (₹)</i>	<i>Securities Provided (₹)</i>
Shri/M/s....		Shri/Ms....			
Shri/M/s....		Shri/Ms....			
Shri/M/s....		Shri/Ms....			

Compliance Inputs

- Relevant ledger accounts.
- Government Approval (for Public Company)
- List of Companies in which director holds 25% or more voting power
- Resolution u/s 292 of the Companies Act, 1956

Checklist

Check whether provisions of section 295(2) of the Companies Act, 1956 are applicable. If applicable:

- (a) Check whether any loan has been made to
- (i) any director of the company or its holding company,
 - (ii) any partner or relative of any such director,
 - (iii) any firm in which any such director or relative is a partner,
 - (iv) any private company of which any such director is a director or a member,
 - (v) any body corporate in which 25% or more voting power is exercised by one or more such directors of the company,
 - (vi) any body corporate whereof, the Board, managing director or manager are accustomed to act in accordance with directions or instructions of the Board or any director(s) of the lending company.

- (b) Check whether the previous approval of the Central Government as per section 295 of the Companies Act, 1956 (except housing-loan to a managing director, as per the guidelines issued by the Central Government) has been obtained.

Note : (1) 'Relative' or 'close relative' means relative as defined in Section 6 of the Companies Act, 1956.

- (2) Provisions of Section 295 of the Companies Act, 1956 are not applicable to a private company unless it is subsidiary of a public company.

"6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexure....and has complied with the provisions of the Companies Act, 1956."

Loans to other Business Entities

Name of Company	Loans Advanced (₹)	Guarantees given (₹)	Securities Provided (₹)
Shri/M/s....			
Shri/M/s....			
Shri/M/s....			

Compliance Inputs

- Board resolutions passed with the consent of all the directors present at the meeting;
- Register maintained in this regard as per the provisions of Section 372A(5) of the Companies Act, 1956;
- Copy of the special resolution filed with the ROC alongwith e-form 23;
- Register showing the particulars in respect of every investment or loans or security or guarantee maintained in this regard as per the provisions of Section 372A(5) of the Companies Act, 1956.

Checklist

- (a) Check whether provisions of Section 372A of the Companies Act, 1956 are applicable [refer Section 372A(8)]. If provisions of Section 372A are applicable, check whether the aggregate of the loans made, guarantees given, securities provided or investments made by the company are within the limits of sixty per cent of its paid-up share capital and free reserves, or one hundred per cent of its free reserves, whichever is more as prescribed under Section 372A.
- (b) Check that:
- (i) Board resolutions were passed with the consent of all the directors present at the meeting;
 - (ii) the details regarding the transaction were entered chronologically in the Register maintained in this regard as per the provisions of section 372A(5), within 7 days of the transaction(s);
 - (iii) the company has complied with the guidelines if any issued by the Central Government under sub-section (7) of Section 372A.
 - (iv) where the company has defaulted in repayment of loan instalments or payment of interest

thereon: if so, whether the company has secured prior approval of the public bank(s)/financial institution(s)

- (c) If the aggregate has exceeded the prescribed limits:
- (i) Check whether Board resolutions were passed unanimously approving the impending transaction subject to members' previous approval at general meeting;
 - (ii) Check whether general meeting(s) (AGM or EGM) have been held and specific special resolutions have been passed stating the limits, particulars of body(ies) corporate in which the investment is proposed to be made or loan or security or guarantees to be given, the purpose and the specific source of funding etc.;
 - (iii) Check that no omnibus special resolution(s) have been passed;
 - (iv) Check whether the company has filed a copy of the special resolution alongwith e-form 23 with the Registrar within 30 days of passing of such resolution;
 - (v) In the case of guarantees given by the Board of directors without the authorisation of special resolution(s) check that :
 - exceptional circumstances existed which prevented the company from obtaining the resolution;
 - the Board passed a resolution authorising the same in accordance with the provisions of Section 372A of the Companies Act, 1956;
 - the Board resolution has been confirmed within 12 months at the earliest general meeting of the company;
 - notice of such general meeting (whether annual or extraordinary) indicated clearly the specific limits, the particulars of body(ies) corporate for which the guarantee was given etc.
- (d) In the case of loans, check whether the interest rate at which it was made was not lower than the prevailing bank rate as prescribed under Section 49 of the Reserve Bank of India Act, 1934;
- (e) Check whether the details regarding the transaction(s) were entered chronologically in the register maintained in this regard as per the provisions of section 372A(5) of the Companies Act, 1956, within 7 days of the transaction(s).
- (f) Check whether the register showing the particulars in respect of every investment or loans or security or guarantee is kept at the registered office of the company.

"7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company's domestic borrowings were as detailed in Annexure..... :"

Format of Annexure ...

Amount due for payment

Borrowing Limit of the Company vide
Board/General Meeting Resolution
no. dated

₹

...

Amount borrowed from Directors

Shri/Ms. ₹ @ % (rate of interest)			₹
Shri/Ms. ₹ @ % (rate of interest)			₹
Total	₹	...	

Amount borrowed from Members

Shri/Ms. ₹ @ % (rate of interest)			₹
Shri/Ms. ₹ @ % (rate of interest)			₹
Shri/Ms. ₹ @ % (rate of interest)			₹
Total	₹	...	

Amount borrowed from Public

Shri/Ms. ₹ @ % (rate of interest)			₹
Shri/Ms. ₹ @ % (rate of interest)			₹
Shri/Ms. ₹ @ % (rate of interest)			₹
Total	₹	...	₹

Amount borrowed from Bank(s) /
financial institution(s)

M/s. ₹ @ % (rate of interest)			₹
M/s. ₹ @ % (rate of interest)			₹
M/s. ₹ @ % (rate of interest)			₹
Total	₹	...	₹

Amount borrowed from Banks

M/s. ₹ @ % (rate of interest)			₹
M/s. ₹ @ % (rate of interest)			₹
M/s. ₹ @ % (rate of interest)			₹
Total	₹	...	₹

Amount borrowed from Others

Shri/Ms./M/s. ₹ @ % (rate of interest)			₹
Shri/Ms./M/s. ₹ @ % (rate of interest)			₹
Total	₹	...	₹
Grand Total	₹	...	₹

Compliance Inputs

In case of Private Company

- Articles of Association
- Balance Sheet

In case of Public Company

- Memorandum and Articles of Association with respect to the powers of the company to borrow money and to charge the assets of the company;
- Minutes of the meeting of the Board at which the power to issue debentures has been exercised;
- Minutes of the meeting of the Board at which the power to borrow money, otherwise than on debentures, has been exercised;

- If the power to borrow money otherwise than on debentures has been delegated to a committee of directors or managing director or manager or any other principal officer of the company or in the case of a branch office, principal officer of the branch office, if the delegation was made at the meeting of the Board and the resolution delegating the power specified the total amount outstanding, at any time, up to which the money may be borrowed by the delegatee;
- If the total amounts borrowed (apart from temporary loans obtained from the company's bankers in the ordinary course of business) exceed the aggregate of the paid-up capital of the company and its free reserves, resolution passed by the shareholders and the total amount specified therein upto which moneys may be borrowed by the company;
- E-Form No. 23 filed with the ROC under Section 192(4)(ee)(i) of the Companies Act, 1956;
- Balance Sheet

Checklist

In case of Private Company

Check whether there are any restrictions on the amount of borrowings contained in the Articles of Association of the company. If yes, check whether borrowings are in accordance with the provisions contained in the Articles.

In case of Public Company

- (a) Check whether the company has defaulted in complying with the provisions of Section 58A of the Companies Act, 1956;
- (b) Check whether the Memorandum and Articles contain provisions with respect to the powers of the company to borrow money and to charge the assets of the company;
- (c) Check whether the power to issue debentures has been exercised at the meeting of the Board;
- (d) Check whether the power to borrow money, other than on debentures, has been exercised at the meeting of the Board;
- (e) Check whether the power to borrow money other than on debentures has been delegated to a committee of directors or managing director or manager or any other principal officer of the company or in the case of a branch office, principal officer of the branch office, if the delegation was made at the meeting of the Board and the resolution delegating the power specified the total amount outstanding, at any time, up to which the money may be borrowed by the delegatee;
- (f) Check whether the total amounts borrowed (apart from temporary loans obtained from the company's bankers in the ordinary course of business) exceed the aggregate of the paid-up capital of the company and its free reserves, if so, consent of the members in general meeting has been obtained. Verify the resolution passed by the shareholders and the total amount specified therein upto which moneys may be borrowed by the directors;
- (g) Check whether e-form no. 23 has been filed with the ROC under Section 192(4)(ee)(i) of the Companies Act, 1956.

"8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies."

Total Public Deposits raised of the above,	₹
Repaid	₹
Outstanding	₹
of this, default in respect of ____	
Depositors aggregating	₹ /Nil
Total unsecured loans raised of the above,	₹
Repaid	₹
Outstanding	₹
of his, defaulted in respect of ____	
Depositors aggregating	₹ /Nil

The Company is not under CIBIL Defaulters' List and/or RBI Caution List

Compliance Inputs

- Register of Deposits
- Register of Loans

"9. The Company has created, modified or satisfied charges on the assets of the company as detailed in Annexure.... Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure"

Format of Annexure

Sl. No.	Description of Asset	Cost of Acquisition of the Asset (₹)	Depreciated Value of Asset (₹)	Amount of Charge (₹)	Charge Holder	Nature of Charge	Whether created, modified or satisfied and date thereof	Document No./ Charge Id	date	Remarks
1.					M/s ...					
2.					M/s ...					
3.					M/s ...					

Compliance Inputs

- Copy of e-form no. 8 duly signed by the company as well as the charge-holder and along with the original/certified copy of the instrument, filed with the ROC;
- Copy of e-form no.10 filed with the Registrar;
- Particulars of modification of charges filed with the ROC in e-form no.8;
- A copy of the instrument creating/modifying charge/a copy of debenture of the series, if any, required to be registered;
- Copy of e-form no.17 filed with the ROC upon satisfaction of the charge;
- Endorsed copies of documents obtained from the ROC in regard to the creation/ modification/ satisfaction of charge;
- Copies of the instruments creating/modifying charges.

Checklist

- (a) Check whether the charge falls within any one of the categories of registrable charges as provided in sub-section (4) of Section 125 of the Companies Act, 1956;
- (b) Check whether the prescribed particulars of the charge requiring registration were filed with the ROC in e-form no. 8 duly signed by the company as well as the charge-holder and along with the original/certified copy of the instrument, if any, within 30 days after the date of its creation or within the time permitted by the ROC under proviso to sub-section (1) of Section 125 of the Companies Act, 1956;
- (c) In case of issue of debentures of a series, if there has been any charge to the benefit of debenture holders of that series, check whether the required particulars have been filed with the Registrar in e-form no.10 within 30 days from the date of execution of or the modification of the trust deed;
- (d) In case commission, allowance, discount is paid or made in consideration for subscribing, etc., to debentures, check whether the forms included particulars of such commission, etc.;
- (e) Check whether abstract of registration is duly endorsed on every debenture or certificate of debenture stock issued, the payment of which is secured by the charge registered;
- (f) Check whether particulars of modification of charges were filed in e-form no. 8 duly signed with the ROC within 30 days of the modification or within the extended period;
- (g) Check whether a copy of the instrument creating/modifying charge/a copy of debenture of the series, if any, required to be registered was kept at the registered office;
- (h) Where payment or satisfaction of charge registered has been effected in full, check whether intimation thereof has been sent to the ROC in e-form no.17 duly signed, by the company as well as the charge-holder within 30 days from the date of such payment or satisfaction (section 138 of the Companies Act, 1956);
- (i) Check whether Register of charges has been maintained and kept open for inspection;
- (j) Check whether the creation/modification/satisfaction of charge has been registered by the ROC and endorsed copies of documents have been obtained;
- (k) In case of delay/omission/mis-statement in filing particulars of charge created/modified or issue of debentures of a series or intimation of satisfaction of charge, to the ROC check whether a petition has been made to the Regional Director and Regional Director order obtained and certified copy of such order has been furnished to the ROC.

(l) Check whether instruments creating/modifying charges are kept open for inspection as prescribed.

“10. Principal value of the forex exposure and Overseas Borrowings of the company as on are as detailed in the Annexure under”

Format of Annexure ...

<i>S. No.</i>	<i>Forex Exposure of the Company</i>	<i>Currency (US\$ Million)</i>	<i>Equ. Amount</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(4)</i>
A.	Funded Exposure		
1.	Foreign Currency Packing Credit		
2.	Foreign Currency Post Shipment Credit		
3.	External Commercial Borrowings		
4.	FCCB		
5.	ADR/GDR etc.		
6.	Other Loans, if any – Please specify		
	(a) Suppliers Credit		
	(b) Buyers Credit		
	(c)		
	(d)		
	Total Funded Exposure		
B.	Non Fund Based Exposure		
	of which :-		
1.	Import Letters of credit opened		
2.	Import Letters of credit accepted		
3.	Guarantees Issued		
4.	Standby letters of Credit		
5.	Others, if any – Please specify		
	(a)		
	(b)		
	(c)		
	Total Non Funded Exposure		
C.	Derivatives		
	(i) Plain Vanilla Contracts		
	1 Forex Forward Contracts		
	2 Interest Rate Swaps		
	3 Foreign Currency Options		
	4 Any other Contracts –		
	Please Specify		
	(ii) Complex Derivatives		
	1 Contracts involving only		
	interest rate derivatives		

- 2 Other Contracts including those involving FC derivatives
- 3 Any other derivatives – Please specify
 - (a)
 - (b)
 - (c)
- Total Derivative Exposure
- Grand Total of all Exposures

**Unhedged Foreign Currency Exposures of the Company :
Currency wise**

<i>S. No.</i>	<i>Type of Exposure</i>	<i>Amount (US\$ Million)</i>
1	Short Terms (viz. < 1 year)	
	(a) Long Positions	
	(b) Short Positions	
	(c) Net Short term Exposures (a - b)	
2	Long Term (viz. > 1 year)	
	(a) Long Positions	
	(b) Short Positions	
	(c) Net Short term Exposures (a - b)	
3	Overall Net Positions (1–2) for each currency (Please give overall Net Position in this format for each currency)	
4.	Overall Net Position across all Currencies	

	<i>Currency</i>	<i>Amount</i>
Total Forex Exposure of the Company		
Fund Based Exposure		
Non-Fund Based Exposure		
Total Borrowing Limit of the Company		
External Commercial Borrowings of the Company		
Borrowing limit of the Company	Currency	Amount (‘)
Amount borrowed from Overseas Directors		
Shri/Ms. ...		
Shri/Ms. ...		

Amount borrowed from Overseas Members

Shri/Ms. ...

Shri/Ms. ...

Amount borrowed from Overseas Public

Shri/Ms. ...

Shri/Ms. ...

Amount borrowed from Foreign Bank(s) /
financial institution(s)

M/s...

M/s...

Amount borrowed from Foreign banks

M/s...

M/s....

Amount borrowed from others

M/s...

Credit Linked Notes

Grand Total

Whether approval of RBI required for the above : Yes/No

If yes, date when approval was obtained _____ (date) vide Reference No.....

**Illustrative List of Foreign Currency Exposures with
Source for Verification**

<i>Type of Exposure</i>	<i>Source for Verification</i>
1. Packing credit in Foreign currency	<ul style="list-style-type: none"> a. Packing credit loan ledger supported by Bank Advice for each disbursement. b. Internal MIS including Trial Balance.
2. Post shipment credit in Foreign Currency	<ul style="list-style-type: none"> a. Post shipment loan Ledger. b. Bill-wise advise from bank. c. Trial Balance/Internal MIS. d. Export Collection Bills e. Advance against FOBCs
3. Foreign Currency Loans	<ul style="list-style-type: none"> a. Last Audited Balance Sheet. b. Bank Advise for disbursement of the loan c. Loan Ledger d. Statement of Account from Lender (Bank)
4. External Commercial Borrowings	<ul style="list-style-type: none"> a. Reporting of loan agreement details under FEMA, 1999

<i>Type of Exposure</i>	<i>Source for Verification</i>
	<ul style="list-style-type: none"> b. Form ECB-2 under FEMA, 1999 (Details of actual transaction of Foreign Currency Loan/ Financial Lease other than short-term Foreign currency Loans) c. Last Interest fixation notification from the Lender d. Loan Ledger
5. Foreign Currency Convertible Bond (FCCB)	<ul style="list-style-type: none"> a. Issuance Approval (if applicable) b. Form ECB-2 (if applicable) c. Board Memorandum copy on FCCB reporting d. Information filed with Stock Exchange
6. American Depository Receipt (ADR)	<ul style="list-style-type: none"> a. Board Resolution for issuance of ADR b. Copy of listing agreement filed with NYSE or NASDAQ c. Statement from RTA
7. Global Depository Receipt (GDR)	<ul style="list-style-type: none"> a. Board Resolution for issuance of GDR b. Statement from RTA c. Copy of listing arrangement with overseas Stock Exchange(s).
8. Loans from Non Residents	
a. J.V. Partner	<ul style="list-style-type: none"> a. Copy of loan agreement
b. Promoter/Director	<ul style="list-style-type: none"> b. Copy of FIRC
c. Others (In all cases:)	<ul style="list-style-type: none"> c. Ledger account extract
9. Imports	
(i) Under LC where the Issuing Banks Nostro A/c has already been debited	<ul style="list-style-type: none"> a. Copy of LC b. Copy of advance documents received directly from overseas seller c. Bank Intimation Letter
(ii) Not under LC but under DA Terms –accepted by the bank or company for payment on a fixed future date.	<ul style="list-style-type: none"> a. Copy of Acceptance b. Bank Intimation
(iii) Buyers credit/Suppliers credit arranged directly by the company	<ul style="list-style-type: none"> a. Copy of LC b. Copy of Invoice c. Term sheet of the overseas Lender (overseas Bank) d. Import Collection Bills
10. Foreign currency on Hand (maximum equal to USD 2000=00)	<ul style="list-style-type: none"> a. Physical counting b. Reasons for keeping the foreign currency
11. Balance in EEFC A/c(Exchange Earners' Foreign Currency Account)	<ul style="list-style-type: none"> a. Statement of Account from the Bank b. EEFC A/c Reconciliation Statement

<i>Type of Exposure</i>	<i>Source for Verification</i>
12. Balances in Bank Accounts held abroad	<ul style="list-style-type: none"> a. General Permission or Special Permission copy b. Statement of Account from the Overseas Bank c. Reconciliation Statement d. Ledger extract from Company's books
13. Investments made abroad	<ul style="list-style-type: none"> a. General or Specific approval copy b. Copy of document evidencing investment c. Ledger extract
14. Loans extended in Foreign Currency	<ul style="list-style-type: none"> a. General or Special Permission copy b. Copy of Loan Agreement c. Proof of remittance of foreign currency d. Ledger extract of Loan Account
15. Advance payments received against exports (exports not taken place)	<ul style="list-style-type: none"> a. Copy of Purchase or Sale contract as the case may be b. Copy of FIRC c. If credited to EEFC A/c cross reference so as to avoid double counting
16. Security Deposits received from Dealers /Distributors abroad	<ul style="list-style-type: none"> a. Copy of appointment letter b. Copy of FIRC c. Copy of Ledger extract
17. Security Deposit paid for overseas officer but parked in Indian Books in respect of (i) Premises (ii) Other utilities (iii) Refundable Regulatory Payment	<ul style="list-style-type: none"> a. Copy of relevant agreement b. Bank Advice copy for remittance c. Ledger extract
18. Capital/Loans/Advances extended to overseas branches or Joint Ventures (JVs) or Wholly Owned Subsidiaries (WOSs).	<ul style="list-style-type: none"> a. Copy of agreement for each loan b. Proof of disbursement c. Ledger extract
19. Forward Contracts Booked [Both Purchases and Sales]	<ul style="list-style-type: none"> a. Copy of Contract Note b. Verification of underlying (i.e. export bill, export LC, Import bill, Import LC, Purchase Order, Sales Contract etc.)
20. Bid Bonds Performance Guarantees	<ul style="list-style-type: none"> a. Copy of each Guarantee with supporting documents

<i>Type of Exposure</i>	<i>Source for Verification</i>
Retention Money Guarantees Advance Payment Guarantees or any other Guarantees issued and outstanding	b. Bank Advice or Bank Correspondence for each instrument
21. Derivative Transactions	a. Term sheet for each contract
— Options	b. Board Resolution
— Foreign Currency Swaps etc.	
— Exchange Traded Currency Futures (Broker/Bank Contract Note for each deal)	
22. Interest Rate Swaps and Forward Rate Agreements	If any one leg is a foreign currency interest rate benchmark, then
	a. Certified copy of the agreement
	b. Term Sheet
	c. Last Payment/Receipt details
	d. Liability computation for broken period for each Interest Rate Swap/Forward Rate Agreement (IRS/FRA) deals.
23. Advance remittance towards import of merchandise/capital goods	
24. Estimated contracts entered into forex future deals.	

Compliance Inputs

- Relevant Ledger Accounts
- Bank specific policies/guidelines
- FEMA 1999 – Notifications issued by Reserve Bank & Rules framed by Government of India
- Guidelines issued by Industrial & Export Credit Department (IECD)/Department of Banking
Operative & Development (DBOD)/DBOS/Foreign Exchange Department (FED) of the Reserve
Bank
- Foreign Trade (Development and Regulation) Act, 1992
- Foreign Trade Policy 2004-09
- Foreign Contribution Regulation Act, 2010
- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974
- Uniform Customs and Practice for Documentary Credits (UCPDC ICC 600)
- FEDAI Rules
- SEBI guidelines
- ODA Guidelines

- Investment abroad – both Assets side and Liabilities side
- Accounting Standards (AS 11, IAS 39, FASB, GAAP norms).

“11. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within the stipulated time in compliance with the provisions of the Companies Act, 1956 and other relevant statutes”

Compliance Inputs

- Debenture Trust Deed issued in case of secured debentures.
- Register of Issue, registration, transfer of shares /debentures.
- All corporate actions of allotment such as IPO, rights, bonus, Compulsorily Convertible Preference Shares (CCPS), preferential allotment and buyback.
- SEBI (ICDR) Regulations, 2009.
- E-Form No. 5 filed with the ROC.
- Books of Accounts.
- Order, if any, of the Company Law Board with regard to redemption of debentures.

Checklist for Buy Back

A company may purchase its own shares or other specified securities out of—

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of any shares or other specified securities:

The buy-back may be—

- (a) from the existing security holders on a proportionate basis; or
- (b) from the open market; or
- (c) from odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or
- (d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

No company shall directly or indirectly purchase its own shares or other specified securities—

- (a) through any subsidiary company including its own subsidiary companies; or
- (b) through any investment company or group of investment companies; or
- (c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures, or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution.

No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 159, 207 and 211 of the Companies Act, 1956.

- (a) Check whether the buy-back is authorised by its articles;
- (b) Check whether special resolution has been passed in general meeting of the company authorising the buy-back;
- (c) Check whether the buy-back is or less than ten per cent of the total paid-up equity capital and free reserves of the company; and such buy-back has been authorised by the Board by means of a resolution passed at its meeting;
- (d) Check whether that no offer of buy-back has been made within a period of three hundred and sixty-five days reckoned from the date of the preceding offer of buy-back, if any;
- (e) Check whether that the buy-back is of less than twenty-five per cent of the total paid-up capital and free reserves of the company;
- (f) Check whether that the buy-back of equity shares in any financial year does not exceed twenty-five per cent of its total paid-up equity capital in that financial year;
- (g) Check whether that the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back: "debt" includes all amounts of unsecured and secured debts;
- (h) Check whether all the shares or other specified securities for buy-back are fully paid-up;
- (i) Check the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulation made by the Securities and Exchange Board of India in this behalf;
- (j) Check whether that the notice of the meeting at which special resolution is proposed to be passed is accompanied by an explanatory statement stating —
 - (a) a full and complete disclosure of all material facts;
 - (b) the necessity for the buy-back;
 - (c) the class of security intended to be purchased under the buy-back;
 - (d) the amount to be invested under the buy-back; and
 - (e) the time limit for completion of buy-back.
- (k) Check whether every buy-back is completed within twelve months from the date of passing the special resolution
- (l) Check whether the company before making such buy-back, filed with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed, and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any.
- (m) Check that no declaration of solvency has been filed with the Securities and Exchange Board of India by the company while its shares are were listed on any recognised stock exchange.

- (n) Check that if the company has bought back its own securities, it has extinguished and physically destroyed the securities so bought-back within seven days of the last date of completion of buy-back.
- (o) Check that where a company completes a buy-back of its shares or other specified securities under this section, it has not made further issue of the same kind of shares (including allotment of further shares under clause (a) of sub-section (1) of section 81 of the Companies Act, 1956 or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
- (p) Check whether the company has maintained a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.
- (q) Check whether the company, after the completion of the buy-back filed with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed.
- (r) Check that where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the share so purchased has been transferred to the capital redemption reserve account and details of such transfer have been disclosed in the balance sheet.

Checklist for Issue of Certificates for Shares and other Securities

- (a) Check whether the company has allotted shares/debentures and entered the names of allottees in the register of members/debentureholders;
- (b) Check whether the company has issued and delivered share certificates as per sections 84 and 113 of the Companies Act, 1956 and the provisions of the Companies (Issue of Share Certificates) Rules, 1960;
- (c) Check whether the company has filed eform 2 – return of allotment with the Registrar;
- (d) Check whether the company has executed Debenture Trust Deed in case of secured debentures;
- (e) Check whether the company has delivered debenture certificates within the prescribed period;
- (f) Check whether the company has registered transfer and transmission of shares as per Sections 108 to 113 of the Companies Act, 1956;
- (g) Check whether the company has kept in abeyance the registration of transfers in cases of Court-injunction.

Checklist for Redemption of Preference Shares

- (a) Check whether the provisions contained in Articles of Association have been complied with;
- (b) Check whether the conditions set out in Section 80 of the Companies Act, 1956 have been met;
- (c) Check whether e-form no. 5 has been filed with the ROC within 30 days from the date of redemption.

Checklist for Redemption of Debentures

- (a) Check whether e-form no. 17 has been filed with the ROC;

- (b) Check whether the company has created a debenture redemption reserve for the redemption of debentures and credited adequate amount from out of the profits until such debentures are redeemed;
- (c) Check that the company has not utilised the debenture reserve except for the redemption of debentures;
- (d) Check whether the company has paid interest and redeemed the debentures in accordance with the terms and conditions of their issue;
- (e) Check whether the company has complied with the any other order, if any, with regard to redemption of debentures.

"12. The Company has insured all its secured assets."

Particulars of Insurance cover obtained by the Company are as under:-

Sl. No.	Particulars of Asset Insured	Value of Asset (₹)	Sum Insured (₹)	Risk Covered	Amount of Policy	Insurance Company	Insurance Policy Number
1.						M/s ...	
2.						M/s ...	
3.						M/s ...	

Note : Insert a remark, whether all the assets have been insured and provide a list of assets that haven't been insured.

Compliance Inputs

- Original insurance policies
- Register of Assets
- Collateral Security offered to the lenders
- Stock Statement
- Premium payment receipts

Checklist for Insurance Policies

- (a) Verify the original insurance policies and check carefully the details of assets covered by the policy.
- (b) Check that the Company has taken a Policy from a General Insurance Co. registered with IRDA.
- (c) Check the period of the policy. Policies are generally issued for a period of one year. Sometimes, short period policies for less than one year are also issued.
- (d) Generally, Fire Insurance policies cover immovable properties, stocks etc. Earthquake,

Terrorism etc. are given as add on covers. Vehicles should have Valid Comprehensive Insurance Policies.

- (e) Check that the sum insured represents the Market value/Replacement value as the case may be (not book value) or else, under insurance will be applicable. Name, address, situation (with Building No. etc.) of the Company should tally with the records.
- (f) Verify the name of the mortgagee.
- (g) Verify any endorsement during the policy period, noting the changes in the sum insured, situation, risk etc.

Checklist for Compliance of Terms of Insurance

Check the following in regard to compliance of terms of insurance:

- (a) the company's assets have been insured comprehensively. Where a joint insurance on plant and buildings has been taken, the value thereof has been apportioned in the manner prescribed/ approved;
- (b) the insurance policy has been taken in the joint names of the company and the bank(s)/financial institution(s) ;
- (c) the policy has been kept alive for such full value, as has been determined by the bank(s)/financial institution(s) , all premia are being paid on time, and the company has not done any such act as would render the policy void or voidable;
- (d) the policy has been taken from an insurance office of repute, as determined by the bank(s)/financial institution(s); and
- (e) all moneys received under the insurance policies are held in trust for better securing to the bank(s)/ financial institution(s) , the payment of all moneys secured under the indenture agreement.

"13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institution at the time of availing any facility and also during the currency of the facility."

Compliance Inputs

- Copy of the Lending Agreement

Checklist for Compliance with the terms and conditions set forth by the lending Institution at the time of availing the facility.

Check the following points to confirm that:

- (a) further funds have not been borrowed from bank(s)/financial institution(s) on hundis, other than from its bankers, without prior consent;
- (b) no donations/contributions have been made to the charitable and other funds, which are not directly related to the business of the borrower or to the welfare of its employees, in excess of the indenture (if any), without the consent of the bank; and
- (c) no merger/consolidation/re-organisation/arrangement/compromise with the creditors/shareholders has been undertaken/permitted without the approval of the bank.

Checklist for Operations of the Company

Check whether the following have been ensured, about the operations of the company:

- (a) the company has not ceased to carry on business, even temporarily;

- (b) any material changes in the operations, including creation of a subsidiary, implementation of expansion programmes, and undertaking any general trading activities have been approved by the bank(s)/financial institution(s);
- (c) the selling/purchasing agency has been given on terms and conditions laid down in the indenture. Where required the existing arrangements have been suitably modified. Specific permission has been taken where agreement is being entered into with the associate concerns of the promoter(s)/director(s) of the company; and
- (d) any arrangements required to be entered into, as per the provisions of the indenture, have been duly made.

Checklist for Security Offered on the Term Loan

Verify the following as regards security offered on the term loan, and subsequent acquisition of assets:

- (a) Assets acquired pursuant to the loan agreement are in line with the terms of the sanction;
- (b) Assets purchased from the money advanced/to be advanced, if not brought upon/fixed to the factory premises, have been hypothecated with the bank(s)/financial institution(s)/commercial bank;
- (c) The company has not entered into any arrangement with the creditors, nor has any act or default been committed, as would render the company liable to be taken into liquidation;
- (d) Where guarantees have been furnished, in the event of death of a guarantor, his heirs have not given notice of revocation; and
- (e) In the opinion of the assessors/valuers appointed by the company the value of the security has not become insufficient or depreciated beyond norms prescribed in the indenture.

Checklist for Default in Payment of Interest/Principal Instalments

Confirm that in the event of default:

- (a) the consent of the bank(s)/financial institution(s) has been taken, where required, prior to distributing dividends and making interest payment on unsecured loans and deposits; and
- (b) sales tax refunds/sum received from incentive schemes, etc., have been applied towards payment of overdue amounts.

Checklist for Information submitted to Bank(s)/Financial Institutions

Verify that the periodical statements required to be submitted to the bank(s)/financial institution(s), are being furnished on time. The statements may be on the operations of the company/implementation of the project undertaken.

Checklist for Utilisation of Moneys Advanced

Ensure that consistency has been maintained in utilisation of moneys advanced to the mortgagor. The following aspects may be specifically examined:

- (a) funds have been utilised for the purposes laid down in the indenture. Where funds have not been so utilised, the requisite permission has been taken;
- (b) requisite conditions laid down to qualify for the outstanding balance of the loan have been fulfilled;
- (c) the drawals from the loan are being kept in a separate Scheduled Bank Account, payments therefrom are being made in the manner laid down in the indenture, the said scheduled bank has

foregone its right to set-off or lien, in respect of the said account, and the mortgagor is maintaining the records pertaining to the said account, as provided in the indenture;

- (d) no part of the loan moneys has been transferred to call, short term, fixed or any other deposits, without prior consent. Where such consent has been obtained, the scheduled bank has foregone its right to set off any amount due from the company, against the deposits, the deposits have been realised on their due dates and the proceeds thereof re-deposited in the special account;
- (e) the expenditure has been financed in the manner provided for in the indenture; and
- (f) any changes/deviations in the time schedule for completion of the project have been made in consultation with the bank(s)/financial institution(s).

Checklist for Payment of Liabilities/Dues

Ensure as regards payment of liabilities/dues that:

- (a) the company has been paying all the ground rents, rates, taxes, dues, duties and outgoings immediately on their becoming due and there is no penalty imposed/adverse remarks by the Regulatory Authorities against the company during the period under review;
- (b) where the company has any account(s) with bank(s)/financial institution(s), guaranteed by Reserve Bank of India, no default has been committed on its maintenance, as would render Reserve Bank of India liable to reimburse the guaranteed amount;
- (c) any prepayments, of any amount other than the term loan and the bank borrowings in the ordinary course of business, have been made with the prior approval, in writing, of the bank(s)/financial institution(s). Any other conditions stipulated under the indenture, have also been complied with; and
- (d) no other bank(s)/financial institution(s) with whom the company has entered into agreements for financial assistance have refused to disburse the loan(s) or any part thereof, nor have they recalled the sums disbursed under their respective loan agreements entered into with it.

Checklist for Books of Accounts

Scrutinise the books of accounts to check that:

- (a) proper books of accounts have been maintained by the company, in consonance with the requirements laid down in the Companies Act, 1956;
- (b) books of accounts have been properly posted up at all times; and
- (c) annual audit of the books of accounts has been conducted in the manner provided for under the Companies Act, 1956, and copies of audited accounts have been submitted to the bank(s)/financial institution(s) within six months from the date of closing of the accounts.

Checklist for Memorandum/Articles of Association

Verify that any alteration in the Memorandum/Articles of Association has been made with the prior consent, in writing, of the bank(s)/financial institution(s).

Checklist for Directors/Promoters

Scrutinise the records to ascertain that:

- (a) the shareholdings of the directors have not been substantially varied, nor have the deposits/

unsecured loans received from the directors been reduced, without the prior consent of the bank(s)/financial institution(s);

- (b) funds procured from the promoters/directors are only subject to such conditions as are laid down in the indenture;
- (c) all amounts payable on account of any sitting fees, expenses, commissions, and remuneration to nominee directors, have been duly paid;
- (d) no commission has been paid to the promoters, directors, managers or any other persons for furnishing guarantees, counter guarantees, obligations, indemnity or for undertaking any other liability/obligation, without the prior approval of the bank(s)/financial institution(s); and
- (e) prior approval of the bank(s)/financial institution(s) has been taken for the appointment/re-appointment of managing director/whole-time director/chairman/consultants, as regards changes in their terms of appointment, except where these are as per the provisions of the Companies Act, 1956. The appointments, where necessary, have the approval of the Central Government.

Checklist for Board Meetings

Verify that all important matters, specifically required by the bank(s)/financial institution(s), were submitted for decision to the Board of Directors and the meetings thereof were both called and conducted, in the manner laid down in the indenture.

Checklist for Technical Experts

Check whether the provisions contained in the indenture, as regards the appointment of experts, their technical training and any other directions, have been complied with, and the bank(s)/financial institution(s) is/are being duly kept informed of such compliance.

Checklist for Licences/Consents

Ensure that:

- (a) the registration/licenses/renewals required under the Industries (Development & Regulation) Act, 1951/FEMA, 1999 and from the Central/State Government/other authorities have been obtained;
- (b) the rights, powers, privileges, concessions, trade marks, patents and licence agreements necessary in the conduct of the business, have been renewed; and
- (c) in case of MSME/SSI unit, the Registration has been renewed;
- (d) Pollution Control/Hazardous Waste treatment related permissions have been obtained.

Checklist for Contracts

Ensure that any strictures as regards agreements for supply of plant and equipment, have been complied with, and competitive tenders have been called for, where required.

Checklist for Legal Proceedings

Verify, as regards possible legal proceedings, that:

- (a) the bank(s)/financial institution(s) have been intimated of any notices received under any Act, including the application for winding up under the Companies Act, 1956;
- (b) where a receiver has been appointed on any of the properties/business undertaking of the

company, or any distress or execution has been allowed to be levied on the mortgaged premises the bank(s)/financial institution(s) has/have been intimated about it; and

- (c) the company is not party to any material litigation with respect to assets acquired under the loan agreement.

Checklist for Takeover of Management

Verify that no proceedings for winding up have been commenced, nor has any receiver been appointed without the prior consent of the bank(s)/financial institution(s).

Checklist for Financial Position

Check the financial position to ensure that:

- (a) the company has not put its funds, nor invested them in purchase of shares of any other concern, without the prior approval of the bank(s)/financial institution(s) as stipulated in the loan agreement;
- (b) no money has been withdrawn from the business, out of the capital or in anticipation of profits, without prior consent of the bank(s)/financial institution(s); and
- (c) proposals to undertake inter-corporate loans or other investments, have the prior approval of the bank(s)/financial institution(s).
- (d) the company has provided adequate provision on depreciation as required u/s 205 of the Companies Act, 1956 in its Book of accounts.

Note:

- (1) In case of project under implementation — check whether the margin money has been brought in by the promoters as per the terms of sanction.
- (2) Furnish the details of inflow viz. date, amount, channel (name of bank (s)), etc.
- (3) Check the compliance of the provisions of Section 293 of the Companies Act, 1956 regarding the powers of the Board.

A specimen Sanction Letter covering terms, conditions, covenants and remarks is placed below for reference.

Specimen sanction letter

To

Relevant Terms, Conditions & Covenants, etc. applicable to the Sanctioned facility(ies)

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
1.	The Company/firm to execute necessary security documents/renewal documents for sanctioned/enhanced limit(s) duly supported by Board resolution and create and register stipulated charges with the authorities specified for the purpose within stipulated time limit before release of sanctioned/enhanced limits.	Self Explanatory

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
2.	Company/firm to have title deeds of the immovable assets released from Term Lenders and re-deposit the same at the Bank as an agent and custodian of First Charge and Second Charge holders.	Self Explanatory
3.	Where Company/firm agrees to give second charge favouring the Bank, it has to complete the process as mentioned in serial “___” above and create second charge on block of fixed assets within a period of ___ months (to be as per terms of sanction) to secure the last enhanced limits and the present enhanced limits alongwith loan of ₹_____ sanctioned by us outside the consortium.	Self Explanatory
4.	Guarantor(s) : All fund based and non fund based facilities to be guaranteed (Joint & Several guarantee) by Mr./M/s. _____. The firm/Company shall not pay any guarantee commission to the guarantors.	Self Explanatory
5.	The release of credit facilities is also subject to vetting of security documents by the bank's approved advocate and bank's internal procedure of Credit Process Audit. The charges for vetting of the documents by the Bank's advocate are payable by firm/Company	Self Explanatory
6.	<p>Stock/book debt statements are to be submitted at a frequency stipulated by the Bank (monthly/quarterly) alongwith select operational data (MSOD) in bank's prescribed formats.</p> <p>Valuation of stocks to be done at cost/invoice / market price, whichever is lower.</p> <p>Non submission of stock/book debts and MSOD statements by 10th (or the date stipulated in sanction) of the succeeding month will attract penal interest @1% p.a. If these statements are not submitted for a continuous period of 3 months, Bank may initiate further action as deemed necessary by the Bank</p>	<p>6 & 7 combined facilitates</p> <p>— Stock & Book debts statement will facilitate verification of end use of funds given for build up of assets as stipulated</p> <p>— MSOD facilitates ensuring movement of stocks from RM- WIP-FG-BDS. Helps spot low-nil level of activity if compared with past stock movement</p> <p>— If these are not commensurate with the funds released, bank may seek reasons for same which can be such as :- advance to suppliers</p>

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
7.	The drawing power in the accounts would be arrived at after deducting the unpaid creditors, outstanding balance, if any, in the accepted DA L/C account. In the case of book debts no drawings would be allowed against book debts on sister concerns, unless specifically agreed to by the bank, and also those which are more than 90/180 days old. Drawings would be allowed based on the QIS returns subject to the availability of drawing powers as mentioned above.	<p>processors/stock in transit not declared/other assets built up/ payment of expenses not relating to mfg but not disclosed/moneys advanced to others without prior approval/cash losses being financed etc.</p> <p>— Can facilitate random check on valuations/whether prices assumed are as per prevailing market price/inflated if quantitywise summaries are available</p> <p>— Quality of debtors, in case of well known companies, can be verified. Movement of debtors on aging is available</p> <p>— LC is a Preferred mode of payment to suppliers since probability of diversion/siphoning of funds is low – the beneficiaries' business product line is ascertained to verify the product is an input to the manufacturing process/ultimate product of borrower company</p> <p>— LC acceptances outstanding with bank can be cross verified with LC creditors declared and also the material yet to be received under outstanding LCs estimated</p> <p>— Non financing of associates book debts is to check double financing/diversion for other uses since associate's finances are often not subject of detailed scrutiny by this lender</p>
8.	Packing Credit will be allowed only against L.C.s opened by acceptable banks and confirmed export orders from approved parties and will be extended for periods not beyond the last shipment date	<p>utilisation of monies</p> <p>— This is to ensure genuineness of the trade transactions since banks also seek status report on these drawees concerned, independently through D&B.</p>

<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
<p>9. Bank will obtain status report on drawees before purchase/discount of the bills and such reports will be updated annually; availability of a satisfactory status report shall be a pre-requisite for such purchase/discount of bills.</p>	<p>—The EPC tenor is normally matched with the manufacturing cycle of borrower to ensure need based financing.</p> <p>—This is a check to ensure that accomodation bills are not being raised by borrower to avail finance</p> <p>— Prima facie verifies the line of business of drawees which should be in same product line/drawee may be a selling agent</p> <p>— Delayed Payments/Return of bills acts as a warning signal to lender on problems likely to arise</p> <p>— Return of goods by drawee can indicate rejections due to product deficiencies or delays in dispatches i.e. inability to meet commitments – may be a reflection of management problems</p>
<p>10. The firm/company to display bank's hypothecation plate/board at its Unit/business premises indicating that stocks/assets are hypothecated to the Bank.</p>	<p>—To put public on notice of lender's interest in the asset of borrowers.</p>
<p>11. All the assets charged/to be charged to the Bank to be kept fully insured at all times against all risks (Burglary, comprehensive risks etc.) and original Insurance cover note/policy in the name of the Bank a/c borrower firm/Company with Bank's Hypothecation clause to be lodged with the Bank.</p>	<p>— This is to ensure that lender's interest is noted and protected in the assets financed with the Insurer & claims will be settled only with the lender/s</p>
<p>12. The company to submit all bills/receipts etc. as applicable to project expenditure. A certificate from bank's approved C.A/Architect/valuer towards expenses incurred on project/progress in implementation of project. Any escalation in the project cost to be met by the promoters/ company/firm from their own sources</p>	<p>To verify end use of funds for financing only those assets as were originally approved</p> <p>That the pricing of equipments is as per the quotations that may have been obtained originally and that the expenditures are within the budgeted figures</p>

Terms, Conditions and Covenants	Remarks
	<p>— To also verify that the promoter's have brought in their contributions as originally envisaged, in the form and time period stipulated i.e. Form as equity/quasi equity</p>
<p>13. The Company/firm to submit copy of statutory permissions/clearances like 'NOC' from Pollution Control Board and ensure for timely renewal of same from time to time.</p> <p>(Only illustrative)</p>	<p>— To ensure lender's funds are not jeopardised due to disruption of activity on account of non-availability/non obtention of/non-adherence to any of the statutory prescriptions</p>
<p>14. Inspection will be done on quarterly basis (in rotation by consortium member banks) or as and when required by the bank. The Bank has the right of deputing its officials/person(s) (like qualified auditors or management consultants or technical experts) duly authorised by the Bank to inspect the unit, assets, books of accounts/records etc. from time to time. Also the Bank may appoint, at its sole discretion, stock/concurrent auditors, valuers, consultants for specific jobs relating to company's/firm's activities, the cost of which will be borne by the company/firm.</p>	<p>— To verify that proper records are being maintained</p> <p>— To verify correctness of data submitted to lender <i>vis-à-vis</i> actuals as per the books</p> <p>— That the drawals with lenders are in fact supported by the physical assets/amounts due from debtors</p> <p>— Verify quality of assets/debtors</p> <p>— To ascertain disputed debtors/non moving stocks/obsolete inventory etc.</p> <p>— Detect diversion of funds to others including associates as per bank account of company</p>
<p>15. Pre shipment and post shipment limits to be secured by Whole Turnover Package Corporate Guarantee (WTPCG) & WTPSG Schemes of Export Credit Guarantee Corporation (ECGC), with the option to the Bank for obtaining comprehensive ECGC coverage depending upon the risk prevailing in the country where export is being made. Premium payable to ECGC by the Bank in respect of WTPCG policy is to be borne by firm/Company</p>	<p>Self Explanatory</p>

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
16	Loan amount of ₹_____ is repayable in _____monthly/quarterly/half yearly instalments of ₹_____each commencing from _____ months after first date of disbursement with an option to pre-pay with/without prepayment charges. Prepayments will attract additional charges @_____(As per terms of sanction).	Self Explanatory
17.	Penal interest of 2% p.a. will be levied on the overdue amount for the period account remains overdrawn due to irregularities such as – non payment of interest immediately on application, non payment of instalments within one month of their falling due, reduction in drawing power/limit, excess borrowings due to over limit, devolvement of L/C, invocation of Guarantee etc. If the account continues to be overdrawn for a period of 90 days, the bank may consider initiation of other action also as deemed fit by the bank.	Self Explanatory
18.	Any default in complying with terms of sanction within the stipulated time will attract penal interest of 1% p.a. from the date of expiry of such time.	
19.	Lead Bank/processing charges of ₹_____ will be levied annually. Earmarking charges of ₹_____p.a. per account for Earmark Limit of ₹_____ at _____branch, Documentation charges of ₹_____ and inspection charges @ ₹_____ per inspection are payable. Working Capital Demand Loan (WC DL) conversion to FCL/FCL rollover charges as applicable maximum ₹ 25, 000/- per transaction. Out of pocket expenses incurred towards title verification and valuation of property/assets, inspections/techno-economic appraisal of the project/unit will be recovered separately.	Self Explanatory
20.	Commitment charges: A minimum commitment charge of 1% p.a. will be levied on unutilised portion of working capital limits subject to tolerance level of 15% of such limits. Company/firm to intimate in advance about the level of utilisation of the limit through QIS returns. If overall utilisation of fund based limits during the year is less than 60% of the sanctioned limit, then commitment charges of 2% p.a. will be recovered and the limits will be pruned down at the time of review	Self Explanatory

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
21.	In case of default either in the payment of interest, the repayment of the principal amounts as and when due and payable or reimbursement of all costs, charges and the expenses when demanded, you shall pay additional interest at the rate of 2% above the interest rate for the facilities on the overdue interest, costs, charges or expenses and/or from the respective due dates for payment and/or epayment.	Self Explanatory
22.	The firm/company is required to submit QIS I, II & III returns. QIS I (showing estimates) is required to be submitted in the week preceding the commencement of the quarter to which it relates, QIS II (showing performance) within six weeks from the close of the quarter to which the statement relates and QIS III (half yearly operating statement) within two months from the close of the half-year. Any delay without specific approval from the bank will attract penal rate of 1%p.a. for the delayed period.	<p>— QIS I — estimates of performance as furnished by company based on which release of limit for Working Capital can be regulated. These should also be in tune with annual project in submitted</p> <p>— QIS II – ascertains actuals <i>vis-à-vis</i> projections—in effect verifying end use of funds. Can check diversion of funds</p> <p>— QIS III- profitability statement can be taken to ensure performance/projections during the half-year</p>
23.	Credit Monitoring Arrangement (CMA) data to be submitted at least one month before the due date of review. Any delay without specific approval from the bank will attract penal rate @1% p.a. In case CMA data is not submitted for a continuous period of three months, the bank may take further action as deemed fit by the Bank.	Self Explanatory
24.	The company/firm to ensure submission of statement of Assets & Liabilities in Bank's format CBD-23 (duly certified by a C.A.) along with copies of Income Tax and Wealth Tax returns/assessment orders of all the partners and guarantors every year.	To ascertain the movement of net worth of the promoter
25.	The company's/firm's entire banking business (including merchant banking, Dividend and interest payments) should be routed through us/ members of the consortium proportionate to the sharing of the working capital facilities.	<p>— To prevent diversion through other channels</p> <p>— To exercise partial – control on verifying end-use of funds</p>

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
26.	<p>Firm/Company to declare/undertake to us:</p> <p>— to supply to us, audited financial statements of the firm /company within 6 months from closure of financial year. Any delay in submitting these audited financial statements without our specific approval will attract penal interest @ 1% p.a. In case these statements are not received by us for a continuous period of 3 months, the bank may take further action as deemed fit by the bank.</p> <p>— to provide to us promptly information (alongwith comments/explanation) about all material and adverse changes in your project/business, ownership, management, liquidity, financial position etc.</p> <p>— that any liabilities or obligations under the facilities shall not, at any time, rank postponed in point and security to any other obligation or liabilities to other lending institutions or banks or creditors, unless expressly agreed or permitted by bank.</p> <p>— not to create or permit to subsist any mortgage, charge (whether floating or specific), pledge, lien or other security interest on any of your undertakings, properties or assets, without our prior consent in writing.</p>	<p>FOR VERIFICATION OF ALL ASPECTS</p> <p>— utilized to verify performance <i>vis-à-vis</i> estimates which can reasonably be led to conclusion of proper end use</p> <p>— for detection of otherwise undisclosed diversions</p> <p>— diversification in business lines/unrelated or related but undisclosed investments /tie-ups are brought to notice of lender</p> <p>Say for e.g. Serious internal problems, change in key management personnel, winding up petitions filed etc.</p> <p>Illustrative only</p> <p>Self Explanatory</p> <p>Self Explanatory</p>
27.	<p>A stamped undertaking to be submitted in favour of the Bank to the following effect that during the currency of bank's credit facilities, the company/firm shall not, without our permission in writing :-</p> <p>— effect any adverse changes in company's/ firm's capital structure.</p> <p>—formulate any scheme of amalgamation or merger or reconstruction.</p>	<p>Acts as a Deterrent.</p> <p>Undertaking to prevent utilisation of funds for unauthorised purposes</p>

<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
<ul style="list-style-type: none"> — implement any scheme of expansion or diversification or capital expenditure except normal replacements indicated in funds flow statement submitted to and approved by the Bank; 	Prevent diversion of short term funds to long term uses which can seriously impair day to day operations and create strain on cash flow.
<ul style="list-style-type: none"> — enter into any borrowing or non-borrowing arrangements either secured or unsecured with any other bank, financial institution, company, firm or otherwise or accept deposits in excess of the limits laid down by Reserve Bank of India. 	
<ul style="list-style-type: none"> — invest by way of share capital in or lend or advance funds to or place deposits with any other company/firm/concern (including group companies/associates)/persons. Normal trade credit or security deposit in the normal course of business or advance to employees can, however be extended. 	Prevents diversion of funds to unauthorised purposes/ investments not approved/ endorsed by lenders etc.
<ul style="list-style-type: none"> — undertake guarantee obligations on behalf of any other company/firm/person 	Can be debilitating if amount large and default ensues
<ul style="list-style-type: none"> — declare dividend for any year except out of profits relating to that year after meeting all the financial commitments to the bank and making all due and necessary provisions. 	To check disproportionate outgo of funds which can adversely impact repayment of lender's dues
<ul style="list-style-type: none"> — make any drastic change(s) in its management set -up. 	Self Explanatory
<ul style="list-style-type: none"> — approach capital market for mobilising additional resources either in the form of Debts or equity. 	
<ul style="list-style-type: none"> — sell or dispose off or create security or encumbrances on the assets charged to the bank in favour of any other bank, financial institution, company, firm, individual. 	To check siphoning of funds
<ul style="list-style-type: none"> — repay monies brought in by the promoters, partners, directors, share holders, their relatives and friends in the business of the company/firm by way of deposits /loans/share application money etc. 	To check siphoning of funds

[illegible]

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
33.	The credit facilities shall be utilised only for the purposes for which same are granted and said facilities shall not be 'diverted' or 'siphoned off' or used for any other purposes.	Self Explanatory
34.	In case of default in the repayment of loans/advances/abovesaid facilities or in the repayment of interest thereon or any of the installment of Loan as per stipulated terms, or in the event of diversion or siphoning off or utilising the said facilities for any other purpose other than for which it is granted, the Bank and/or the Reserve Bank of India (RBI) will have an unqualified right to disclose or publish the name of the company/firm or its directors/partners as defaulters in such manner and through such medium as the Bank or RBI or such other agency authorised by them, in their absolute discretion may think fit.	Self Explanatory
35.	Please note that the cheques drawn by firm/ Company will not be honoured by bank if in its view the payment is going towards a purpose for which the facilities are not sanctioned. Further, please note that Bank will not allow cash withdrawals beyond Rs._____ per cheque/per day.	To prevent diversion to un- authorised purposes/investments/ siphoning off of funds
36.	Bank assumes no obligation whatsoever to meet your further (fund based or non fund based) requirements on account of growth in business or otherwise without proper revision and sanction of credit limits decided at the sole discretion of the bank. Further, if sanction terms are not complied with by you or if your account is classified as Non-performing Asset (NPA), then bank may not allow further withdrawals in the account.	Self Explanatory
37	(a) Notwithstanding what is stated herein above, we shall at any time and from time to time, be entitled to notify you and charge interest/commission/charges at such notified rates and this letter shall be construed as if such revised rates were mentioned herein.	Self Explanatory

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
	(b) You shall pay to or reimburse all costs, charges, expenses (including charges between the attorney or counsel and bank and those of our internal legal adviser/officer and other experts, consultants or professionals), disbursements, taxes, fees, stamp duties etc. whatsoever, incidental or to arising out of the facilities, their negotiation, the preparation, execution, registration and stamping of the documents relating thereto, the preservation or protection of our rights and interests of the enforcement or realisation of any security or any demand or any attempted recovery of the amounts due from you.	Self Explanatory
38.	We shall be entitled to debit the amounts of all costs, charges and expenses to your account and such amounts shall stand secured by all securities given to or created in our favour in connection with the facilities. You indemnify and keep us fully and completely indemnified from time to time against the liabilities including all costs, charges and expenses stipulated herein whether debited to your account or not.	Self Explanatory
39.	Any failure to exercise or delay in exercising any of our rights hereunder or under any other documents will not act as a waiver of that or any other right nor shall any single or partial exercise preclude any future exercise of that right.	Self Explanatory
40.	So long as any monies are due to us from you under any of the facilities, we shall have a lien/charge for such amounts on all your credit balances, deposits, securities or other assets with, any of the branches of the Bank or of its subsidiaries any where in the world and upon the happening of any of the events of default referred herein, we shall be entitled to exercise a right of set off between the amounts due and payable to us and the said credit balances, deposits, securities and other assets.	Self Explanatory
41.	You shall not, except after prior written permission from us, make any alterations in your constitution, controlling ownership or any documents relating to its constitution or any other material change in your management or in the nature of your business or operations during the period of the subsistence of facilities.	Self Explanatory

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
42.	The bank reserves the right to discontinue any/all the credit facilities granted without giving you any prior notice in case of non-compliance and/or breach of any of the terms and conditions based on which the facilities have been sanctioned to you and/or if any information/particulars/documents furnished by you are found to be incorrect.	Self Explanatory
43	You shall not undertake derivative transactions without approval of the Bank. You should obtain NOC from the Bank before entering into any derivative agreement with any other Bank.	Self Explanatory
44.	The Bank carries out the credit rating exercise every year when the facilities are reviewed. However, it reserves the right to carry out the credit rating exercise of the facilities at frequencies considered necessary and the rate of interest chargeable to the facilities would depend upon the rating obtained by the borrowing firm/Company.	Self Explanatory. Due to implementation of Basel II External rating is also being asked for.
	The Bank reserves the right to add, amend, alter, cancel and modify any of the terms and conditions stipulated hereinabove with or without any prior reference to you. Further, the bank's general rules governing advances shall also apply. The company/firm to abide by such terms and conditions as the bank may stipulate from time to time.	Self Explanatory

"14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956."

Dividend on Equity Capital

	<i>Rate of Dividend (%)</i>	<i>Dividend Declaration Date</i>	<i>Amount transferred to Reserves (₹)</i>
Interim Dividend – 1			
Interim Dividend – 2			
Final Dividend			

Dividend on Preference Capital

	<i>Rate of Dividend (%)</i>	<i>Dividend Declaration Date</i>	<i>Amount transferred to Reserves (₹)</i>
Dividend			

Compliance Inputs

- Board resolution recommending final dividend;
- Board resolution approving interim dividend;
- Board authorization for opening of a separate Bank Account for payment of dividend;
- Books of account;
- Register of members;
- Declaration of dividend at the annual general meeting;
- Permission of Reserve Bank of India, if required before dividend was remitted to foreigners/non resident Indians and withholding tax if any;
- Intimation to stock exchanges, in case of listed company;

Checklist

- (a) Check whether Board resolution recommending final dividend has been passed;
- (b) Check whether Board resolution approving interim dividend has been passed;
- (c) Check whether dividends were declared out of profits after providing for depreciation according to the provisions of Section 205(2) of the Companies Act, 1956;
- (d) Check whether specified minimum amount has been transferred to reserves according to the Companies (Transfer of Profits to Reserves) Rules, 1975;
- (e) Check whether the Board has authorised the opening of a separate Bank Account for payment of dividend;
- (f) Check whether the amount of dividend including interim dividend was deposited in the separate Bank Account within 5 days from the date of declaration of such dividend;
- (g) Check whether register of members was closed as per the provisions of Section 154 of the Companies Act, 1956;
- (h) Check whether dividend recommended by the Board was declared at the annual general meeting;
- (i) Check whether dividend warrants were printed, signed and despatched to the registered shareholders within 30 days of declaration;
- (j) Check whether permission of Reserve Bank of India, if required was obtained before dividend was remitted to foreigners/non resident Indians, withholding tax, if any;
- (k) Check whether stock exchanges were duly intimated, in case of listed company;
- (l) Check whether voluntary transfer to reserves, if any, was made according to the Companies (Transfer of Profits to Reserves) Rules, 1975;
- (m) In case of inadequacy of profits, check whether the Companies (Declaration of Dividends out of

Reserves) Rules, 1975, were complied with or previous approval of the Central Government was obtained, before such declaration;

- (n) Check whether dividends were paid in accordance with Section 206 of the Companies Act, 1956 only to the registered shareholder or his order or to his bankers. In case of a share warrant, dividend has been paid to the bearer of such warrant or to his bankers;
- (o) Check whether unpaid or unclaimed dividend was transferred to the unpaid dividend account within 7 days after the expiry of 30 days from the date of declaration;
- (p) Check whether amount of dividend remaining unpaid and unclaimed for seven years from the date they became due for payment has been transferred to the Investor Education and Protection Fund, established by the Central Government pursuant to Section 205C of the Companies Act, 1956 and while transferring the amount, the company furnished a statement in the prescribed form under Section 205A(6) of the Companies Act, 1956.

"15 The Company has insured fully all its assets."

Particulars of Insurance cover obtained by the Company are as under:-

Sl. No.	Particulars of Asset Insured	Value of Asset (₹)	Sum Insured (₹)	Risk Covered	Amount of Policy	Insurance Company	Insurance Policy Number
1.						M/s ...	
2.						M/s ...	
3.						M/s ...	

Note : Insert a remark, whether all the assets have been insured and provide a list of assets that haven't been insured.

Compliance Inputs

- Original insurance policies
- Register of Assets
- Collateral Security offered to the lenders
- Stock Statement
- Premium payment receipts

Checklist for Insurance Policies

- (a) Verify the original insurance policies and check carefully the details of assets covered by the policy.
- (b) The Company should take a Policy from a General Insurance company registered with IRDA
- (c) Policies are issued for a period of one year. Sometimes, short period policies for less than one year are also issued. Hence Policy period should be checked.
 - Generally Fire Insurance policies cover immovable properties, stocks etc. Earthquake,

Terrorism etc. are given as add on covers. Vehicles should have Valid Comprehensive Insurance Policies.

- Sum insured should represent the Market value/Replacement value as the case may be (not book value) or else, under insurance will be applicable. Name, address, situation (with Building No. etc.) of the Company should tally with the records.
- Name of the mortgagee should be verified.
- Any endorsement during the policy period, noting the changes in the sum insured, situation, risk etc. should be verified.

Checklist for Terms of Insurance

Check the following in regard to compliance of terms of insurance:

- (a) the company's assets have been insured comprehensively. Where a joint insurance on plant and buildings has been taken, the value thereof has been apportioned in the manner prescribed/ approved;
- (b) the insurance policy has been taken in the joint names of the company and the bank(s)/financial institution(s) ;
- (c) the policy has been kept alive for such full value, as has been determined by the bank(s)/financial institution(s) , all premia are being paid on time, and the company has not done any such act as would render the policy void or voidable;
- (d) the policy has been taken from an insurance office of repute, as determined by the bank(s)/financial institution(s) ; and
- (e) all moneys received under the insurance policies are held in trust for better securing to the bank(s)/ financial institution(s) , the payment of all moneys secured under the indenture agreement.

"16. The name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India."

Definition of wilful default

A "wilful default" would be deemed to have occurred if any of the following events is noted :-

- (a) The company has defaulted in meeting its payment/repayment obligations to the lender even when it has the capacity to honour the said obligations.
- (b) The company has defaulted in meeting its payment/repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
- (c) The company has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

In order to prevent the access to the capital markets by the wilful defaulters, a copy of the list of wilful defaulters (non-suit filed accounts) and list of wilful defaulters (suit-filed accounts) are forwarded to SEBI by RBI and Credit Information Bureau (India) Ltd. (CIBIL) respectively.

Compliance Inputs

- Register of Deposits
- Register of Loans

- RBI defaulters list and ECGC's Specific Approval List : The Reserve Bank of India periodically releases the lists of willful defaulters. These are available on the Reserve Bank of India website.

Checklist

- (a) Check that the name of the Company or its Director(s) does not appear in the Defaulters list of Reserve Bank of India;
- (b) Check whether the company has/has not entered into any One Time Settlement (OTS) arrangement with any FI/Bank(s) during the period to which the Report pertains.

"17. The name of the Company and /or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation"

Compliance Inputs

- Specific Approval List of Export Credit Guarantee Corporation (ECGC):

The ECGC's Special Approval is not a public document. However, the information about a particular company is made available by the ECGC on a case to case basis. The Practising Company Secretary (PCS) may visit the ECGC's website www.ecgc.in to obtain the names and contact details of the respective officers in his/her vicinity who can be approached for obtaining the required information.

Checklist

- (a) Check that the name of the Company or its Director(s) does not appear in the Specific Approval List of ECGC;

"18. The Company has paid all its Statutory dues and satisfactory arrangements had been made for arrears of any such dues"

Note: Obtain a Report from the management of the company regarding the applicable laws and compliance thereof.

Compliance Inputs

- Original receipts evidencing payment of liabilities/dues of all the ground rents, rates, taxes, duties and outgoings immediately on their becoming due.
- Relevant ledger accounts.

Checklist

- (a) Check whether the disputed dues have been paid.
- (b) Check that as regards payment of liabilities/dues that the company has been paying all the ground rents, rates, taxes, dues, duties and outgoings immediately on their becoming due.
- (c) Check whether satisfactory provisions have also been made for meeting tax liabilities for subsequent years.
- (d) Check whether the company has a structured compliance reporting system in place on statutory payments

"19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed."

Checklist for Utilisation of moneys advanced

- (a) Check that any changes/deviations in the time schedule for completion of the project have been made in consultation with the bank.

Checklist for Financial Position

Check the financial position to ensure that:

- (a) no money has been withdrawn from the business, out of the capital or in anticipation of profits, without prior consent of the bank(s)/financial institution(s) ; and

Checklist for Utilisation of Moneys Advanced

Ensure that consistency has been maintained in utilisation of moneys advanced. The following aspects may be specifically examined:

- (a) funds have been utilised for the purposes laid down in the loan agreement. Where funds have not been so utilised, the requisite permission has been taken;
- (b) requisite conditions laid down to qualify for the outstanding balance of the loan have been fulfilled;
- (c) the drawals from the loan are being kept in a separate Scheduled Bank Account, payments therefrom are being made in the manner laid down in the indenture, the said scheduled bank has foregone its right to set-off or lien, in respect of the said account, and the borrower is maintaining the records pertaining to the said account, as provided;
- (d) no part of the loan moneys has been transferred to call, short term, fixed or any other deposits, without prior consent. Where such consent has been obtained, the scheduled bank has foregone its right to set off any amount due from the company, against the deposits, the deposits have been realised on their due dates and the proceeds thereof re-deposited in the special account;
- (e) the expenditure has been financed in the manner provided for in the indenture.

Diversion and siphoning of funds

The terms “diversion of funds” and “siphoning of funds” should construe to mean the following:-

Diversion of funds, would be construed to include any one of the under noted occurrences:

- (a) utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
- (b) deploying borrowed funds for purposes/activities or creation of assets other than those for which the loan was sanctioned;
- (c) transferring funds to the subsidiaries/Group companies or other corporates by whatever modalities;
- (d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
- (e) investment in other companies by way of acquiring equities/debt instruments without approval of lenders;
- (f) shortfall in deployment of funds vis-à-vis the amounts disbursed/drawn and the difference not being accounted for.

Siphoning of funds, should be construed to occur if any funds borrowed from banks/FIs are utilised for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would have to be a judgement of the lenders based on objective facts and circumstances of the case.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents.

The default to be categorised as wilful must be intentional, deliberate and calculated.

Compliance Inputs

Term Loan

Large term loans

- In most cases, more than one bank will be involved and a lender's engineer might have been appointed, who is expected to inspect and benchmark progress against milestones and expenditure incurred commensurate with the drawals. The PCS may rely on such certification.
- Wherever letters of credit (inland/foreign) have been opened for specific items of capital expenditure and the relative bill(s) debited to term loan account end use is automatically taken care of.
- It's quite likely that in some projects where civil construction takes place, architect certificate is asked for. The PCS may rely on such certification.
- Lenders in some specific cases, permit reimbursement of expenditure incurred. PCS are advised to verify that proper certification exists for such transactions.
- Wherever items of expenditure are clearly identified PCS may comment on compliance with monetary outgo in respect of such items.

Mid Size and Small Projects

- Wherever lenders engineer/architect certification is available these may be relied upon; similarly for inland foreign L/C for capital expenditure.
- In other cases PCS may verify mode of payment made to the supplier/intended beneficiary in respect of drawals from term loans.
- Wherever certification such as engineer/chartered engineer's valuation report exists, reliance can be placed on the same.

Working Capital

Cash Credit Accounts

- Compliance inputs
 - Cash and Bank Book
 - Stocks/Book debts Statements submitted to the bank(s)
 - Monthly Select Operational Data (MSOD)/Quarterly Information System (QIS)/Financial Follow up Report (FFR) filings to banks
 - Stock /Book Debt (Receivables) Audit Report commissioned by any of the member bank(s)
 - Auditors Report under CARO to ensure compliance

- Quality of Inventory Management system

Suggested alerts:

- Disproportionately large cash payments in relation to normal requirements in a company of its size
- Frequent circular transactions between various bank accounts
- Inordinate delay in submission of stock statements/book debts/quarterly filings to the Bank(s)
- Large differences between MSOD/QIS2/FFR etc. with stock statements and inventory regularly and particularly as on date of balance sheet.
- Delay/default in meeting statutory payments
- Any apparent unrelated payment(s) that come to notice
- Disproportionate holding of Work-in-progress (WIP)
- Regular on account payments to creditors
- Regular on account payments from debtors
- Any differential pricing system to associates
- Any attachment of bank accounts from statutory authorities (input from bank)
- Borrowings from unconventional sources
- Dishonour of cheques
- Unduly large sales returns/return of bills
- Lack of tie ups in project finance resulting in diversion of short term funds
- Winding-up cases if any filed against the company
- Insolvency proceedings against any of the promoter(s)/director(s)

“20. The Company has complied with the provisions stipulated in Section 372 A of the Companies Act in respect of its Inter Corporate loans and investments.”

<i>Name of the Company (Rs.)</i>	<i>Loans Advanced (Rs.)</i>	<i>Guarantees Given (Rs.)</i>	<i>Securities Provided (Rs.)</i>	<i>Investments made (Rs.)</i>
M/s....				
M/s....				
M/s....				
M/s....				
M/s....				

Compliance Inputs

- Relevant ledger accounts
- Board resolutions passed with the consent of all the directors present at the meeting
- Register maintained in this regard as per the provisions of Section 372A(5) of the Companies Act, 1956
- Copy of the special resolution filed with the ROC alongwith e-form no. 23

- Register showing the particulars in respect of every instalment or loans or security or guarantee maintained in this regard as per the provisions of Section 372A(5) of the Companies Act, 1956.
- Register of Investments or Loans Made, Guarantee Given or Security Provided under Section 372A of the Companies Act, 1956

Checklist

- (a) Check whether provisions of section 372A are applicable [refer section 372A(8)] of the Companies Act, 1956. If provisions of section 372A are applicable, check whether the aggregate of the loans made, guarantees given, securities provided or investments made by the company are within the limits of sixty per cent of its paid-up share capital and free reserves, or one hundred per cent of its free reserves, whichever is more as prescribed under section 372A.
- (b) Check that:
 - (i) the company has not defaulted in complying with the provisions of section 58A of the Companies Act, 1956;
 - (ii) Board resolutions were passed with the consent of all the directors present at the meeting;
 - (iii) the details regarding the transaction were entered chronologically in the Register maintained in this regard as per the provisions of section 372A(5), within 7 days of the transaction(s);
 - (iv) the company has complied with the guidelines if any issued by the Central Government under sub-section (7) of section 372A.
- (c) If the aggregate has exceeded the prescribed limits, check whether:
 - (i) Board resolutions were passed unanimously approving the impending transaction subject to members' previous approval at general meeting;
 - (ii) the company has secured prior approval of the public bank(s)/financial institution(s) where any term loan is subsisting if it has defaulted in repayment of loan instalments or payment of interest thereon as per terms and conditions of such loan as required under sub-section (2) of section 372A;
 - (iii) general meeting(s) (AGM or EGM) have been held and specific special resolutions have been passed stating the limits, particulars of body(ies) corporate in which the investment is proposed to be made or loan or security or guarantees to be given, the purpose and the specific source of funding etc.;
 - (iv) no omnibus special resolution(s) have been passed;
 - (v) the company has filed a copy of the special resolution along with e-form 23 with the Registrar within 30 days of passing of such resolution;
 - (vi) in the case of guarantees given by the Board of directors without the authorisation of special resolution(s) check that :
 - exceptional circumstances existed which prevented the company from obtaining the resolution;
 - the Board passed a resolution authorising the same in accordance with the provisions of section 372A;
 - the Board resolution has been confirmed within 12 months at the earliest general meeting of the company;

- notice of such general meeting (whether annual or extraordinary) indicated clearly the specific limits, the particulars of body(ies) corporate for which the guarantee was given etc.
- (d) In the case of loans, check whether the interest rate at which it was made was not lower than the prevailing bank rate as prescribed under Section 49 of the Reserve Bank of India Act, 1934;
- (e) Check whether the details regarding the transaction(s) were entered chronologically in the register maintained in this regard as per the provisions of section 372A(5) of the Companies Act, 1956 within 7 days of the transaction(s).
- (f) Check whether the register showing the particulars in respect of every investment or loans or security or guarantee is kept at the registered office of the company.

"21. It has been observed from the Reports of the Directors and the Auditors that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India."

Compliance Inputs

- Auditors' Report
- Boards' Report

Checklist

Based on the last auditor's Report check whether the company has complied with the applicable Accounting Standards.

In this regard

- Section 217(2AA) of the Companies Act, 1956 requires that the Board's Report should include a directors responsibility statement indicating therein:
 - that in the preparation of the annual accounts, the applicable accounting standards have been followed along with proper explanation relating to material departures;
- Section 211 (3B) of the Companies Act, 1956 requires where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and the balance sheet, the following:
 - the deviation from the accounting standards;
 - the reasons for such deviation; and
 - the financial effect, if any arising due to such deviations.
- Section 227(3)(d) of the Companies Act, 1956 also requires the auditor's Report to state whether in his opinion, the profit and loss account and balance sheet comply with the Accounting Standards referred to in sub-section (3C) of section 211(specified standards). The standards of accounting specified by ICAI shall be deemed to be accounting standards until the accounting standards are prescribed by the Central Government under section 211(3C) of the Act.

In view of this, while it may be possible to certify that all Accounting Standards have been followed, it may be not be practical to state that all Accounting Standards have been complied with.

"22. The Company has credited and paid to the Investor Education and Protection Fund all the unpaid dividends and other amounts required to be so credited."

Compliance Inputs

- Annual Accounts and Annual Return

- Relevant ledger accounts
- Copy of the challan filed with the Registrar of Companies along with a statement in e-form 1 duly certified by a Company Secretary or a Chartered Accountant or a Cost Accountant practising in India or by the statutory auditors of the company.

Checklist

- (a) Check whether the company has transferred the following amounts to the Investor Education and Protection Fund within a period of thirty days of such amounts becoming due to be credited to the fund:
 - (i) amounts in the unpaid dividend accounts of the company;
 - (ii) the application money received by the company for allotment of any securities and due for refund;
 - (iii) matured deposits with the company;
 - (iv) matured debentures with the company;
 - (v) interest accrued on the amounts referred to in clauses (i) to (iv) above;

if such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.
- (b) Check whether the company has filed with the concerned Registrar of Companies one copy of the challan along with a statement in e-form 1 duly certified by a Company Secretary or a Chartered Accountant or a Cost Accountant practising in India or by the statutory auditors of the company.
- (c) Check whether the company has kept a record relating to folio number, certificate number etc. in respect of persons to whom the amount of unpaid and unclaimed dividend, application money, matured deposit or debentures, interest accrued is payable for a period of three years.
- (d) Check whether the company has furnished estimates of the amounts to be credited to the fund, if so called upon by the Committee as per the Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001.

“23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and /or its directors in such cases are detailed in Annexure.....”

Compliance Inputs

- In case of show cause notice issued for non-compliance of any of the provisions of the Companies Act, 1956 – the explanations given by the company while assessing enormity of the violations in question.
- The notices of prosecution/show cause.

Checklist

- (a) Check whether the company has been issued any show cause notice for non-compliance of any of the provisions of the Companies Act, 1956; if so, verify the explanations given by the company while assessing enormity of the violations in question;
- (b) Check whether the notices of prosecution/show cause have been placed before the Board;

- (c) Check whether the company has received any prosecution notice;
- (d) Check whether any inspection or investigation has been ordered under the Companies Act, 1956 and if so, assess the status at the time of issuing the Compliance Certificate;
- (e) Check whether any fines and penalties or any other punishment was imposed on the company;
- (f) Check whether any order has been issued under the Companies Act, 1956 for compounding of the offences; if so check whether the company has complied with the orders passed by the concerned authorities.

“24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement”

Compliance Inputs

- Clause 41 of the listing agreement
- Quarterly Reports filed by the company under the listing agreement
- Copies of the Reports filed with the Stock Exchange
- Copy of the Prospectus
- Register of Directors u/s 303 of the Companies Act, 1956
- Minutes of the Board and General Meetings
- E-form 32 filed with ROC
- Minimum and maximum number of directors on the Board as per the Articles of Association/Board resolution
- Resolution of the Board of Directors/Company appointing, designating, varying the terms of appointment of each director and notices and explanatory statements pertaining to such matters
- Resume of each Director
- Disclosure of interest made by each Director
- Register of Directors
- Register of Directors Shareholding
- Register of Firms/parties in which Directors are interested
- Management Representations
- Declaration given by the Directors
- Resolution of the Board of Directors /General Meetings with regard to compensation payable to Non-Executive Directors and notices and explanatory statements pertaining to such matters
- Abstract of terms of appointment of Directors, Managing/Wholetime Directors
- Stock options scheme, as applicable to Non-Executive Directors including Independent Directors
- Management representation in this behalf
- Noting, Minutes of meetings of Board
- Minutes of the meetings of committees of the Board
- Agenda of the Board/committee meetings
- Disclosures made by directors from time to time

- The Code of Conduct of the Company
- The Minutes of the Meeting in which the Board approved the code
- The website of the Company
- Annual affirmation letters of compliance by all the board members and senior executives
- Declaration of the CEO
- Annual Report of the Company
- Minutes of Board and Audit Committee meetings
- Qualification and experience of Members of the Audit Committee
- Notices of Meetings of Audit Committee
- Agenda of the Audit Committee meetings
- Attendance Register, if any
- Minutes of Meetings of Audit Committee
- Whistle Blower Policy
- Action Taken Report submitted by the Company Secretary to the Committee
- Minutes of the Board Meetings of the “material” non-listed Indian subsidiary Company
- Disclosures made in the Annual Report as per AS-18 (Related Party)
- Register of Contracts
- Application for Approval of Central Government under the Act and orders granting approval
- Notes on accounts
- Directors’ Responsibility Statement
- Report of the Auditors
- Accounting Policy
- Disclosures made in the Corporate Governance Report
- Risk Assessment Policy, if any
- Prospectus/Letter of Offer
- Disclosure under Clause 43 of the Listing Agreement
- Disclosure under Section 217 of the Companies Act, 1956 in the Directors’ Report
- Certificates issued by the auditors of the Company
- Notices, notes, minutes and explanatory statements of Meetings of the Board of directors, Company, remuneration committee
- Register of Directors’ shareholding under Section 307 of the Companies Act, 1956
- Declaration of Beneficial Interest Section 187-C of the Companies Act, 1956 read with the Companies (Declaration of Beneficial Interest in Shares) Rules, 1975
- Relevant Annual Report
- Management Discussion and Analysis Report

- Notes relating to each item to be included therein
- Human Resources at work and their categories
- Disclosure by senior management about all material financial and commercial transactions
- Organization Chart
- Information about directors and candidates for directorships
- Disclosures made by Directors
- Information published on website
- Quarterly results/presentation made to analysts
- Minutes of Meeting of Board of Directors of the Company constituting Shareholders/Investors Grievance Committee
- Resolution regarding delegation of authority for expeditious transfer of shares
- Resolution appointing CEO/CFO
- Qualification and experience of CEO/CFO
- Auditors Report under CARO
- Intimations sent to the Stock Exchange
- Corporate Governance Report

“25. The Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities”

Compliance Inputs

- Relevant Ledger Accounts
- No dues certificate from the Provident Fund Authorities

Checklist

Check whether the company has constituted a Provident Fund for its employees or any class of employees and approval under the Employees Provident Fund and Miscellaneous Provisions (EPF & MP) Act, 1952 has been obtained. If yes, check that all moneys contributed to such fund (whether by the company or by the employees) or received or accruing by way of interest or otherwise to such fund have been deposited within 15 days from the date of contribution, receipt of accrual, as the case may be, in an account as specified in clause (a) of subsection (1) of section 418 or invested in the securities mentioned or referred to in clause (a) to (e) of section 20 of the Indian Trust Act, 1882.

LESSON ROUND UP

- In October 1996, various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements were withdrawn by Reserve Bank of India with a view to introducing flexibility in the credit delivery system and to facilitate smooth flow of credit. However, Central Vigilance Commission (CVC), Government of India, in the light of frauds involving consortium/multiple banking arrangements which have taken place in the recent past, expressed concerns on the working of Consortium Lending and Multiple Banking Arrangements in the banking system. The CVC attributed the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of the account of the borrowers among various banks.

- The matter was examined by the Reserve Bank of India (RBI) in consultation with the Indian Banks Association (IBA) who were of the opinion that there is need for improving the sharing/dissemination of information among the banks about the status of the borrowers enjoying credit facilities from more than one bank.
- The Reserve Bank of India vide its Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008 advised all the scheduled commercial Banks (excluding RRBs and LABs) to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in the aforesaid notification.
- Further RBI vide its Circular dated January 21, 2009 also advised all Primary Urban Co-operative Banks to obtain Diligence Report. Subsequently the RBI vide its Circulars dated December 08, 2008 and February 10, 2009 revised the format of Diligence Report for Scheduled Commercial Banks and also for Primary Urban Co-operative Banks vide its Circular dated February 12, 2009.
- This report includes twenty five point compliance check list covering matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilisation/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What is the necessity for diligence report for banks?
2. What are the aspects covered in the diligence report for banks?
3. Describe the compliance with respect to listed companies in the context of diligence report for banks?

This image shows a blank sheet of white paper with horizontal ruling lines. At the very top, there is a thick, solid black rectangular bar that spans the entire width of the page. Below this bar, there are ten evenly spaced horizontal grey lines that run across the page, providing a template for writing or drawing. The margins are consistent on all sides.

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Lesson 11

ENVIRONMENTAL DUE DILIGENCE

LESSON OUTLINE

- Introduction
- Environmental failures may lead to financial, reputational damage and business discontinuity as well.
- Why Environmental due diligence?
- Process involved in environmental due diligence
- Regulatory framework relating to environment
- Checklist on various compliances
- Environment Impact Assessment
- Environment Management Plan
- Identification of potential issues, impact analysis and remedial measures etc.,

LEARNING OBJECTIVES

Environmental failures not only result in financial loss, but reputation loss, public damage and at times total business failure. Compliance with environmental responsibilities from the letter and spirit is the primary requirement of organizations today for business sustainability.

Environmental due diligence has gained importance in the recent past while carrying out inorganic business transactions such as mergers, acquisitions, takeovers etc mainly due to increased awareness and consciousness of the public from potential negative environmental impact of the organization that may be caused by the company on them. Besides the regulatory framework also supports the environmental cleaning mechanism. Any potential non compliance of laws /negligence towards society would cause major environmental risk which will have an impact on the financial side too, in addition to reputational damage.

After reading this study you will be able to understand the impact of environmental failures on business, importance of due diligence on environmental obligations of business, various compliances of environmental laws, environment impact assessment, environment management plan etc.,

“Earth provides enough to satisfy every man's needs, but not every man's greed.”

— **Mahatma Gandhi**

Environmental Due Diligence has become an important feature of an increasing number of mergers & acquisitions(M&A) transactions.

— **Environmental Due Diligence: a survey of major UK companies by KPMG**

INTRODUCTION

Environmental problems often threaten the viability of transactions. If a business transaction proceeds without environmental risks being correctly evaluated or addressed, they can significantly reduce the profitability of the acquisition.

Society is increasingly unwilling to tolerate harm to the environment, and those businesses that are perceived to be irresponsible towards environment and community can expect considerable criticisms from the media and public. Environmental risk can have serious negative effects on an organisation's financial well being and its ability to achieve its business objectives.

Considering the impact of business failures towards environment in terms of cost of non-compliance, in terms of economic and other reputational matters, businesses are to be assessed from the point of view of environment.

Environmental failures may lead to financial, reputational damage and business discontinuity as well.

Environmental non-compliances may not only result in huge financial liability or reputation wreck, but also may result in business discontinuity or huge public damage. The following case studies would throw some light on the impact of environmental failures.

1. Sri Ram Food and Fertilizer Case (*M.C. Mehta v. Union of India*, AIR 1987 SC 1086)

In that case, a major leakage of Oileum Gas affected a large number of persons, both amongst the workmen and public. The Supreme Court held that where an enterprise is engaged in a hazardous or inherently dangerous activity and harm results to any one on account of an accident in the operation of such hazardous and inherently dangerous activity resulting in the escape of toxic gas the enterprise is strictly and absolutely liable to compensate all those who are affected by the accident and such a liability is not subject to any exception.

2. Dehradun Valley Case (*Rural Litigation & Entitlement Kendra v. State of U.P.*, AIR 1985 SC 652; see also AIR 1988 SC 2187)

In that case, carrying haphazard and dangerous limestone quarrying in the Mussorie Hill range of the Himalaya, mines blasting out the hills with dynamite, extracting limestone from thousand of acres had upset the hydrological system of the valley. The Supreme Court ordered the closing of limestone quarrying in the hills and observed that this would undoubtedly cause hardship to them, but it is a price that has to be paid for protecting and safeguarding the right of the people to live in healthy environment with minimal disturbance of ecological balance.

3. Effluents by tanneries in river Ganga (*M.C. Mehta v. Union of India*)

In *M.C. Mehta v. Union of India* the Court directed that the work of those tanneries be stopped, which were discharging effluents in River Ganga and which did not set up primary effluent treatment plants. It held that the financial incapacity of the tanners to set up primary effluent treatment plants was wholly irrelevant. The Court observed the need for (a) imparting lessons in natural environment in educational institutions, (b) group of experts to aid and advise the Court to facilitate judicial decisions, (c) constituting permanent independent centres with professional public spirited experts to provide the necessary scientific and technological information to the Court, and (d) setting up environmental courts on regional basis with a right to appeal to the Supreme Court.

Why Environmental Due diligence?

As discussed, environmental failure may result in ethical disaster and business continuity. For any type of strategic decision, be it a strategic alliance, starting up of a new venture, merger or acquisition, due diligence of environmental factors, both present and prospective, covering regulatory and social issues, are vital and essential.

Some of the reasons for performing environmental due diligence include

- To assess hazardous substances emission and the mitigation measures through examination of industrial sites
- Regulatory compliances and the cost of non-compliances if any
- Societal reaction to emission of effluents and its impact on the financial health of the company.
- To have an overall environmental impact assessment
- To suggest remedial course of actions and environmental management plan
- To assess the sustainability initiatives of the company and its potential impact on the business
- To allocate liabilities identified during the investigation, draft indemnities, or perhaps re-price the deal.

Process involved in Environmental Due diligence

Environmental due diligence involves

1. Company analysis

- Business assessment
- Sites assessments
- Products assessment
- Process assessment
- Safety standards
- Pollution control mitigation measures

2. Media Report Analysis

3. Stakeholders analysis

4. Regulatory Analysis (Potential Compliance Risks)

- Regulatory compliance check lists
- Non compliance details from Regulatory authorities

5. Risk analysis matrix

- Nature of business
- Area of operations
- Potential Issues
- Impact Assessment

- Mitigation measures
- Management plan

6. Reporting and suggestions.

Regulatory Framework relating to environment

Indian Constitution and Environment

Indian Parliament inserted two Articles, i.e., 48A and 51A in the Constitution of India in 1976, Article 48A of the Constitution rightly directs that the State shall endeavour to protect and improve the environment and safeguard forests and wildlife of the country. Similarly, clause (g) of Article 51A imposes a duty on every citizen of India, to protect and improve the natural environment including forests, lakes, river, and wildlife and to have compassion for living creatures. The cumulative effect of Articles 48A and 51A (g) seems to be that the 'State' as well as the 'citizens' both are now under constitutional obligation to conserve, perceive, protect and improve the environment.

Besides, a number of Central/State Legislations/Regulations etc., govern environmental aspects India. It includes the following

Acts

- **The Water (Prevention and Control of Pollution) Act** was enacted in 1974 to provide for the prevention and control of water pollution, and for the maintaining or restoring of wholesomeness of water in the country.
- **The Water (Prevention and Control of Pollution) Cess Act** was enacted in 1977, to provide for the levy and collection of a cess on water consumed by persons operating and carrying on certain types of industrial activities.
- **The Air (Prevention and Control of Pollution) Act** was enacted in 1981 and amended in 1987 to provide for the prevention, control and abatement of air pollution in India.
- **The Environment (Protection) Act** was enacted in 1986 with the objective of providing for the protection and improvement of the environment.
- **Public Liability Insurance Act 1991** is to provide for damages to victims of an accident which occurs as a result of handling any hazardous substance.
- **National Green Tribunal Act 2010** for effective and expeditious disposal of cases relating to environmental protection and conservation of forests and other natural resources including enforcement of any legal right relating to environment and giving relief and compensation for damages to persons and property and for matters connected therewith or incidental thereto.

Rules

1. The Water (Prevention and Control of Pollution) Cess Rules, 1978
2. The Water (Prevention and Control of Pollution) Rules, 1975
3. The Air (Prevention and Control of Pollution) (Union Territories) Rules, 1983
4. The Air (Prevention and Control of Pollution) Rules, 1982
5. The Environment (Protection) Rules, 1986

6. The Public Liability Insurance Rules, 1991, amended 1993
7. Hazardous Wastes (Management and Handling) Rules, 1989

From the above facts, we can derive that there is no dearth of legislations in India. What is needed is the effective and efficient enforcement of the constitutional mandate and the other environmental legislations. This can be achieved with the co-ordinated efforts of the states as well as citizens.

CHECKLIST ON MAJOR COMPLIANCES

THE ENVIRONMENT (PROTECTION) ACT, 1986 (READ WITH THE ENVIRONMENT (PROTECTION) RULES, 1986)

<i>Sl. No.</i>	<i>Section/ Rule</i>	<i>Nature of Statutory Compliance</i>	<i>Due date</i>	<i>Penalty</i>
1.	Sec. 5 & Rule 4	<p>A company has to follow directions given by the Central Government. The direction shall specify the nature of action to be taken and the time within which it shall be complied with by the company.</p> <p>The Directions may include closure, prohibition of industry, process or operation, stoppage of electricity or water etc.</p>	As and when	<p>Imprisonment for a term which may extend to five years or with fine which may extend to 1 lakh.</p> <p>In case the failure or contravention continues with additional fine which may extend to Rs.5,000/- for every day during which such failure or contravention continues after convictions for the first such failure or contravention. (Section 15)</p> <p>Any person aggrieved by the direction may prefer an appeal to National Green Tribunal. (Section 5A)</p>
2.	Sec. 7	A company carrying on any industry, operation or process shall not discharge or emit or permit to be discharged or emitted any environmental pollutant in excess of such standards as may be prescribed.	Always	Penalty as prescribed under Section 15, as mentioned in point no. 1.
3.	Sec.8	Company not to handle or cause to be handled any hazardous substance except in accordance with such procedure and after complying with such safeguard as may be prescribed.	Always	

4.	Sec. 9	A company shall be responsible for the discharge of any environmental pollutant in excess of the prescribed standard due to any accident or other unforeseen act or event and the person in charge the place at which such discharge occurs or is apprehended to occur shall be bound to prevent or mitigate the environmental pollution caused as a result of such discharge and shall also forthwith – (i) intimate the fact of such occurrence or apprehension of such occurrence (ii) be bound, if called upon, to render all assistance, to such authorities or agencies as may be prescribed.	Always	Where any offence has been committed by a Company, every person who was directly in charge of and was responsible to the Company for the conduct of business of the Company as well as the Company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. (Section 16)
5.	Sec. 10	A company has to assist the person empowered by the Central Government for carrying out the functions.	As and when	Penalty as prescribed under Section 15, as mentioned in point no. 1.
6.	Sec. 11	A company has to give access to the Central Government or any offices empowered by it to collect samples of air, water, soil or other substance from the factory, premises or other place in such manner as may be prescribed.	As and when	Penalty as prescribed under Section 15, as mentioned in point no. 1.
7.	Rule 12	Where the discharge of environmental pollutant in excess of the prescribed standard occurs or is apprehended to occur due to any accident, the person in charge of the place at which such discharge occurs or is apprehended to occur shall forthwith intimate the fact of such occurrence to the authorities as specified in these provisions.	As and when	Penalty as prescribed under Section 15, as mentioned in point no. 1.

8	Rule 14	Every person carrying on an industry, operation or process requiring consent under Section 25 of the Water (Prevention and Control of Pollution) Act, 1974 or under section 21 of the Air (Prevention and Control of Pollution) Act, 1981 or both or authorization under the Hazardous Wastes (Management and Handling) Rules, 1989 issued under the Environment (Protection) Act, 1986 shall submit an environmental audit report for the financial year ending the 31st March in prescribed form to the concerned State Pollution Control Board.	On or before the thirtieth day of September every year	Penalty as prescribed under Section 15, as mentioned in point no. 1.
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THE WATER (PREVENTION & CONTROL OF POLLUTION) ACT, 1974
[READ WITH WATER (PREVENTION & CONTROL OF POLLUTION) RULES, 1975]

<i>Sl. No.</i>	<i>Section/ Rule</i>	<i>Nature of Statutory Compliance</i>	<i>Due Date</i>	<i>Penalty</i>
1	Section 20	Directions from state government regarding abstracting water from any stream or well as also discharge of sewage and effluents.	As and when	Imprisonment for a term which may extend to three months or with fine which may extend to ten thousand rupees or with both and in case the failure continues, with an additional fine which may extend to five thousand rupees for every day during which such failure continues after the conviction for the first such failure. (Section 41)
2	Section 24	A company shall not knowingly cause or permit any poisonous, noxious or polluting matter determined in accordance with such standards as may be laid down by the State Board to enter (whether directly or indirectly) into any stream or well or sewer or on land to enter into any stream any other matter which may tend, either directly or in	Always	Imprisonment which shall not be less than one year and six months but which may extend to six years and with fine. (Section 43)

		combination with similar matters, to impede the proper flow of the water of the stream in a manner leading or likely to lend to a substantial aggravation of pollution due to other causes or of its consequences.		
3.	Sec. 25	<p>A company to take previous consent of the State Board by making Application in prescribed form :</p> <p>(i) to establish or take any steps to establish any industry, operation or process, or any treatment and disposal system or any extension or addition thereto, which is likely to discharge sewage or trade effluent into a stream or well or sewer or on land or</p> <p>(ii) to bring into use any new or altered outlet for the discharge of sewage or</p> <p>(iii) to begin to make any new discharge of sewage.</p>	Always	Imprisonment which shall not be less than one year and six months but which may extend to six years and with fine. (Section 44)
4.	Sec. 31	If at any place where any industry, operation or process, or any treatment and disposal system or any extension or addition thereto is being carried on, due to accident or other unforeseen act or event, any poisonous, noxious or polluting matter is being discharged, or is likely to be discharged into a stream or well or sewer or on land and, as a result of such discharge, the water in any stream or well is being polluted, or is likely to be polluted, then the person in charge of such place shall forthwith intimate the occurrence of such accident act or event to the State Board.	Always	Imprisonment which may extend to three months or with fine which may extend to ten thousand rupees or with both and in the case of a continuing contravention or failure, with an additional fine which may extend to five thousand rupees for every day during which such contravention or failure continues after conviction for the first such contravention or failure.(Section 45A)

THE AIR (PREVENTION & CONTROL OF POLLUTION) ACT, 1981
[READ WITH THE AIR (PREVENTION & CONTROL OF POLLUTION) RULES, 1982]

<i>Sl. No.</i>	<i>Section/ Rule</i>	<i>Nature of Statutory Compliance</i>	<i>Due Date</i>	<i>Penalty</i>
1	Section 19	Adhering to the directions of State Government regarding use of approved fuel.	As and when	Imprisonment for a term which may extend to three months or with fine which may extend to ten thousand rupees or with both, and in the case of continuing contravention, with an additional fine which may extend to five thousand, rupees for every day during which such contravention continues after conviction for the first such contravention.(Section 39)
2.	Sec. 21	A company shall have to obtain prior consent of the State Board, to establish or operate any industrial plant in an air pollution control area. Upon consent being granted by the State Board to the Company, the Company shall comply with the conditions as may be imposed by the State Board within the stipulated period.	As and when	Imprisonment for a term which shall be between one and half year and six years and with fine and in case the failure continues, with an additional fine which may extend to five thousand rupees for every day during which such failure continues after the conviction for the first such failure. (Section 37)
2.	Sec. 21(5)	After consent has been granted by the State Board it, shall have to comply with the following :- the control equipment of such specification as the State Board may approve in this behalf shall be installed and operated in the premises where the industry is carried on/ proposed to be carried on; the existing control equipment, if any, shall be altered or replaced in accordance with the directions of the State Board; the control equipment referred to in clause (i) or clause (ii) shall be kept at all times in good running condition; chimney, wherever necessary, of such specifications as the State Board may approve in this behalf shall be erected or re-erected in such premises; such other conditions as the State Board may specify in this behalf and the conditions referred to in clause	Always	Penalty under Section 37 as mentioned above.

		(i) (ii) and (iv) shall be complied with within such period as the State Board may specify in this behalf.		
3.	Sec. 22	Company not to operate any industrial plant, in any air pollution control area, which shall discharge or cause or permit to be discharged the emission of any air pollutant in excess of the standards laid down by the State Board.	Always	Penalty under Section 37 as mentioned above.
4.	Sec. 23	Where in any area the emission of any air pollutant into the atmosphere in excess of the standards laid down by the State Board occurs or is apprehended to occur due to accident or other unforeseen act or event, the person in charge of the premises from where such emission occurs or is apprehended to occur shall forthwith intimate the fact of such occurrence or the apprehension of such occurrence to the State Board and to the prescribed authorities or agencies.	Always	Three months or fine upto ten thousand or both Section 38(e).
5.	Sec. 24(2)	The Company operating any control equipment or any industrial plant, in an air pollution control area shall be bound to render all assistance to the person empowered by the State Board for carrying out the functions and if he fails to do so without any reasonable cause or excuse, he shall be guilty of an offence under this Act.	Always	Penalty under Section 39 as mentioned in point 1.
6.	Sec. 24(3)	If any person willfully delays or obstructs any person empowered by the State Board in the discharge of his duties, he shall be guilty of an offence under this Act.	As and when	Penalty under Section 38.
7.	Sec. 31A	If any direction is given by the State Board, the Company is to comply with such direction.	Always	Penalty under Section 39 as mentioned in point 1.

Environmental Guidelines for Industries by Ministry of Environment¹

Location of industry

In order to help the concerned authorities and the entrepreneurs, it is necessary to frame certain broad guidelines for siting an industry. It is also necessary to identify the parameters that should be taken into account while setting up an industry. With this in view, the following environmental guidelines are recommended for siting of Industries to ensure optimum use of natural and man-made resources in sustainable manner with minimal depletion, degradation and/or destruction of environment. Those are in addition to those directives that are already in existence under the Industries (Development and Regulation) Act.

Areas to be avoided

In siting industries, care should be taken to minimise the adverse impact of the industries on the immediate neighbourhood as well as distant places. Some of the natural life sustaining systems and some specific land uses are sensitive to industrial impacts because of the nature and extent of fragility. With a view to protecting such an industrial sites shall maintain the following distances from the areas listed:

- *Ecologically and/or otherwise sensitive areas:* At least 25 km; depending on the geo-climatic conditions the requisite distance shall have to be increased by the appropriate agency.
- *Ecological and/or otherwise sensitive areas include:* (i) Religious and Historic Places; (ii) Archaeological Monuments (e.g. identified zone around Taj Mahal); (iii) Scenic Areas; (iv) Hill Resorts; (v) Beach Resorts; (vi) Health Resorts; (vii) Coastal Areas rich in Coral, Mangroves, Breeding Grounds of Specific Species; (viii) Estuaries rich in Mangroves, Breeding Ground of Specific Species; (ix) Gulf Areas; (x) Biosphere Reserves; (xi) National Parks and Sanctuaries; (xii) Natural Lakes, Swamps; (xiii) Seismic Zones; (xiv) Tribal Settlements; (xv) Areas of Scientific and Geological interest; (xvi) Defence Installations, specially those of security importance and sensitive to pollution; (xvii) Border Areas (International) and (xviii) Airports.
- *Coastal areas:* at least 1/2 km from High Tide Line.
- *Flood Plain of the Riverine Systems:* at least 1/2 km from flood plain or modified flood plain affected by dam in the upstream or by flood control systems.
- *Transport/Communication System:* at least 1/2 km from highway and railway.
- *Major settlements (3,00,000 population):* distance from settlements is difficult to maintain because of urban sprawl. At the time of siting of the industry if any major settlement's notified limit is within 50 km, the spatial direction of growth of the settlement for at least a decade must be assessed and the industry shall be sited at least 25 km from the projected growth boundary of the settlement.

Pre-requisite: State and Central Governments are required to identify such areas on a priority basis.

Economic and social factors are recognized and assessed while siting an industry. Environmental factors must be taken into consideration in industrial siting. Proximity of water sources, highway, major settlements, markets for products and raw material resources is desired for economy of production, but all the above listed systems must be away for environmental protection. Industries are, therefore, required to be sited, striking a balance between economic and environmental considerations. In such a selected site, the following factors must be recognized:

¹ www.moef.gov.in

- No forest land shall be converted into non-forest activity for the sustenance of the industry (Ref:Forest Conservation Act, 1980).
- No prime agricultural land shall be converted into industrial site.
- Within the acquired site the industry must locate itself at the lowest location to remain obscured from general sight.
- Land acquired shall be sufficiently large to provide space for appropriate treatment of waste water still left for treatment after maximum possible reuse and recycle. Reclaimed(treated) wastewater shall be used to raise green belt and to create water body for aesthetics, recreation and if possible, for aquaculture. The green belt shall be 1/2 km wide around the battery limit of the industry. For industry having odour problem it shall be a kilometer wide.
- The green belt between two adjoining large scale industries shall be one kilometer.
- Enough space should be provided for storage of solid wastes so that these could be available for possible reuse.
- Lay out and form of the industry that may come up in the area must conform to the landscape of the area without affecting the scenic features of that place.
- Associated township of the industry must be created at a space having physiographic barrier between the industry and the township.
- Each industry is required to maintain three ambient air quality measuring stations within 120 degree angle between stations.

Environmental Impact Assessment (EIA)

1. The purpose of Environmental Impact Assessment (EIA) is to identify and evaluate the potential impacts (beneficial and adverse)of development and projects on the environmental system. It is an useful aid for decision making based on understanding of the environment implications including social, cultural and aesthetic concerns which could be integrated with the analysis of the project costs and benefits. This exercise should be undertaken early enough in the planning stage of projects for selection of environmentally compatible sites, process technologies and such other environmental safeguards.
2. While all industrial projects may have some environmental impacts all of them may not be significant enough to warrant elaborate assessment procedures. The need for such exercises will have to be decided after initial evaluation of the possible implications of a particular project and its location. The projects which could be the candidates for detailed Environment Impact Assessment include the following:-
 - Those which can significantly alter the landscape, land use pattern and lead to concentration of working and service population;
 - Those which need upstream development activity like assured mineral and forest products supply or downstream industrial process development;
 - Those involving manufacture, handling and use of hazardous materials;
 - Those which are sited near ecologically sensitive areas, urban centers, hill resorts, places of scientific and religious importance.
 - Industrial Estates with constituent units of various types which could cumulatively cause significant environmental damage.

3. The Environmental Impact Assessment (EIA) should be prepared on the basis of the existing background pollution levels *vis-a-vis* contributions of pollutants from the proposed plant. The EIA should address some of the basic factors listed below:
 - Meteorology and air quality Ambient levels of pollutants such as Sulphur Dioxide, oxides of nitrogen, carbonmonoxide, suspended particulate matters, should be determined at the center and at 3 other locations on a radius of 10 km with 120 degrees angle between stations. Additional contribution of pollutants at the locations are required to be predicted after taking into account the emission rates of the pollutants from the stacks of the proposed plant, under different meteorological conditions prevailing in the area.
 - Hydrology and water quality
 - Site and its surroundings
 - Occupational safety and health
 - Details of the treatment and disposal of effluents(liquid, air and solid) and the methods of alternative uses
 - Transportation of raw material and details of material handling
 - Control equipment and measures proposed to be adopted.
4. Preparation of Environmental Management Plan is required for formulation, implementation and monitoring of environmental protection measures during and after commissioning of projects.

ISO standards for Environment.

The ISO 14000 family addresses various aspects of environmental management. It provides practical tools for companies and organizations looking to identify and control their environmental impact and constantly improve their environmental performance. ISO 14001:2004 and ISO 14004:2004 focus on environmental management systems. The other standards in the family focus on specific environmental aspects such as life cycle analysis, communication and auditing.

Elements of the ISO 14001 standard

ISO 14001 contains the core elements for an effective environmental management system. It can be applied to both service and manufacturing sectors. The main elements of the standard are:

- Environmental policy
- Planning
- Implementation and operation
- Checking and corrective action
- Management review
- Continuous improvement

Environmental Management Plan (EMP) for commissioning of projects.

Preparation of environmental management plan is required for formulation, implementation and monitoring of environmental protection measures during and after commissioning of projects. The plans should indicate the details as to how various measures have been or are proposed to be taken including cost components as may be required. Cost of measures for environmental safeguards should be treated as an integral component of the project cost and environmental aspects should be taken into account at various stages of

the projects:

- Conceptualization :preliminary environmental assessment
- Planning :detailed studies of environmental impacts and design of safeguards
- Execution :implementation of environmental safety measures
- Operation :monitoring of effectiveness of built-in safeguards

The management plans should be necessarily based on considerations of resource conservation and pollution abatement, some of which are:

- Liquid Effluents
- Air Pollution
- Solid Wastes
- Noise and Vibration
- Occupational Safety and Health
- Prevention, maintenance and operation of Environment Control Systems
- House-Keeping
- Human Settlements
- Transport Systems
- Recovery - reuse of waste products
- Vegetal Cover
- Disaster Planning
- Environment Management Cell

1. Liquid Effluents

- Effluents from the industrial plants should be treated well to the standards as prescribed by the Central/State Water Pollution Control Boards.
- Soil permeability studies should be made prior to effluents being discharged into holding tanks or impoundments and steps taken to prevent percolation and ground water contamination.
- Special precautions should be taken regarding flight patterns of birds in the area. Effluents containing toxic compounds, oil and grease have been known to cause extensive death of migratory birds. Location of plants should be prohibited in such type of sensitive areas.
- Deep well burial of toxic effluents should not be resorted to as it can result in re-surfacing and ground water contamination. Re-surfacing has been known to cause extensive damage to crop and livestock.
- In all cases, efforts should be made for re-use of water and its conservation.

2. Air Pollution

- The emission levels of pollutants from the different stacks, should conform to the pollution control standards prescribed by Central or State Boards.

- Adequate control equipment should be installed for minimising the emission of pollutants from the various stacks.
- In-plant control measures should be taken to contain the fugitive emissions.
- Infrastructural facilities should be provided for monitoring the stack emissions and measuring the ambient air quality including micro-meteorological data (wherever required) in the area.
- Proper stack height as prescribed by the Central/State Pollution Control Boards should be provided for better dispersion of pollutants over a wider area to minimise the effect of pollution.
- Community buildings and townships should be built up-wind of plant with one-half to one kilometer greenbelt in addition to physiographical barrier.

3. Solid Wastes

- The site for waste disposal should be checked to verify permeability so that no contaminants percolate into the ground water or river/lake.
- Waste disposal areas should be planned down-wind of villages and townships.
- Reactive materials should be disposed of by immobilising the reactive materials with suitable additives.
- The pattern of filling disposal site should be planned to create better landscape and be approved by appropriate agency and the appropriately pretreated solid wastes should be disposed according to the approved plan.
- Intensive programs of tree plantation on disposal areas should be undertaken.

4. Noise and Vibration: Adequate measures should be taken for control of noise and vibrations in the industry.

5. Occupational Safety and Health: Proper precautionary measures for adopting occupational safety and health standards should be taken.

6. Prevention, maintenance and operation of Environment Control Systems:

- Adequate safety precautions should be taken during preventive maintenance and shut down of the control systems.
- A system of inter-locking with the production equipment should be implemented where highly toxic compounds are involved.

7. House-Keeping: Proper house-keeping and cleanliness should be maintained both inside and outside of the industry.

8. Human Settlements

- Residential colonies should be located away from the solid and liquid waste dumping areas. Meteorological and environmental conditions should be studied properly before selecting the site for residential areas in order to avoid air pollution problems.
- Persons who are displaced or have lost agricultural lands as a result of locating the industries in the area, should be properly rehabilitated.

9. Transport Systems

- Proper parking places should be provided for the trucks and other vehicles by the industries to avoid any congestion or blocking of roads.
- Siting of industries on the highways should be avoided as it may add to more road accidents

because of substantial increase in the movements of heavy vehicles and unauthorised shops and settlements coming up around the industrial complex.

- Spillage of chemicals/substances on roads inside the plant may lead to accidents. Proper road safety signs both inside and outside the plant should be displayed for avoiding road accidents.

10. Recovery - reuse of waste products: Efforts should be made to recycle or recover the waste materials to the extent possible. The treated liquid effluents can be conveniently and safely used for irrigation of lands, plants and fields for growing non-edible crops.

11. Vegetal Cover

Industries should plant trees and ensure vegetal cover in their premises. This is particularly advisable for those industries having more than 10 acres of land.

12. Disaster Planning: Proper disaster planning should be done to meet any emergency situation arising due to fire, explosion, sudden leakage of gas etc. Fire fighting equipment and other safety appliances should be kept ready for use during disaster/emergency situation including natural calamities like earthquake/flood.

13. Environment Management Cell: Each industry should identify within its setup a Department/Section/Cell with trained personnel to take up the model responsibility of environmental management as required for planning and implementation of the projects.

PREPARING A RISK ANALYSIS MATRIX

Preparation of Risk Analysis matrix includes the following aspects

Nature of Business

It covers the nature of industry, amount of air/water/noise pollution in the process, period of its existence, background of promoters, number of subsidiaries, stakeholders involved, turnover, profit from operations, contribution to CSR activities, business acquisition history etc.

Area of Operations

It covers location of site operations, Degree of diversification of products, location of sites of subsidiaries etc.

Identification of potential issues

It covers with interaction with internal stakeholders such as employees, contractual labourers and with external stakeholders such as local community, shareholders, regulators, NGOs etc. A questionnaire may be evolved for each stakeholder for identifying the potential hidden issues.

Potential issues may be

1. Regulatory non-compliance
2. Health hazard due to the operations to local community
3. Location of industry near agricultural land
4. Amount of noise
5. Impact of effluents on the rivers etc.
6. Lack of disaster planning
7. Inadequate safety systems.

8. Lack of sustainability initiatives
9. Lack of occupational or safety measures
10. Improper waste disposal systems.

Impact analysis

It covers cost of regulatory non-compliance, low level of employee morale, degree of reputation risk, agitation of local community, degree of threat to long term sustainability, impact of potential issues on the financial health of the company.

Suggestions and mitigation measures

It covers compliance management system, proper disposal of wastes including e-waste, strong safety management systems, updated technology for manufacturing process, conservation in usage of water, energy, educating and training employees of environmental issues, frequent interaction with local community, sustainability initiatives and its reporting in the Annual Report.

ENVIRONMENTAL MANAGEMENT AS A TOOL- FOR VALUE CREATION

Proper compliance of laws relating to Environment will increase the credibility and would also create value for a business organisation. Companies do earmark separate budget to meet the business expenditure relating to investments for meeting environmental compliances. There is a strong evidence and proof that improved environmental performance is positively correlated with increased competitiveness. Further, the effective environmental systems based on fundamentally sound regulatory structures can play an important role in encouraging business organisations to improve environmental performance, which can strengthen broader competitiveness related goals. Now-a-days, people are willing to pay more for a product which is environment friendly for e.g. lead free paint, jute bags instead of plastic, green homes etc and business houses are also being attracted to the liberalised policies of Indian Government which has encouraged the same. Companies should not view the total amount to be spent on protection of environment as an expenditure. They should consider that it is an investment for creating value, for building goodwill and for making the presence felt. Reputation of an organisation often correlated with the way they function i.e. compliance of rules and regulations, adherence to environment safety, health policy, creating awareness to the workers/employees and also to the outsiders regarding various safety techniques and policies to be observed while entering into a factory, hazardous industry, mines etc. and last but not least is accomplishing the task of corporate social responsibility etc.

Because of the various advantages and value creation, almost all businesses across the world come forward to introduce and implement proper implementation of Environmental Management. The advantages of proper environmental management are as follows:-

- (a) It avoids punishment which includes prosecution including fines.
- (b) Eliminates increased liability to environmental taxes.
- (c) Avoids loss in value of land.
- (d) Avoids destruction of brand values, loss of sales, consumer boycotts and inability to secure finances.
- (e) Avoids loss of insurance cover and contingent liabilities.
- (f) Fixes and ensures more accurate and comprehensive information about responsibility of business houses towards environment for improving corporate image with stakeholders, customers, local communities, employees, government and bankers.

- (g) Helps to attain competitive advantage in respect of identification of costs and benefits associated with it.
- (h) It will boost employee morale and organisation attains a good reputation in the market.
- (i) Ultimately add value to the economy as a whole.

LESSON ROUND UP

- Environmental due diligence has gained importance in the recent past while carrying out inorganic business transactions such as mergers, acquisitions, takeovers etc mainly due to increased awareness and consciousness of the public from potential negative environmental impact of the organization that may be caused by the company on them.
- Environmental Due diligence involves company analysis, regulatory analysis, stakeholder analysis, impact assessment, risk analysis etc.
- The Indian regulatory framework for environmental protection are enforced through legislations like Environmental Protection Act, 1986, National Green Tribunal Act, 2010, Air/Water Pollution Prevention Acts etc.
- The compliances under various environmental legislations are essential not only during strategic business decisions, but for business sustainability as well.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What necessitates environmental due diligence?
2. Write brief note on regulatory framework in India to protect environment.
3. Write short notes on
 - (a) Environmental Impact Assessment.
 - (b) Environment Management Plan.
 - (c) ISO standards on environment

Lesson 12

SEARCH/STATUS REPORTS

LESSON OUTLINE

- Legal provisions relating to charges.
- e-filing of Form 8, 10, 17 etc.
- Requirement of Financial Institutions and corporate lenders
- Check-list for scrutiny of documents for preparing search report.

LEARNING OBJECTIVES

MCA-21 offers the facility to view certain public documents which include documents relating to registration, modification and satisfaction of charges.

This facility is handy for users and banks and financial institutions while sanctioning loans and to evaluate the extent upto which the company has already borrowed moneys and created charges on the security of its movable and/or immovable properties. The Banks/Financial Institutions view these documents by an online inspection process by paying a nominal fee. The report generated out of Inspection Process is called Search/Status report.

After reading this lesson you will be able to understand the meaning, nature of search report, process involved in online inspection of documents while preparing search reports, provisions of companies act relating to creation, modification or satisfaction of charges.

INTRODUCTION

Company as a separate entity has a facility of raising capital for earning large-scale profits, which is normally not within the purview of individual efforts and means. In the past, the companies used to raise money by way of issue of equity or preference shares. However, with the increasing pressure of capital requirements, different and alternative modes of financing were explored and the concept of loan capital came into being. The loan requirements of a company to be met, had to be raised frequently and also by a number of individuals as in the case of share capital. This brought to the fore the concept of *pari passu* ranking.

A charge is created when the security on the property of the company is conferred on another person. Where in a transaction for value, both parties evidence an intention that the property existing or future, shall be made available as security, the charge on the property is created.

The Companies Act, 1956 provides for a comprehensive list of charges which require registration and it also provides for the consequences of non-registration. The Act envisages registration of charges with the Registrar of Companies so that any person acquiring the property of the company has constructive notice of the charge prior to acquisition. Once a certificate of charge is issued by the Registrar of Companies, it is conclusive evidence that the document creating the charge is properly registered.

Banks and various State Financial/Industrial Investment Corporations, while granting loans to companies invariably obtain a status report on the position of borrowings made by the company and the particulars of charges already created by the company on its assets. This is a part of the security aspect of the amount proposed to be lent.

The Report, *inter alia*, informs the lenders, about the status of charges held by them vis-à-vis charges, if any held by others. The Search and Status Report acts as a tool to confirm and evidence information and contains information on status of charges. It is basically a report furnished based on the information gathered by a search of specific records made available for inspection in a Public Office or in any other convenient form. It is not merely verbatim reporting of the information as made available but also supplemented by observations/comments by the person who furnishes the Report.

The Search and Status Report enables furnishing of information to the lender as to whether the charges created through various documents are in fact registered with Registrar of Companies and whether such particulars reflect the correct position of charges held by Lenders. As the Report provides information on the charges created in favour of other lenders, it enables the lenders to assess the exact position of the company and to foresee where they would stand, if the company would go into liquidation. Normally, practicing Company Secretaries are entrusted with the preparation of status/search reports.

SCOPE AND IMPORTANCE

The scope of a Search report depends upon the requirements of the Bank or Financial Institution concerned.

A Search report prepared enables the Bank/Financial Institution to evaluate the extent upto which the company has already borrowed moneys and created charges on the security of its movable and/or immovable properties. This information is very vital for considering the company's request for grant of loans and other credit facilities. The Bank/Financial Institution, while assessing the company's needs for funds, can take a conscious decision regarding the quantum of loan/credit facility to be sanctioned, sufficiency of security required and its nature, as also other terms and conditions to be stipulated. The Search report, thus, acts as an important source of information enabling the lending Bank/Institution to take an informed and speedy decision, and also assures it about the credit-worthiness or otherwise of the borrowing company.

SEARCH/STATUS REPORT

A Search and Status Report as is apparent from, its name contains two aspects. The first being 'search' which involves physical inspection of documents and the second activity 'status' which comprises of reporting of the information as made available by the search.

Thus a search and status report *de facto* acts as a 'Progress Report' on the legal aspects and also a ready reckoner of the exact position.

(a) Particulars of Charges

When a charge on the assets of the Company is created or modified or when a property subject to charge is acquired by a company, particulars thereof are filed in Form No. 8 with the Registrar of Companies (ROC). When the charge is satisfied, the fact is intimated in Form No. 17 to the ROC (now e-forms 8 and 17).

Particulars of a series of debentures containing or giving reference to any other instrument any charge to the benefit of which the debentureholders of the said series are entitled, are filed with the ROC in Form No. 10 (now e-form 10).

After the Registrar registers it, a certificate of registration of the charge is then given by the ROC stating the amounts thereby secured. Such certificate is the conclusive evidence that the legal requirements relating thereto have been complied with.

(b) Examination of documents and registration

MCA-21 offers the facility to view documents and also search and other facilities of public documents. This facility is handy for users and banks and financial institutions while sanctioning loans.

This facility enables viewing of public documents of companies for which payment has been made by user. The document can be viewed only within 7 days after the payment has been confirmed. Also, the documents are available for only 3 hours after the user has started viewing the first document of the company-

- (a) User has to access My MCA portal and login to the My MCA portal.
- (b) Click on the 'My Documents' tab after logging into the system.
- (c) List of company names will be displayed, for which user have already paid for public viewing. It also displays
 - (i) Date of request i.e. the date, when user made the request to view the company document.
 - (ii) Status of the request i.e. whether viewed or to view.
- (d) Click on the view link under status field.
- (e) The documents are grouped under five categories i.e. user has to click on the desired category under which the document falls.
- (f) If more than one document is listed, the user can arrange them name wise or date wise.
- (g) On clicking the document name, the document shall be displayed for viewing.

The public documents under this facility are available for viewing by public on payment of requisite fee. Public documents include Incorporation documents, charge documents, annual returns and balance sheet, change in directors and other documents.

The basic record on the basis of which the report was previously submitted to the banks/institutions, was the Register of Charges maintained in the Office of the ROC. With respect to each company, a Register of charges is maintained by the ROC.

Particulars of charges which are registrable with the ROC can be filed by the company or the creditor (Section 125). Particulars of modification of charges have to be filed only by the company concerned (Section 135). The satisfaction of any charge in full has to be informed only by the company concerned under Section 138 except in cases covered under Section 139. Thereafter, the Registrar would make appropriate noting in the Register of Charges in accordance with Sub-section (2) of Section 138.

(c) Inspection

Form 8, Form 10, Form 17 and copies of certificates of registration thereof are available for inspection at the website.

Prior to introduction of e-filing the documents in the Document File at the ROC's office could be inspected by any person after making an application in writing and paying Rs. 50* towards the fee. Normally, more than two persons were not allowed to carry out jointly the inspection of Document File(s) of one company.

While taking the inspection at Registrar's office, a verbatim copy of the contents was not allowed. Notes could be made by using pencil. Pen or ballpen could not be used for taking down the notes.

(d) Verification of Documents Relating to Charges

Before proceeding with the inspection it would be advisable for the company secretary in practice to know if the concerned bank/financial institution or the client requires the Search Report, in any specific format and if so, the contents of the format.

Meticulous care will have to be taken in noting down the following particulars from the Register of Charges:

- (a) Date of registration (preferably with the serial number) of the document
- (b) Date and nature of the document creating the charge
- (c) Amount of the charge
- (d) Brief particulars of the property charged
- (e) Name and address of the person in whose favour the charge is created.

In respect of each of the charges created, it would be essential to identify the modifications effected from time to time by noting down carefully the following particulars:

- (a) Date of registration of the document (preferably with the serial number)
- (b) Nature and date of the instrument modifying the charge
- (c) Effect of Modification.

Each modification should be noted in chronological order and the above particulars should be compiled together for each charge.

If and when the charge is satisfied, fool-proof identification of the exact charge which is satisfied is of paramount necessity. The following particulars can be noted chronologically by way of modification by the

* Increased vide F.No. 1/15/91-CL.V dated 27.4.2000.

Search Report.

- (a) Date of registration (preferably with the serial number) of the document
- (b) Date of satisfaction.

Non-essential particulars of charges comprise of the gist of terms and conditions with regard to (a) mode of repayment (b) rate of interest and (c) margin; these need not be given in the Search Report unless specifically so required by the client.

If the client requires particulars of the charges pending registration, it is advisable to give a separate report based on the verification of the registers and records maintained by or available with the company.

Some financial institutions require a Report by Company Secretaries in Practice, on certain additional points relevant and important for them. A separate Report can be given after inspecting or verifying the documents and records available with the Registrar and/or the company. The points normally covered under such Report are:

<i>Item</i>		<i>Records to be verified</i>
1		2
(a)	Name of the Company	Memorandum of Association Certificate of Incorporation or Fresh Certificate of Incorporation/Change of Name.
	(Note: If capital is raised other than by cash, it should be shown separately).	
(b)	Date of Incorporation	Certificate of Incorporation.
(c)	Company Number/Corporate Identity Number	Certificate of Incorporation/Fresh Certificate upon change of name/ Certificate of registration of CLB Order for shifting registered office to another State.
(d)	Address of Registered Office	Form 18, Form 23 Resolution(s) of Board/General Body, Form 21 with copy of CLB Order.
(e)	Name and address of present directors (with their date of joining)	Articles of Association, Form(s) 32, Register of Directors.
(f)	Authorised Share Capital of the company divided into _____ Shares of Rs. _____ each	Memorandum of Association, Form 5, Form 23
(g)	Paid-up Capital of the company divided into _____ Shares of Rs. _____ each	Form 23, Form 2, Register of Members, Accounts Ledger
(h)	List of Members with details as to shares held by each of them. The names of directors to be specifically mentioned in such list of shareholders (List of members holding shares of a specified monetary threshold is also asked for in some cases).	Form 2, Annual Return, Register of Members, Register of Directors.

	1	2
(i)	Provision in the Articles of Association as to affixation of common seal of the company. (Particulars as to the persons in whose presence the seal of the company can be affixed to any deed).	Articles of Association. If there is no specific cause and the Articles have adopted Table A, Regulation 84 of Table A may be referred.
(j)	Main Objects of the company.	Information regarding the relevant objects in clause IIIA or IIIC in the Memorandum of Association.
(k)	Whether the Memorandum of Association of the company contains provisions for borrowing and charging fixed and movable assets of the company for securing repayment of such secured borrowing.	In Memorandum of Association, careful examination of incidental objects in clause IIIB.
(l)	Whether the Articles of the company contains provisions for nomination by the corporation a director on the board of the company.	Articles of Association of the company.

Apart from the above, the master data available at the My MCA portal can be resorted to mere reproduction of the particulars of charges in form of Search and Status Report is not sufficient. It also requires:

- A thorough study of the particulars relating to the amount secured by the charge and the terms and conditions governing the charge.
- An analysis of the security available to a particular lender for its advances.
- A comparison of charges created in favour of a particular lender *vis-à-vis* other lenders.

In other words, it does not necessary mean verbatim reporting of the information as made available but also supplemented by observations/comments by the person who furnishes the Report.

In nutshell, the following have to be borne in mind:

- The Search and Status Report should give exact details of particulars of charges/modifications/satisfactions as effected, filed and registered from time to time.
- Identify those charges and modification of charges, which have been created in favour of a particular lender.
- Take the particulars of the documents creating the charge as specified in Form Nos.8 and 10.
- Ascertain as to whether the amount secured by the charge as per the documents executed has been duly mentioned.
- Ascertain as to whether 'properties' offered as security are mentioned as per the documents creating the charge and attached with the Forms and verify whether they are as per the terms of Sanction.
- Check whether the terms and conditions governing the charge have been mentioned.
- Ascertain whether the name of the lender is properly mentioned.
- In case of modification of charge ascertain whether the names of documents effecting the modification are mentioned and whether the particulars of modification are clearly mentioned.
- In case of charge, the particulars of documents attached with forms, amount secured by the charge

as per the documents and/or sanction ticket, the properties/assets secured by the charge, the terms and conditions governing the charge and the name of the lender is properly mentioned in the relevant columns of Forms Nos.8.

Further, a Search and Status Report should always be supported by expert observations on the charges created by the borrower in respect of the subject lender. It is necessary to peruse the observations/comments offered and the same should be read in conjunction with the Report. The observations/comments of the experts/ professional (company secretary in practice) will certainly help to throw additional light on certain points which would have missed the attention of the “lenders” when the Form Nos. 8 was presented before them for signature.

Company Secretary in Practice giving the above information is required to certify that his report has been submitted on the basis of the search carried by him on a particular date, with the Registrar's office/MCA portal. He is also required to certify that the company has filed all returns/forms within stipulated time with the Registrar's office upto the date required to be filed in regard to the above matters and also to report, if any notices have been served upon the company for breaches/non-compliance of any provisions of the Companies Act, 1956.

(e) Compilation and Preparation of Search Report

Search Report compiled on the basis of the scrutiny of the above documents is, therefore, related and restricted to only those documents which are available for the inspection on the date(s) when the search is carried out.

An index of the charges is prepared at the website of MCA. This index provides, charge ID, the date of filing of the document charge amount secured, name of chargeholder and its address. In order to view index of charges, it is primarily necessary to quote CIN/FCRN of the company. This number will primarily be available at the website of the ministry.

It is advisable to note down from the index, the short particulars of all Form Nos. 8, 10, and 17 for the purpose of cross-checking and ensuring that no document is missed in the Search Report.

Also, it would be advisable to mention in the Search Report by way of a footnote as to what was the last document which was available for inspection when the scrutiny was taken/completed. This information can be helpful in identifying the forms and based on which the Search Report is given. If a charge which is registered and in respect of which the certificate of registration is issued by the Registrar, but, if the document is not available for inspection, the aforesaid footnote can readily clarify the position.

(f) Format of Search Report and its Preparation

Some of the banks and financial institutions insist that the Search Report be given in their own format. It would, therefore, be advisable to know if any specific format is insisted upon by the client.

In the absence of any specific format, the Search Report may be given in the format given at **Annexure**.

LEGAL PROVISIONS

Sections 124 to 145 in Part V of the Companies Act, 1956 provide for the registration of charges in so far as any security on the company's property or undertaking is conferred, modified or satisfied thereby.

Prescribed particulars of the charge together with the instrument, if any, evidencing, creating or modifying the charge (or a certified copy thereof) are required to be filed with the Registrar of Companies within thirty days after the date of creation or modification of the charges. In case of satisfaction of charge, the intimation is required to be given to the Registrar within thirty days from the date of payment or satisfaction of the charge.

The Registrar has discretionary powers to condone the delays upto thirty days in case of particulars relating to

creation or modification of the charge. In the case of satisfaction of charge, the delays can be condoned by Regional Director of the respective regions upon a petition (application) filed by the company or interested person.

The prescribed particulars in e-Form 8 or e-Form 10 together with copy of the instrument creating or modifying the charge and those relating to satisfaction of charge in e-Form 17 are required to be filed with the Registrar of Companies. All these forms should be in triplicate and should be duly signed on behalf of the concerned company as well as the respective charge holder.

Non-filing of particulars of a charge renders the charge void against the liquidator or against any other creditor of the company. This implies that if particulars of a subsequent charge created on the property are filed and the particulars of the earlier charge particulars are not filed, then the subsequent charge-holder would enjoy precedence over the earlier charge-holder, e.g., in selling the property in order to satisfy his debt. It should be noted that the concerned company cannot, even in the event of non-filing of particulars of charge, repudiate its contractual obligation *vis-à-vis* the creditor in whose favour charge is created.

The following tables depicts the manner of verifying forms 8/10/17 relating to charges:

TABLE A
Charges Requiring Registration

<i>Sl. No.</i>	<i>Relevant Provisions</i>	<i>Charges under Reference</i>	<i>Illustrative Instruments</i>	<i>To Verify Whether Or Not</i>
(1)	(2)	(3)	(4)	(5)
I.	Sub-section (4) of Section 125 of the Companies Act, 1956	(a) a charge for the purpose of securing any issue of debentures	(a) Hypothecation or mortgage including floating charge	*The instrument is executed and is dated.
		(b) a charge on uncalled share capital of the company	(b) Deed of assignment	*The common seal is affixed and if yes, the authority thereof is mentioned.
		(c) a charge on any immovable property, where-ever situate, or any interest therein	(c) Mortgage	*The instrument bears adequate stamps in accordance with the applicable Stamp Act
		(d) a charge on any book debts of the company	(d) Hypothecation	*The instrument creates the charge specifying the amount of charge and the assets charged.
		(e) a charge, not being a pledge, on any movable property of the company	(e) Hypothecation	*The instrument modifying a charge refers to the original charge under modification and spells the extent of modification.

(1)	(2)	(3)	(4)	(5)
		(f) a floating charge on the undertaking or any property of the company including stock-in-trade	(f) Hypothecation	*The instrument bears names of the persons in whose favour the charge is created or modified.
		(g) a charge on calls made but not paid	(g) Deed of assignment	*The instrument contains the terms relating to (a) mode of repayment, (b) applicable rate/s of interest, (c) margin and (d) priority or precedence of charge/s.
		(h) a charge on a ship or any share in ship	(h) Hypothecation	
		(i) a charge on goodwill, or on a patent or a license under a patent, or on a trade-mark, or on a copyright, or a license under a copyright	(i) Deed of assignment	
II.	Sub-section (1) of Section 127 of the Companies Act, 1956	Charges on properties acquired subject to any charge thereon	Relevant instrument and also the instrument, evidencing the acquisition of the property which is subject to charge.	

*The instrument bears adequate stamps in accordance with the applicable Stamp Act.

TABLE B
Time for Filing Forms

<i>Event</i>	<i>Time Limit</i>	<i>Effect</i>	<i>Relevant provisions</i>
(1)	(2)	(3)	(4)
Creation of charge or modification of charge or acquisition of property which is subject to charge	Within thirty days after the date of creation, modification or acquisition	The date when the event takes place is to be excluded while calculating the limit	Sections 125, 127 and 135 of the Act.
Satisfaction of the charge.	Within thirty days from the date of satisfaction	The date when the event takes place is to be excluded while calculating thirty days	Section 138 of the Act.

REQUIREMENTS OF VARIOUS FINANCIAL INSTITUTIONS AND OTHER CORPORATE LENDERS

The All-India Financial Institutions while granting term loans to companies insist on certain formalities to be completed by a company availing such loan. These include furnishing of certificates by Company Secretaries in Practice in regard to the following:

- (a) Necessary power of a company and its directors to enter into an agreement.
- (b) Borrowing limits of a company under Section 293(1)(d) of the Companies Act, 1956, including details of share capital – authorised, issued, subscribed and paid-up, and the actual borrowing.
- (c) List of members of a company.
- (d) Copies of resolutions passed at company meeting to be furnished to financial institutions.

Many State Financial/Industrial Investment/Development Corporations have also agreed to accept the certificates issued by Company Secretaries in Practice, in regard to all/some of the aforesaid matters.

Certification by Company Secretaries in Practice

The certification to be done by Company Secretaries in Practice has to conform to any specific requirement of the Institution/Corporation. It may be stated that the matters to which certification extends can be verified by the Institutions themselves from the Memorandum/Articles of Association of companies, which are submitted to them. However, Institutions, by way of abundant caution insist for stipulation on certificates by independent professionals like Company Secretaries in Practice, in respect of these matters. The various certifications are explained in the following paragraphs.

Necessary Powers of a Company and its Directors to Enter into an Agreement

Resolutions passed at the meeting of the board/general meeting for exercising the power of borrowing have to be checked; in the absence of any provision to the contrary in the articles of association, the borrowing power may be exercised by the Board of directors.

Section 292 of the Companies Act requires *inter alia*, that the power to borrow moneys otherwise than on debentures can be exercised by the Board of Directors only by means of resolution passed at meetings of the Board. This power of borrowings may also be delegated to any committee of directors, managing director, manager or any other principal officer. The delegation should be only by means of resolution passed at board meeting and not by circulation. Every resolution delegating this power should specify the total amount upto which moneys may be borrowed by the delegate.

The financial institutions require that this certificate will have to refer to the relevant clause(s) of the Memorandum of Association of the company, which gives specific powers to the company, and to secure the repayment of the same by mortgage, charge, lien, etc. the opinion will also have to refer to the relevant article(s) of the Article of Association and the general body resolution, if any, under which the Board of Directors are authorised to borrow or raise moneys, secure the repayment thereof and execute on behalf of the company, bonds, deeds, documents, etc. The opinion should also spell out the limitations and restrictions, if any, on the powers of the Board of directors to borrow or raise money.

Borrowing Limits and Compliance of Section 293(1)(d)

- (i) In the case of a public company or a private company which is a subsidiary of a public company, the consent of general meeting is required if the moneys to be borrowed alongwith the moneys already

borrowed exceeds the aggregate of paid-up capital and free reserves. If the borrowings exceed this limit check the minutes of the general meeting of members to ensure that the Board is authorised to borrow and also that the proposed borrowing does not exceed the amount specified in the resolution passed by the company in general meeting. Temporary loans repayable on demand or within six months obtained from the company's bankers in the ordinary course of business are excluded from the purview of borrowings under this section.

- (ii) Obtain a certified true copy of the resolution passed by the members of the company under Section 293(1)(d) of the Companies Act, 1956.
- (iii) Check the resolution passed by the Board to borrow the money.
- (iv) Check the latest audited balance sheet of the company for verifying the amount of share capital, free reserves and the total amount of borrowings.
- (v) Also check the Register of Charges.

'Free reserve' means, "reserves not set apart for any specific purpose".

Any change in these items after the date of balance sheet should be checked from the accounts of the company, allotment register and agreements entered to borrow the moneys and such other records and documents.

ANNEXURE

ANNEXURE

Format of Search Report

Search report

On

the charges on the assets of

..... Limited

(Company Number.....)

I/We have carried out the search of the Register of Charges and the documents related to the charges on the assets of the above named Company as registered by and available for inspection on..... at the office of Registrar of Companies*..... and hereby report that the following particulars of charges in respect of the above-named Company have been so registered:

<i>Sl. No.</i>	<i>Date of registration</i>	<i>Instrument creating charge and date</i>	<i>Amount of charge Rs.</i>	<i>Short Particulars of property charged</i>
(1)	(2)	(3)	(4)	(5)

* Now available on the website.

<i>Name & address of Person in whose favour the charge is created</i>	<i>Particulars of Modification</i>		
	<i>Date of registration</i>	<i>Instrument modifying the charge</i>	<i>Effect of modification</i>
(6)	(7)	(8)	(9)

- Notes :**
- (1) The figures in bracket in column numbers 2 and 7 indicate the serial numbers under which the respective documents have been registered.
 - (2) The last document registered in the Document File and available for inspection at the office of Registrar of Companies,
 - (3)
 - (4)

.....
 (Signature with seal)
 Name and Address of Company
 Secretary in Practice.....

Place:Certificate of Practice No.

Date:Membership No.

LESSON ROUND UP

- The search/status report enables furnishing of information to the lender as to whether the charges created through various documents are in fact registered with ROC and whether such particulars reflect the correct position of charges held by lenders.
- MCA21 offers the facility to view documents relating to charges created by the company which is handy for banks and financial institutions while granting loans.
- The scope of search report depends upon the requirements of the bank or financial institution concerned.
- Search/status report enables banks/financial institutions to evaluate the extent upto which the company has already borrowed moneys or created charges on scrutiny of its movable and/or immovable properties.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What is a status/search report? Discuss the format normally followed for this report.
2. State the general points to be kept in mind by Company Secretary in Practice while preparing status/search report.
3. State the procedure of registering charges (created/modified) with the Registrar of Companies as required under Section 124 to 145 of the Companies Act 1956.

[illegible]

Lesson 13

COMPLAINT MANAGEMENT

LESSON OUTLINE

- The concept, scope, significance and need for compliance management
- Establishment of Compliance Management Framework
- Compliance Management process
- Systems approach to compliance management
- Apparent, Adequate and absolute compliance
- Role of Company Secretary in compliance management

LEARNING OBJECTIVES

Expansion in terms of geographies and functions, has necessitated the corporates to comply with multiple regulations. It requires systematic approach and co-ordination among functional departments, to avoid any material non compliance. Nevertheless, some corporates perceive legal compliance, substantive and procedural, as mundane activity involving costs and fail to realize the cost of non compliance that may have an irreversible negative impact on the reputation of business. Here, the emphasis of the compliance management is on enabling companies acquire the skill-sets and systems to ensure continued adherence of law.

There has emerged a clear need to create proper systems, processes, tools and dynamic corporate compliance management systems. To promote a good compliance management, it is important that functions like tax/legal/finance have constant dialogue amongst themselves of the compliance obligations, discussing grey areas, if any, and seek constant best guidance for promoting compliance. These functions should stay in constant touch with business and identify any new business situations, which may warrant evaluation of newer compliances, and arrangements to be put in place to manage compliances.

After reading this lesson you will be able to understand the importance, need of compliance management, process involved, and systems approach to compliance management. Further the lesson also deals with apparent, adequate and absolute compliances.

INTRODUCTION

A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution.

The compliance program consists of the policies and procedures which guide in adherence of laws and regulations. The compliance audit is independent testing of level of compliance with various laws and regulations applicable.

Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management must recognize the scope and implications of laws and regulations that apply to the company. They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. To ensure an effective approach to compliance, the participation of senior management in the development and maintenance of a compliance program is necessary. They should review the effectiveness of its compliance management system at periodic intervals, so as to ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management

NEED FOR COMPLIANCE

Corporate accountability is on everyone's mind today. Business executive face significant pressure to comply with multiple regulations. Many companies are adopting comprehensive compliance plans to address emerging regulatory paradigm and those that fail to address the new regulations, pay hefty fines or incurring punitive restrictions on their operations.

The organizations face mounting pressures that are driving them towards a structured approach to enterprise-wide compliance management. Increased liability and regulatory oversight has amplified risk to a point where it demands continuous evaluation of compliance management systems. Furthermore, the multiplication of compliance requirements that organizations face increases the risk of non-compliance, which may have potential civil and criminal penalties.

This focused attention on compliances with spirit and details of laws casts upon Company Secretaries an onerous responsibility to guide the corporates in this direction. They have to advise companies in totality to provide full, timely and intelligible information. To enable companies to put in place an effective Compliance Management System, company secretaries should ensure that companies:

- adhere to necessary industry and government regulations,
- Change business processes according to legislative change,
- Realign resources to meet compliance deadlines,
- React quickly and cost-effectively if regulations change.

Risk of Non-compliance

The risks of non-compliance of the law are many:

1. Cessation of business activities
2. Civil action by the authorities
3. Punitive action resulting in fines against the company/officials
4. Imprisonment of the errant officials
5. Public embarrassment
6. Damage to the reputation of the company and its employees
7. Attachment of bank accounts.

SIGNIFICANCE OF CORPORATE COMPLIANCE MANAGEMENT

1. Better compliance of the law
2. Real time status of legal/statutory compliances
3. Safety valve against unintended non compliances/ prosecutions, etc.
4. Real time status on the progress of pending litigation before the judicial/quasi-judicial fora
5. Cost savings by avoiding penalties/fines and minimizing litigation
6. Better brand image and positioning of the company in the market
7. Enhanced credibility/creditworthiness that only a law abiding company can command
8. Goodwill among the shareholders, investors, and stakeholders.
9. Recognition as Good corporate citizen.

Compliance with the requirements of law through a compliance management programme can produce positive results at several levels:

- Companies that go the extra mile with their compliance programs lay the foundation for the control environment.
- Companies with effective compliance management programme are more likely to avoid stiff personal penalties, both monetary and imprisonment.
- Companies that embed positive ethics and effective compliance management programme deep within their culture often enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns.

Clearly, the benefits of implementing and maintaining an effective ethics and compliance program far outweigh its costs. Not only does the compliance management protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

SCOPE OF CORPORATE COMPLIANCE MANAGEMENT

Corporate compliance management should broadly include compliance of :

- Corporate Laws
- Securities Laws

- Commercial Laws including Intellectual Property Rights Laws
- Labour Laws
- Tax Laws
- Pollution Control Laws
- Industry Specified laws
- All other Laws affecting the company concerned depending upon the type of industry/activity.

The details of the above mentioned legislations are given below.

(a) Corporate & Economic Laws

Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws. Some of the important corporate laws are given below in brief:

- Companies Act, 1956 and the Rules and Regulations framed there under, MCA-21 requirements and procedures.
- Secretarial Standards/Accounting Standards/Cost Accounting Standards issued by ICSI/ICAI/ICMAI, respectively.
- Emblems and Names (Prevention of Improper Use) Act, 1947.
- Foreign Exchange Management Act, 1999 and the various Notifications, Rules and Regulations framed there under.
- Foreign Contribution (Regulation) Act, 2010.
- Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.
- Competition Act, 2002.
- Special Economic Zones Act, 2005.
- Prevention of Money Laundering Act, 2002.
- Micro, Small and Medium Enterprises Development Act, 2006.
- Essential Commodities Act, 1955.
- Intellectual Property Rights Laws.

(b) Securities Laws

- SEBI Act, 1992
- Securities (Contracts) Regulation Act, 1956 and rules made thereunder
- Various rules, regulations guidelines and circulars issued by SEBI
- Provisions of Listing Agreement
- Depositories Act, 1996

(c) Commercial Laws

- Indian Contract Act, 1872
- Transfer of Property Act, 1882
- Arbitration and Conciliation Act, 1996

- Negotiable Instruments Act, 1881
- Sale of Goods Act, 1930

(d) Fiscal Laws

- Income Tax Act, 1961
- Central Excise Act, 1944
- Customs Act, 1962
- Wealth Tax Act, 1957
- Central Sales Tax/State Sales Tax/VAT
- Service Tax.

(e) Labour Laws

- Minimum Wages Act, 1948
- Payment of Bonus Act, 1965
- Payment of Gratuity Act, 1972
- Employees' Provident Funds and (Misc. Provisions) Act, 1952;
- Employees' State Insurance Act, 1948;
- Factories Act, 1948;
- Employees' Compensation Act, 1923;
- Maternity Benefit Act, 1961;
- Industrial Dispute Act, 1947; and
- Contract Labour (Regulation and Abolition) Act, 1970.

(f) Pollution/Environment related Laws

- Air (Prevention and Control of Pollution) Act, 1981
- Water (Prevention and Control of Pollution) Act, 1974
- Water (Prevention and Control of Pollution) Cess Act, 1974
- Environment Protection Act, 1986
- Public Liability Insurance Act, 1991
- National Green Tribunal Act, 2010.

(g) Industry Specific Laws

Legislations applicable to specific categories of industries – electricity, power generation and transmission, insurance, banking, chit funds, etc.

(h) Local Laws

These would include Stamp Act, Registration Act, municipal and civic administration laws, shops and establishments, etc.

Individual companies may suitably add or delete to/from the above list as required.

Establishment of compliance management framework

The Compliance Management encompasses (1) Compliance Identification (2) Compliance Ownership (3) Compliance Awareness (4) Compliance Reporting and (5) Periodical Compliance MIS.

Compliance Identification

This process involves the identification of compliances under various legislations applicable to the company, in consultation with the functional heads. The legal team has to identify the legislations applicable to the company and identify the compliances that are required under each legislation or rules and regulations made there under.

Compliance Ownership

The next important aspect of compliance management is ownership. The ownership of the various compliances has to be described function wise and individual wise. Clear description of primary and secondary ownership is also very important. While the primary owner is mainly responsible for the compliance the secondary owner (usually the supervisor of the primary owner) has to supervise the compliance. Ex: Secretarial Officer /Asst Company Secretary may be primarily responsible and Group Company Secretary's responsibility is secondary.

Compliance Awareness

The next important step in establishing a legal compliance Management is creation of awareness of the various Legal Compliances amongst those responsible. Many a times compliances are handled by persons who are not fully aware of the requirements of the legislations and hence creating appropriate awareness amongst the owners is very important. This could be done in the form of meetings/trainings explaining the various compliances or some manual containing the details of compliances.

Compliance Reporting

Compliances or non-compliances should be communicated to the Concerned. Reporting of non-compliances ensures that appropriate corrective action is taken by the responsible person, Ex. Automated escalation emails in case of non compliance

Process of Corporate Compliance Reporting (CCR)

Although the actual process of compiling the information under the various laws may vary from company to company and is dependent on various factors such as the number of units and scale of operations, a brief process of the CCR mechanism is as follows:

- (A) Functional heads for the reporting of various laws have to be identified. For instance, the Company Secretary would be the functional head for reporting of company law, listing agreement and commercial laws. Similarly, the head of the Personnel Department could report the compliance of labour and industrial laws and the fiscal law compliance would be the domain of finance/accounts departments.
- (B) Each of the functional heads may collect and classify the relevant information from the various units/locations pertaining to their department and consolidate them in the form of a report.
- (C) The report shall carry an affirmation from the functional heads that the said report has been prepared based on the inputs received from the various units/offices and then list out the specific compliances/non-compliances, as already circulated to the functional heads.

- (D) Each of the functional heads will forward their respective compliance reports to the Company Secretary/Managing Director.
- (E) The Company Secretary would then brief the Managing Director and with suitable inputs from the Company Secretary, the Managing Director would consolidate and present, under his signature, a comprehensive CCR to the Board for its information, advice and noting.
- (F) The whole process of CCR is contingent on the creation and implementation of comprehensive legal Management Information System (MIS).

Role of Information Technology In Compliance Management Systems Through Web Based Compliance Systems

A critical component of an effective compliance program is the ability to monitor and audit compliance in a “real time manner.” Yet, as companies cross geographical and industry boundaries, it is becoming harder to perform this role in the traditional manner. As a result, companies are increasingly seeking technology solutions.

Information Technology can play an effective role in implementation of a Corporate Compliance Management Programme across various departments of an organization in terms of real-time compliance reminders, generation of reports, sending warning signals, generation of compliance calendar etc.

Many companies are introducing comprehensive web-based compliance systems that links various offices/units for better co-ordination and continued compliance. Companies prefer to introduce full-fledged compliance management systems for smooth compliance of multiple laws. Web-based compliance software are available industry-wise and tailor made compliance software can also be made according to company specifications which has to be updated on continuous basis.

The Systems Approach to compliance management

A well-designed compliance management programme has abilities to perform the following key functions across the enterprise:

- *Compliance Dashboard:* The compliance programme must provide a single enterprise-wide dashboard for all users to track and trend compliance events. All compliance events should be easily viewed interactively through the enterprise compliance dashboard. External auditors, internal auditors, compliance officers can use the dashboards to make decisions on the compliance status of the organization.
- *Policy and Procedure Management:* A well-designed document management system forms the basis of managing the entire lifecycle of policies and procedures within an enterprise. Ensuring that these policies and procedures are in conformity with the ever-changing rules and regulations is a critical requirement. The creation, review, approval and release process of the policy documents and SOPs (Standard Operating Procedures) should be driven by collaborative tools that provide core document management functionality.
- *Event Management:* The compliance management system must have ability to capture and track events, cases and incidents across the extended enterprise. Compliance officers, call center personnel, IT departments, QA personnel, ethics hotline should be able to log in any adverse event across the enterprise, upon which the necessary corrective and preventive actions are initiated.
- *Rules and Regulations:* A well-designed compliance management solution must offer capabilities for organization to continuously stay in sync with changing rules and regulations. As soon as there are

regulatory changes, the various departments should be notified proactively through “email based” collaboration. This process critically enables the organization to dynamically change their policies and procedures in adherence to the rules and regulations. While tracking a single regulation may be manually feasible, it becomes an error-prone task to track all local, state, and central regulations including those taking place across the globe. A well-designed Compliance management programme offers up-to-date regulatory alerts across the enterprise.

- *Audit Management:* Audits have now become part of the enterprise core infrastructure. Internal audits, financial audits, external audits, vendor audits must be facilitated through a real-time system. Audits are no more an annual activity and corporations offer appropriate audit capabilities. Appropriate evidence of internal audits becomes critical in defending compliance to regulations.
- *Quality Management:* Most organizations have internal operational, plant-level or departmental quality initiatives to industry mandates like Six-sigma or ISO 9000. A well-designed compliance management program incorporates and supports ongoing quality initiatives. Most quality practitioners agree that compliance and quality are two sides of the same coin. Therefore, it is critical to ensure that compliance management solution offers support for enterprise-wide quality initiatives.
- *Training Management:* Most compliance programs often require evidence of employee training. Regulations like Clause 49 of Listing Agreement and Sarbanes-Oxley Act, stress on employee training. In USA, lack of documented training can lead to fines and penalties. Often the compliance office has to work closely with the HR organization to facilitate employee training. Well-designed compliance program requires a well-integrated approach to training management.
- *Compliance Task Management:* Organizations must plan, manage and report status of all compliance related activities from a centralized solution. Automated updates from the various compliance modules should provide for up-to-the-minute status reporting that could be viewed by the Board, corporate compliance officer, entity compliance coordinators, quality offices and others as designated.

Compliance solutions

In this age of information technology and outsourcing, where corporate solutions are available at every step and in respect of every matter, there are several companies offering ‘compliance solutions’.

Approach to Compliance Solutions

Compliance solution providers adopts following approaches for creating or enhancing an ethics and compliance program for companies—

Risk/Cultural Assessment: Through employee surveys, interviews, and document reviews, a company’s culture of ethics and compliance at all levels of the organization is validated. Our Reports and recommendations with detail observations identify gaps between company’s current practices and benchmarks with international practices.

Program Design/Update: In this phase, compliance solution providers help company in creating guideline documents that outline the reporting structure, communications methods, and other key components of the code of ethics and compliance program. This encompasses all aspects of the program, from grass roots policies to structuring board committees that oversee the program; from establishing the mandatory anonymous complaint reporting mechanism—i.e., compliance and ethics help line or whistleblower hot line—to spelling out the specifics of the code of ethics in a way that is easily understood by everyone at all levels of organization.

Policies and Procedures: In this phase compliance solution providers help company to develop or enhance the detailed policies of the program, including issues of financial reporting, antitrust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, securities, and sexual harassment, among others.

Communication, Training, and Implementation: Even the best policies and procedures are useless if they are not institutionalized—they must become part of the fabric of the organization. Compliance solution providers help company to clearly articulate, communicate, and reinforce not only the specifics of the program, but also the philosophy behind it, and the day-to-day realities of it. In this way, key stakeholders and other personnel are more likely to embrace the program and incorporate it into their attitudes and behaviours.

Ongoing self-Assessment, Monitoring, and Reporting: The true test of a company's ethics and compliance program comes over time. How do one know in one year or five that both the intent and letter of the law are still being observed throughout organization? How does the program and the organization adapt to changing legislation and business conditions? As the organization evolves for example, through mergers and acquisitions will the program remain relevant? The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organisations achieve sustained success.

APPARENT, ADEQUATE AND ABSOLUTE COMPLIANCES

Corporates are expected to comply with the regulatory prescriptions in their true letter and spirit and should be seen as an opportunity to make their systems and processes more robust and bring them in line with global practice, resulting in the enhanced trust level of stakeholders. As regards corporate disclosure, there has been a paradigm shift from letter to spirit because of factors like demand from stakeholders, regulatory shift from control to self regulation, market competition etc.

Good Corporate Governance demands compliances level that match the intentions of legislature, expectations of stakeholders and requirements of regulators. The compliances, however, generally found to fall in three categories, i.e. Apparent Compliances, Adequate Compliances and Absolute Compliances.

Apparent compliance is a disguise form of non-compliance, which is worse than a non compliance. The classic example for Apparent Compliances are generating documents such as notice, agenda, minutes on papers for board and general meeting which are not actually held.

Adequate compliance is compliance in letters. The aspects specified in law are complied in letters, without getting into the spirit of the law, e.g. box ticking practices.

Absolute compliances are those which are in line with the spirit and intent of the law. A typical example in this regard is demonstrating shareholder democracy as prescribed by law. When a company complies with law in spirit it gains public confidence as well. For example, Infosys has set new and effective standards in communicating with shareholders, stock exchanges and general public at large. Its Annual Report is said to be a trend setter and has been commended as an ideal report by SEC. This company has demonstrated through its practices and procedures its commitment to enhance investor-relations and has amply rewarded its shareholders through its impressive performance and its value based management philosophy helps increase its brand value. The company has achieved trust of stakeholders by having a strategic balance between wealth and welfare.

Experts view Annual report as self appraisal report of the company. The shift from shareholder concept to stakeholder concept has necessitated the corporates to provide a transparent report which is viewed by all

stakeholders such as shareholders, creditors, lenders, strategic investors etc as a potential source of information. In order to attain corporate sustainability and to ensure a level playing field with international market, corporates has to necessarily increase their level of compliance from apparent to adequate leading to level of absolute, compliances.

SECRETARIAL AUDIT AND COMPLIANCE MANAGEMENT SYSTEM

The compliance system and processes in a company are dependent mainly on the following factors:

- (a) Nature of business(es).
- (b) Geographical domain of its area of operation(s).
- (c) Size of the company both in terms of operations as well as investments, technology, multiplicity of business activities and manpower employed.
- (d) Jurisdictions in which it operates.
- (e) Whether the company is a listed company or not.
- (f) Regulatory authority(ies) in respect of its business operations.
- (g) Nature of the company viz., private, public, government company, etc.

Based on the above the Secretarial Auditor can constitute a broad idea about the desired system and process to be adopted by a company. For example, a multi product / multi operation company is supposed to comply all the applicable corporate laws in addition to regulatory framework applicable at products/ operations.

At corporate level, monitoring of such complex web of compliances are generally made on a back-to-back mechanism. In such cases Boards' reporting on compliances are made on the basis of reports/certification provided by field level management. As a better compliance structure in such cases it is desired to have a internal checking mechanism about the quality of such report either on regular basis or sample basis.

Now-a-days most of the large companies have adopted Enterprise Resource Planning (ERP) Systems to cater to their complex operations. In many a cases, compliance system becomes a part of these modules. Auditing in such systems requires the Auditor to enter and to have access within the system. While taking up the audit assignment, the Auditor needs to ensure that access would be given so that assessment of proper system and process of compliance is made.

Auditing of compliance system and process is not a fault finding exercise, rather a device to scale up compliance mechanism of a company commensurate to its size and operations. It is desired that the Secretarial Auditor as an expert in corporate compliance would advice the companies to build up strong corporate compliance system in case the system appears to be insufficient during the audit process.

Role of Company Secretaries in Compliance Management

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the 'Compliance Manager' of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary. These disclosures can be classified into statutory disclosures, non-statutory disclosures, specifies disclosures and continuous disclosures. Clause 49 of Listing Agreement spells out elaborately on various aspects of disclosures which are to be made by the company such as contingent liabilities, related party transactions, proceeds from initial public offerings, remuneration of directors and various details giving the threats, risks and opportunities under management discussion and analysis in the corporate governance report which is published in the annual accounts duly

certified by the professional like company secretaries. A Company Secretary has to ensure that these disclosures are made to shareholders and other stakeholders in true letter and spirit.

In nutshell, the Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

LESSON ROUND UP

- A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc.
- A tool, which helps companies comply with provisions of various governing legislations as well as rules, regulations and guidelines issued thereunder, is a Compliance Solution.
- In the context of corporate governance, ethics is the intent to observe the spirit of law—in other words, it is the expressed intent to do what is right.
- Corporate Compliance Management can add substantial business value only if compliance is done with due diligence.
- The Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Write a brief note on apparent, adequate and absolute compliances.
2. Describe the scope of compliance management.
3. Explain compliance management process in general.
4. Explain the systems approach to compliance management.

PROFESSIONAL PROGRAMME
SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

PP-SACM&DD/2013

TEST PAPERS

This Test Paper set contains three test papers. Test Paper 1/2013, 2/2013 and 3/2013. The maximum time allowed to attempt each test paper is 3 hours.

Students are advised to attempt at least **one Test Paper out of three** and send the response sheet for evaluation to make him/her eligible for Coaching Completion Certificate.

While writing answers, students should take care not to copy from the study material, text books or other publications. Instances of deliberate copying from any source, will be viewed very seriously.

WHILE WRITING THE RESPONSE SHEETS TO THE TEST PAPERS GIVEN AT END OF THIS STUDY MATERIAL, THE STUDENTS SHOULD KEEP IN VIEW THE FOLLOWING WARNING AND DESIST FROM COPYING.

W A R N I N G

Time and again, it is brought to our notice by the examiners evaluating response sheets that some students use unfair means in completing postal coaching by way of copying the answers of students who have successfully completed the postal coaching or from the suggested answers/study material supplied by the Institute. A few cases of impersonation by handwriting while answering the response sheets have also been brought to the Institute's notice. The Training and Educational Facilities Committee has viewed seriously such instances of using unfair means to complete postal coaching. The students are, therefore, strongly advised to write response sheets personally in their own hand-writing without copying from any original source. It is also brought to the notice of all students that use of any malpractice in undergoing postal or oral coaching is a misconduct as provided in the explanation to Regulation 27 and accordingly the studentship registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information :

"27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may *suo motu* or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

PROFESSIONAL PROGRAMME
SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

TEST PAPER 1/2013

Time Allowed: 3 hours

Maximum Marks: 100

Part A (25 Marks)

[Answer Question No.1 which is COMPULSORY and ANY THREE of the rest from this part]

1. Write short note on:
 - (a) Secretarial Standard
 - (b) Secretarial Audit *(5 marks each)*
2. Prepare a check list for Buy-back of shares by your Company, where you are the Company Secretary.
3. Prepare a check list for Company's Inter-corporate loan and investments under Companies Act, 1956.
4. Briefly discuss about reporting requirement under Foreign Direct Investment.
5. Briefly analysis the Secretarial Standard two (2) issued by the ICSI *(5 marks each)*

Part B (75 Marks)

[Answer ALL Questions from this part]

6. (a) "All preferential issues by the listed companies should be approved by the shareholders' resolution in the meeting of shareholders". Critically examine and comment. *(8 marks)*
 - (b) Write a note on 'intellectual property due diligence'. *(7 marks)*
7. Distinguish between the following:
 - (i) 'Due diligence' and 'Audit'. *(8 marks)*
 - (ii) 'Dematerialisation' and 'Rematerialisation'. *(7 marks)*
8. (a) Explain briefly the possible hurdles that may occur while carrying out the due diligence and the steps needed to overcome such hurdles. *(8 marks)*
 - (b) As a Company Secretary of the company, advise the company on the constitution, composition, quorum and the role of audit committee. *(7 marks)*
9. (a) Discuss the need for Due Diligence for banks. *(8 marks)*
 - (b) Enumerate the points to be checked by a Secretarial Auditor in respect of the Air (Prevention and Control of Pollution) Act, 1981. *(8 marks)*
10. (a) A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction. *(7 marks)*
 - (b) Under the Employee Stock Option Scheme, the companies have freedom to determine the exercise price. *(8 marks)*

TEST PAPER 2/2013*Time Allowed: 3 hours**Maximum Marks: 100***Part A (25 Marks)***[Answer Question No.1 which is COMPULSORY and ANY THREE of the rest from this part]*

1. Write short note on:
 - (a) Advantages of Secretarial Standard
 - (b) Benefits of Secretarial Audit *(5 marks each)*
2. Prepare a procedural checklist for Indian party, desired to invest outside India through Automatic Route.
3. Briefly analysis the Secretarial Standard five (5) issued by the ICSI.
4. Discuss the Guidelines for consideration of Foreign Direct Investment proposals by Foreign Investment Promotion Board.
5. Discuss Composition of Offences under Depository Act, 1996. *(5 marks each)*

Part B (75 Marks)*[Answer ALL Questions from this part]*

6. (a) Prepare a Due Diligence Checklist for Compliance with Competition Act 2002. *(8 marks)*
 - (b) A Practising Company Secretary ignored some material discrepancies while issuing compliance certificate to a company. Explain the professional responsibility involved and state whether any penal provisions are prescribed for taking action in such circumstances. *(7 marks)*
 7. (a) Explain the significance of securities management and compliances by a Company Secretary under the Companies Act, 1956. *(7 marks)*
 - (b) Discuss about Process of Due Diligence for Banks. *(8 marks)*
 8. (a) The objectives of a legal due diligence exercise may vary from case to case. *(7 marks)*
 - (b) Discuss about Stages of Merger & Acquisition Due Diligence. *(8 marks)*
 9. (a) Prepare a Check List on Major Regulatory Compliances under Environmental Due Diligence. *(8 marks)*
 - (b) Briefly discuss about Common Anti-Competitive Practices under Competition Law. *(7 marks)*
 10. (a) Discuss about the CEO/CFO certification under Listing Agreement. *(8 marks)*
 - (b) Search and status report on the position of borrowings made by a company. *(7 marks)*
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TEST PAPER 3/2013

Time Allowed: 3 hours

Maximum Marks: 100

Part A (25 Marks)

[Answer Question No.1 which is COMPULSORY and ANY THREE of the rest from this part]

1. Write short note on:
 - (a) Secretarial Standard issued by the ICSI
 - (b) Price Sensitive Information (5 marks each)
2. Briefly analysis the Secretarial Standard seven (7) issued by the ICSI.
3. Indian party desired to invest outside India. Advise the Indian Part on method of funding for the purpose of investment outside India.
4. Discuss about the compliance requirement with the terms and conditions of the listing agreement.
5. Discuss the legal requirement for the appointment of Whole-Time Company Secretary and Compliance Certificate from a Company Secretary in Whole-Time Practice under Companies (Compliance Certificate) Rules, 2001 (5 marks each)

Part B (75 Marks)

[Answer ALL from this part]

6. (a) Write a note on 'pre-issue due diligence' and 'post-issue due diligence'. (8 marks)
 - (b) As a Practising Company Secretary, you are required to advise the acquirer company about the meaning of 'trigger point' and the different trigger points to be followed under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. (7 marks)
 7. (a) Discuss about Regulatory Framework on issue of American Depository Receipts and Global Depository Receipts. (8 marks)
 - (b) The managing director of Banking Company invites you as a Practising Company Secretary to explain him about compilation and preparation of search report before lending funds to a private company. Explain briefly the issues involved in this regard. (7 marks)
 8. (a) Write short note on the following:
 - (i) Cultural Due Diligence
 - (ii) Operational due diligence
 - (iii) Compliance Management (5 marks each)
 9. (a) As part of good corporate governance practices under Clause 49 of the listing agreement, a company is required to make disclosures on certain aspects. Critically examine. (8 marks)
 - (b) Why it is necessary for Environmental Due Diligence? (7marks)
 10. (a) As a Practising Company Secretary Prepare a Check list for preparation of Due Diligence Report to Banks. (8 marks)
 - (b) Environmental Management is a tool for value creation. Elucidate. (7 marks)
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