PROFESSIONAL PROGRAMME
STUDY MATERIAL

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

MODULE IV - PAPER 7

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

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

IMPORTANT NOTE

We are all witnessing a new confidence and aggressiveness in India Inc in not only garnering resources from the stock and other markets but also in annexing foreign entities and giants within its fold. The globalization phenomenon is thus acquiring unimagined dimensions. Various new skills, international class knowledge and confidence par excellence will be required on the part of corporate professionals to lend value added support to the newly developing corporate ethos in Indian business on various aspects of corporate compliances and due diligence.

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. While preparing the study material, all these aspects of the due diligence process have been kept in mind. It is therefore imperative for corporate professionals like Company Secretaries to acquire and refine the required skills in due diligence exercise so that they are equipped to protect and add value for corporates going in for initial public issues, restructuring, alliances, mergers or takeovers for their inorganic growth.

The paper on *Due Diligence and Corporate Compliance Management* has been introduced to provide the students thorough understanding and appreciation of composite legal due diligence regarding corporate activities as well as the expert knowledge about Corporate Compliance Management.

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.

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 and professional Development* in the Institute for clarification.

This study material is updated upto December 31, 2011. Should there be any discrepancy, error or omission in the study material, the Institute shall be obliged if the same is brought to its notice for issue of corrigendum in the Student Company Secretary.

PROFESSIONAL PROGRAMME

SYLLABUS

FOR

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

Level of knowledge : Expert knowledge.

Objective :

(i) To provide thorough understanding and appreciation of composite legal due diligence in regard to certain corporate activities.

(ii) To provide expert knowledge about the Corporate Compliance Management

Detailed contents :

1. Due Diligence

Nature, objectives, significance and scope of due diligence; steps in the process of due diligence.

Areas of Due Diligence

— Initial Public Offer (IPO), Follow-on Public Offer (FPO), Rights issue, Employees Stock Option Plans (ESOPs), Preferential Allotment
— Issue of debt (both long term & short term) such as debentures, bonds, warrants etc.
— Takeovers and acquisitions
— Setting up of business units in India and abroad
— Setting up joint ventures
— Compliance of Listing Agreement
— Internal Audit of Depository Participants
— Issue of Global Depository Receipts
— Issue of Indian Depository Receipts
— Legal Due Diligence

2. Compliance Management

Concept and significance; systems approach to compliance management; process of establishment of compliance management system; compliance in letter and spirit.

3. Secretarial Audit

Need, objectives and scope; process; periodicity and format for secretarial audit report; check-list under various corporate laws; share transfer audit; compliance certificate.

4. Search/Status Reports

Importance, scope; verification of documents relating to charges; requirements of financial institutions and corporate lenders; preparation of report.

5. Securities Management and Compliances

Meaning, need and scope; mechanism for self-regulation; advantages to company, regulator and investors.

LIST OF RECOMMENDED BOOKS / WEBSITES

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

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.	Snowwhite	:	Foreign Exchange Management Manual
4.	Taxmann	:	Guide to filing e-Company forms
5.	Rao	:	Joint Ventures
6.	ICSI	:	Securities Management and Compliances
7.	ICSI	:	Guidance Note on Compliance Certificate
8.	ICSI	:	Handbook on Internal Audit of Depository Participants.
9.	ICSI	:	Handbook on Mergers Amalgamations and takeovers.

10. The Art of M&A Due Diligence - Alexandra Reed Lajoux & Charles M. Elson
11. Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc from time to time.
12. Bare Acts
13. Listing agreement for Equity, debts, Indian Depository Receipts etc.
14. 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
15. Journals

(a)	ICSI	—	Chartered Secretary
(b)	ICSI	—	Student Company Secretary
(c)	SEBI and Corporate Laws	—	Taxmann
(d)	Corporate Law Advisor	—	Vishaman Publisher (P) Ltd.
(e)	Corporate Courier	—	The tax publisher

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 journels like Student Company Secretary, Chartered Secretary etc.

(ii) The reference to websites of different regulatory authorities is essential.

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Study Lesson No.		*Topic*
I	—	Due Diligence – An Overview
II	—	Due Diligence – Equity Issues
III	—	Due Diligence – Issue of Debt Instruments
IV	—	Takeovers and Acquisitions
V	—	Compliance of Listing Agreement
VI	—	Internal Audit of Depository Participants
VII	—	Issue of Depository Receipts
VIII	—	Indian Depository Receipts
IX	—	Setting up of Business Units and Joint Ventures in India
X	—	Setting up of Business Units and Joint Ventures Abroad
XI	—	Legal Due Diligence
XII	—	Compliance Management
XIII	—	Secretarial Audit
XIV	—	Share Transfer Audit
XV	—	Compliance Certificate
XVI	—	Search/Status Reports
XVII	—	Securities Management and Compliances

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DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

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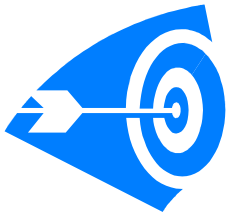
DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

STUDY I

DUE DILIGENCE — AN OVERVIEW

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- 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

I. 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.

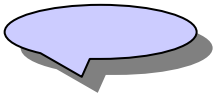
"Due diligence" is an analysis and risk assessment of an impending business transaction. It is the careful and methodological investigation of a business or persons, or the performance of an act with a certain standard of care to ensure that information is accurate, and to uncover information that may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

Due Diligence



- *is a Risk assessment tool with respect to a business transaction.*
- *is a Evaluation Mechanism with respect to a business opportunity.*
- *is a Tool that provides insight into hidden facts.*
- *Takes care of present, past and future aspects that affects the business transaction.*

My God!!!!! There are so many issues…..Multiple financial statements, Regulatory files, labour files, bundles of agreements……I am confused whether I have to proceed with the acquisition deal!!!!

Don't Worry. Carry out a Due diligence Exercise. You will find hidden risks, future prospects, cultural and employees issues etc from the outcome of due diligence. This will help to arrive at a conclusion and to do the right negotiations on the deal.

NEED FOR DUE DILIGENCE AND ITS 'SIGNIFICANCE'

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.

Due diligence is necessary to allow the investigating party to find out everything that one needs to know about the subject of the diligence. The objective is to allow the investigator to consider the following options, considering the facts found in the course of due diligence.

(i) *Withdrawal of deal* – if the due diligence uncovers information that disclosed the investments, loan or participation, a risky or undesirable one and which cannot be adequately resolved then the investigator may withdraw from the deal.

(ii) *Adjusting the valuation of the investment* – the investigator may revise his valuation of the company or reassess the price at which it will provide services. More often, the information will be adverse and therefore the valuation will go down or the price will go up.

(iii) *Solving of problems uncovered* – it may be possible for a problem uncovered by the due diligence to be solved before the deal goes ahead. For example, unpaid stamp duty could be paid, company filings could be put in order or, if negative information is uncovered on a principal of the target company, the investor may put pressure on the target is put into a state that the investigator is happier with before it deals with it.

➢ ***The Due Diligence is required to arrive at the conclusions which may result in***

- *Withdrawal of business deal.*
- *Adjusting the valuation of the investment .*
- *Solving of problems uncovered.*

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 may be to—

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 of customers 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.

Once a purchase price is agreed upon the prospective buyer usually enters into a conditional agreement with a due diligence clause with the target business, in

which the buyer has a limited period to conduct due diligence. During this time, the potential buyer requests full access to all relevant materials in the target business, all customer, vendor, financial and other information in order to conduct a thorough investigation. Here it is to be ensured that the potential buyer does not use this information for its own benefit if it decides to back out of the deal, a confidentiality agreement is usually signed to protect the target businesses' interests. But a possibility of re-negotiation of the purchase price or cancellation of the agreement on the part of buyer is seen if the information found is not acceptable to the potential buyer. Again after due diligence, the goal is to either reaffirm the purchase price or renegotiate, depending on what was discovered. But the ultimate goal is to make a rational decision based on the facts. While it may be hard to overcome the excitement of purchasing a business, here the potential buyer is prepared to cancel the deal as earlier said if something is discovered that runs counter to why the business looked like a good deal in the first place.

V. 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.

- *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.*
- *In general it covers compliances, litigations, uncovered risks, future prospects etc*

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
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

➢ *Due Diligence may be operational, financial, legal, secretarial, ethical, human resource, information security etc*

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.

Important things to remember while carrying out due diligence excercise

- Understand the purpose for the transaction
- Plan the schedule of Due diligence
- Negotiate for adequate time to analyse the facts
- Background check of promoters and senior management
- Infrastructure adequacy
- Information from external sources
- Observation of culture of employees
- Limiting the Report only with material facts

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.

Some important aspects in various stages of Due diligence

- Execution of Non Disclosure Agreement
- Creation of Data room
- Maintaining cordial relationship to get more information
- Analysis of data
- Reporting and outcomes
- Corrective actions for non-compliances if any
- Any other rectifications if required

Example of due diligence process in a M&A strategy

Stages	For Buyer	For seller
Preparation Stage	➢ M&A Strategy formulation ➢ Prepare a of List of potential targets ➢ Appoint external advisor for evaluation of targets ➢ Short list targets ➢ Create Due diligence team	➢ Structure a Business plan ➢ Prepare a list of potential buyers ➢ Appoint external advisor ➢ Shortlist buyers
Pre diligence	➢ Approach targets ➢ Negotiate initial terms ➢ Execute Non Disclosure Agreement ➢ Compile a list of data required	➢ Approach buyers ➢ Negotiate initial terms ➢ Execute Non-Dis-closure agreement ➢ Create a Data room
Due diligence	➢ Inspection of Data room ➢ Analysis of private documents ➢ Evaluation of risk and return ➢ Structuring the terms and conditions	➢ Assistance in data room ➢ Setting deadlines for offer
Negotiations	➢ Make final offer ➢ Negotiate and agree on terms	➢ Compile final offers ➢ select best offer ➢ negotiations
Post diligence	➢ Post merger integration and cultural adjustments	➢ Termination of data room and ownership exchange

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 transfree 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 to 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.

Principals 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

Sl No.	*Particulars*	*Physical Data Room*	*Virtual Data Room*
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.

XII. 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.

Particulars	*Audit*	*Due diligence*
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

The due diligence review should provide an overall evaluation of the viability of the target business. The due diligence reports will form a valuable tool for the new owners of the business in providing an overview of the business and identification of areas of weaknesses and threats which will have to be addressed.

Each due diligence review is unique but the overall aim is to provide the investor with sufficient, relevant and timely information in order to assist in the investment decision. The due diligence exercise is not simply a number crunching exercise but involves collation of strategic non financial information which is likely to be crucial in the overall investment decision.

The successful performance of a due diligence investigation is dependent upon the scope, planning, co-ordination and the use of a highly skilled team.

The cost of the preparation of a quality due diligence exercise is insignificant when compared to the cost of a bad acquisition.

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.

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.

SCHEDULE

1. Parties

1.1 xxx, a company incorporated under the Companies Act, 1956 (no. "INSERT CO. NUMBER") of "INSERT ADDRESS".

1.2 xxx, [*Insert name, address and company number (if a company) of other party*.]

2. Purpose

To discuss "INSERT PURPOSE OF DISCUSSION".

3. Date

"INSERT DATE"

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)

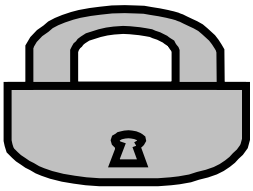
_____
(Title/position)

_____
(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, Acquistions,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



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

STUDY II

DUE DILIGENCE – EQUITY ISSUES

LEARNING OBJECTIVE

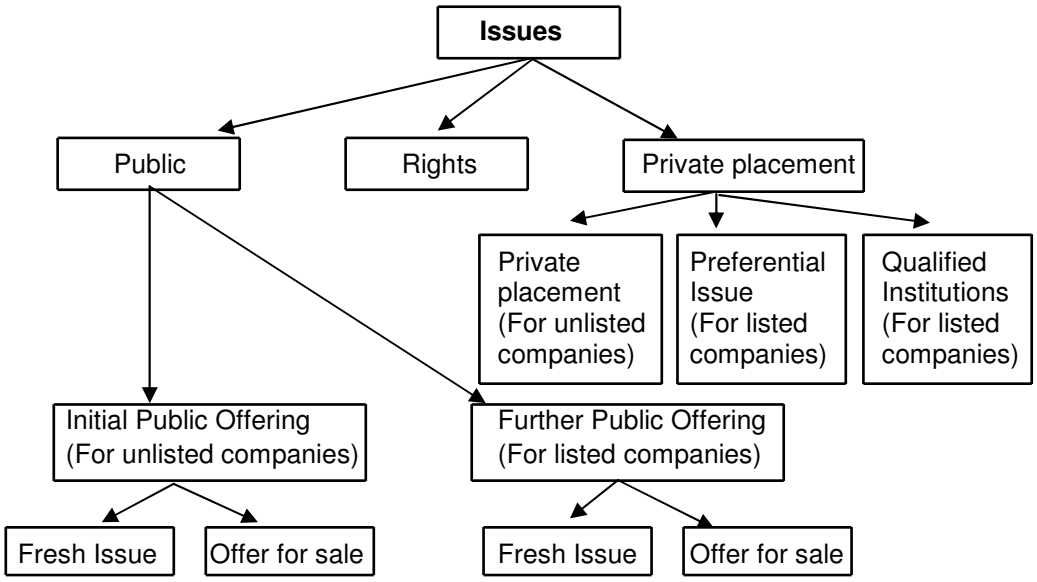
The objective of this study lesson is to enable the students to understand

- Meaning, The objective of this study lesson is to enable the students to understand
- Public issue due diligence under SEBI(ICDR) Regulations, Listing agreement etc and the role of company secretary
- Due diligence of preferential issue by listed and unlisted companies
- Compliances for issue of rights/bonus shares
- Issue of Shares under Employee Stock Option scheme

I. INTRODUCTION AND REGULATORY FRAMEWORK

Introduction*

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:



* Source: sebi.gov.in

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.

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*.

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.

The following are the conditions for making initial public offer

(a) 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;

(b) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of the immediately preceding five years, excluding extraordinary items.

(c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);

(d) 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;

(e) 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.

If the above conditions are not satisfied, the issuer may make public offer if

(a) (i) the issue is made through the book building process and the issuer undertakes to allot at least fifty per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make allotment to the qualified institutional buyers ;

or

(ii) at least fifteen per cent. of the cost of the project is contributed by scheduled commercial banks or public financial institutions, of which not less than ten per cent. shall come from the appraisers and the issuer undertakes to allot at least ten per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make the allotment to the qualified institutional buyers;

(b) (i) the minimum post-issue face value capital of the issuer is ten crore rupees;

or

(ii) the issuer undertakes to provide market-making for at least two years from the date of listing of the specified securities, subject to the following:

(A) the market makers offer buy and sell quotes for a minimum depth of three hundred specified securities and ensure that the bid-ask spread for their quotes does not, at any time, exceed ten per cent.;

(B) the inventory of the market makers, as on the date of allotment of the specified securities, shall be at least five per cent of the proposed issue.

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-Initiol 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 – Assn. 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 OR (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/lese 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, statuary 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 to carry out the obligations relating 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.

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

Ensure that the issue through book building route is underwritten

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 Pubic 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.

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.

12. Pricing

- Ensue the norms relating to price/price band, cap on price banks 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 & restriction on transferability of their securities

- 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;
  - (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 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 exemptions specified.

(c) Specified securities allotted to promoters 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.

14. Other lock in requirements

- Ensure that the pre-issue capital held by persons other than promoters is subject to lockin for the period of one year from the date of allotment, subject to speicified exemptions.

- Transferability of lock in shares

  Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, the specified securities held by promoters and locked-in 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 may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred:

  However, 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.

15. 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.

However Government companies and infrastructure Companies are exempted from these provisions subject to exceptions.

16. Reservation on Competitive Basis

- For issue made through the book building process

(1) 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 of the issuer including employees of the promoting companies in case of a new issuer;

  (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 of the issuer including employees of the promoting companies in case of a new issuer;

(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;

17. Allocation of net offer to public

In case of issue through book building

(i) Not less than 35% to Retail individual investors

(ii) Not less than 15% to non-institutional investors

(iii) Nor more than 50% to qualified institutional buyers and 5% of which shall be allocated to mutual funds.(up to 35% of the portion available for allocation of qualified institutional buyers may be allocated to anchor investor)

However at least 50% of net offer is to be allocated to qualified institutional buyers if an issuer has not satisfied the basic eligibility criteria and undertakes to allot so. Further if the issuer is required to allot 60% of the net offer to the public to Qualified institutional Buyers in terms of 19(2)(b) of Securities Contracts Regulation Rules, 1957, allocation to retail individual investors and non institutional investors shall be 30% and 10% respectively.

In case of issue other than book building

(i) Minimum 50% to retail individual investors and

(ii) Remaining to individual applicants other than retail individual investors and

(iii) Other investors including corporate bodies or insitutiions , irrespective of the number of securities applied for.

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 closin**g

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

- **Post issue 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 Rs.5000 to Rs. 7000

21. Allotment procedure and basis of allotment

The allotment of specified securities to applicants other than 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

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 with in 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.

ROLE OF COMPANY SECRETARY IN AN IPO

The Securities Exchange Board of India Act, 1992 (SEBI Act) was formed, inter alia, to provide for the establishment of a Board (SEBI) to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

SEBI regulates the securities market by prescribing measures to register and regulate the working of Capital Market Intermediaries associated with Securities market. Such intermediaries undertake following major activities relating to securities in addition to other activities:

— Management of an Issue of Capital

— Manager of Co-manager

— Advisor to issue

— Corporate Advisory Services

— Underwriting

— Registrar to an Issue and Share Transfer Agent

— Private Placement

— Public announcement and offer documents for acquisition of shares under Takeover code

— Portfolio Manager

— Brokers, Sub-brokers.

The main role of these Capital Market Intermediaries is to provide maximum information to the investors by means of disclosures carrying vital information. The intermediaries are necessarily compelled to associate with other professionals to advise the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., directly by the Board or the Central Government to point out the non-compliance and ensure the complete compliance. In a capital market issue, the major role in synchronizing these activities of intermediaries lies with a qualified Company Secretary.

Section 2(2) of the Company Secretaries Act, 1980 indicates the various areas of practice which are open to a Company Secretary holding certificate of practice issued by the Institute. The objective of authorizing members to practice is to make available professional services of a Company Secretary to the corporate sector.

The educational background, knowledge, training and exposure that a company secretary acquires makes him a versatile professional capable of rendering a wide range of services to companies of all sizes, other commercial and industrial organizations; including small and medium sized companies which are not required by law, to employ compulsorily a Whole-Time Company Secretary.

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 right include preferential allotments, issue of shares through rights issue, bonus issue or ESOP scheme etc. various important aspects to be taken case before and after the issue are diseased below.

III-A. DUE DILIGENCE – PREFERENTIAL ISSUE

Due diligence of preferential issue may be

(a) Due diiligence of preferential issues by listed companies.

(b) Due diligence of preferential issues by unlisted companies.

Due diiligence 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 (51 of 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 (1 of 1956);

(ia) *the securitization company or reconstruction company which has obtained a certificate of registration under sub-section (4) of section 3 of the Securitisationand Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 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 regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, 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.

Test Your Knowledge

(i) Do provisions of SEBI (ICDR) Regulations 2009 relating to pricing and lock in requirements on preferential issue of shares apply to Securitization companies?

(ii) Do lock-in requirements apply to preferential issue by listed company pursuant to the scheme of amalgamation approved by High Court?

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.

(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 regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 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, 1997 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 in terms of regulation 29A of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, 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 6 months

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 six months 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 6 months

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than six months 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 six months 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 six months 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 six months 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, 1997, 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) What is the validating of Special Resolution for preferential issue, if the allotment of such shares is made after 15 days of passing the Resolution?

(ii) 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.

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 guarantees.

(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 3(iii) 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 a 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 International Accounting Standard (IAS) 33.
   (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 wit 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 if it has outstanding fully or partly convertible debt instruments at the time of making the bonus issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.
- The equity shares reserved for the holders of fully or partly convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion on 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 if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

The equity shares reserved for the holders of fully or partially convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms on 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. 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;

7. Obligation of issuer/intermediaries

The obligation of issuer/intermediaries for a rights issuer, with respect to advertisement, appointment of compliance offier, redressal of investor grievances, due diligence, post issue reports, post issue advertisements etc is same as the public issue.

III-E QUALIFIED INSTITUIONS 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 listing agreement with the stock exchange;

(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.

A copy of the placement document shall be filed with the Board for its record within thirty days of the allotment of eligible securities.

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 monthsfrom 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.

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.

ANNEXURE I

CHECKLIST ON MAJOR COMPLIANCES

Sl. No.	*Particulars*	*To be filed with*	*Clause No. of SEBI(ICDR) Regulations 2009*	*No. of days*
Filing of draft prospectus/Red Herring prospectus etc with SEBI, ROC, Stock Exchange as the case may be				
1.	Draft Prospectus through an eligible merchant banker	SEBI	6(1)	30 days prior to registering the prospectus, red herring prospectus or shelf prospectus with Registrar of Companies or filing of letter of offer with Designated stock exchange as the case may be
2	Draft offer document to be made available to the public	—	9	Draft offer document is to be made available to the public for atleast 21 days from the date of filing of draft offer document with SEBI
3	Filing of comments received from public on draft offer document	SEBI	9	After a period of 21 days from the date of offer document
4.	Registering the prospectus, red herring prospectus or shelf prospectus with Registrar of Companies	ROC	6	30 days after filing draft prospectus with SEBI and simultaneously while filing the letter of offer with SEBI or filing the letter of offer with designated stock exchange
5	Letter of offer with SEBI	SEBI	6	Simultaneously while filing the prospectus/Red Hearing Prospectus/Shelf prospectus with ROC or filing the letter of offer with designated stock exchange.
6	Letter of offer with designated stock exchange	Designated Stock Exchange	6	Simultaneously while filing the prospectus/Red Hearing Prospectus/Shelf prospectus with ROC or filing the letter of offer with SEBI.

Filing of copy of In-Principle Approval of the stock exchange				
1	Obtain and furnish an in-principal approval of the Stock Exchange for listing of securities	SEBI	6	With draft offer document or immediately after filing draft offer document, as the comments from SEBI on draft offer documents would be received after the filing of copy of in-principle approval letter.
Filing of Due Diligence Certificates				
1.	Due diligence certificate	SEBI/ROC	8	At the time of filing draft offer document with SEBI At the time of registering the prospectus with ROC Immediately before opening of the issue with SEBI certifying the necessary corrective actions sought by SEBI After the issue opened but before it closure with SEBI
Advertisements				
1.	Issue advertisement	—	47, 48,66	1.Pre-issue Advertisement- Immediately after registering the Red herring prospectus/ prospectus with Registrar of companies 2. Advertisement for issue opening and issue closing 3. Post issue Advertisement-within 10 days from the date of completion of various post issue activities such as basis of allotment, dispatch of refund orders etc.

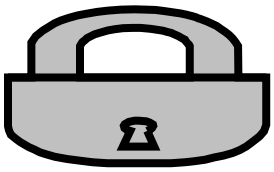
Agreement with Depository/Merchant Banker				
1	Agreement with depository for demat of securities	—	4	Before Filing draft prospectus
2	Agreement with lead merchant banker	—	5,8	Before filing the draft prospectus
3	Appointment of Compliance officer	—	63	Before the issue
Promoters Contribution				
1.	Promoter's contribution to be brought in	—	32(4)	One day before issue opening date
Time Limit for issue				
1.	Issue to open	—	11	i. within twelve months from the date of issuance of the observations by the (or) ii. within three months of expiry of 30 days from the period specified under Regulation 6(2), if no observations are received.
Subscription period				
1.	Subscription list to be kept open for	—	46	At least 3 working days and not more than 10 working days
2.	Basis of allotment to be finalized	—	—	After closure of the issue and before commencement of listing and trading
IPO Grading				
1	IPO Grading from at least one credit rating agency	—	26	As on the date of registering prospectus or red herring prospectus with ROC

Allotment/Refund/Listing				
1.	Allotment/Refund	—	18	Within 15 days from the date of closure of the issue.
2.	Formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed	—	Schedule VIII	Within seven working days of finalisation of basis of allotment.
Post Issue Monitoring Report				
1.	Post issue monitoring reports	SEBI	65	Within 3 days from the date of closure of issue
2.	Final post issue monitoring report	SEBI	65	Within 15 days from the date of finalization of allotment.
Book building process				
1.	Appointment of one or more merchant bankers as book runners	—	Schedule XI	Before filing of draft Redherring prospectus with SEBI
2.	Appointment of syndicate members by book runners	—	Schedule XI	—
3.	Agreement with Stock Exchanges for online offer of securities	—	Schedule XI	—
4	Appointment of Bidding/Collection centres	—	Schedule XI	—
5.	Bidding process through electronic bidding facility	—	Schedule XI	—
6	Registration of final prospectus with price	ROC	Schedule XI	—

LESSON ROUND UP

- 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.

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.

STUDY III

DUE DILIGENCE – ISSUE OF DEBT INSTRUMENTS

LEARNING OBJECTIVE

The objective of this study lesson is to enable the students to understand

- Various types of debt instruments
- Regulatory Framework for issue of debt instruments
- Compliance Requirements under
  - (a) Listing agreement (for privately placed Debentures/Debentures issued through public issue).
  - (b) SEBI (ICDR) Regulations, 2009 (Compliances with respect to convertible debt instruments)
  - (c) SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (Compliance requirements with respect to non-convertible debt instruments)
  - (d) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008

DEBT INSTRUMENTS AND ITS VARIOUS TYPES

A tradable form of a loan/debt is normally termed as Debt Instruments. It pertains to obligations of issuer with regards to certain future cash flows representing payment of interest and principal by the issuer to the holder (legal owner) of the instrument. There are various types of fixed income instruments, which cater to the needs of both investors and issuers. These instruments can be classified on the basis of interest, time duration, etc.

The classification instruments are given below:

Fixed Instruments

— Deposit (includes Time Deposit/Savings Deposit/Current Account)

— Fixed Deposit

Interest Based Bonds

— Coupon Bonds

— Zero Coupon Bonds

Derived Instruments

These instruments are not direct debt instruments. Instead they derive their value from other debt instruments.

— Mortgage Bonds

— Pass Through Certificates (PTCs)
— Participation Certificates (PCs)

Benchmarked Instruments

Debt instruments wherein the fixed income earned is based on some bench mark rate is called Benchmarked Instruments. For instance, the Floating Interest rate Bonds are benchmarked to either the LIBOR, MIBOR etc.

Money Market Instruments

— Call/Notice Money
— Treasury Bills
— Inter-Bank Term Money
— Certificate of Deposits
— Inter Corporate Deposits
— Commercial Papers
— Commercial Bills

Hedging Instruments

There are certain hedge instruments that help to reduce the risk of investing in Fixed income instruments.

— Interest Rate Swaps
— Interest Rate Options
— Swaptions

Corporate Debentures

A Debenture is a debt security issued by a company (Issuer), which offers to pay interest in lieu of the money borrowed for a certain period. In essence it represents a loan taken by the issuer who pays an agreed rate of interest during the lifetime of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

Debentures are divided into different categories on the basis of:

1. Convertibility of the instrument
   — Non Convertible Debentures (NCD)
   — Partly Convertible Debentures (PCD)
   — Fully Convertible Debentures (FCD)
   — Optionally Convertible Debentures (OCD)
2. Security
   — Secured Debentures
   — Unsecured Debentures

The instruments traded can be classified into the following segments based on

the characteristics of the identity of the issuer of these securities:

Market Segment	*Issuer*	*Instruments*
Government Securities	Central Government	Zero Coupon Bonds, Coupon Bearing Bonds, Treasury Bills, STRIPS
	State Governments	Coupon Bearing Bonds.
Public Sector Bonds	Government Agencies/ Statutory Bodies	Govt. Guaranteed Bonds, Debentures
	Public Sector Units	PSU Bonds, Debentures, Commercial Paper
Private Sector Bonds	Corporates	Debentures, Bonds, Commercial Paper, Floating Rate Bonds, Zero Coupon Bonds, Inter-Corporate Deposits
	Banks	Certificates of Deposits, Debentures, Bonds
	Financial Institutions	Certificates of Deposits, Bonds

RISKS ON TRADING IN DEBT SECURITIES

1. **Default Risk** is the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security.
2. **Interest Rate Risk** is the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments.
3. **Reinvestment Rate Risk** is the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.
4. **Counter Party Risk** refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.
5. **Price Risk** refers to the possibility of not being able to receive the expected price on any order due to a adverse movement in the prices.

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 of 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 this regulation:

(I) Two persons shall be deemed to be "part of the same group" if they belong to the group within the meaning of clause (ef) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969) or if they own "inter connected undertakings within the meaning of clause (g) of section 2 of the said Act;

(II) 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 (1 of 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 the following conditions are satisfied as on the date of filing of draft offer document and final offer document.

— Ensure that 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.

— 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 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.

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.

C. UNDER LISTING AGREEMENT FOR DEBENTURES ISSUED THROUGH PUBLIC/RIGHTS ISSUE

Important Compliance requirements

Sl. No.	*Particulars*	*Details*	*Clause Ref No.*
1.	Debenture trustee	The Company shall have a debenture trustee for each debenture issued and listed by it on a exchange on a continuous basis	Clause 5
2.	Security	The Company shall create and maintain security ensuring adequate security cover at all times for secured debentures	Clause 7
3.	Information to the exchange	The company shall inform about attachment, prohibitory orders, any action that results in redemption, conversion, cancellation etc of debentures, change in the Board, Auditors, change in general character of business, alteration of capital, dividend etc.	Clause 8
4.	Closure of books/record date	The Company shall intimate atleast 30 days before the closure of book/record date for the purpose of payment of interest/redemption as the case may be. Gap between two book closures and/or record dates would be atleast 30 days.	Clause 9

5.	Intimation to Exchange- declaration of issue of convertible debentures	At least 7 days in advance of the date of the meetings of its Board of Directors/ Council of issuer at which the recommendation or declaration of issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or any other matter affecting the interests of debenture holders is due to be considered.	Clause 10
6.	Intimation about issue new debentures	The Company shall intimate the Exchange in advance, of its intention to raise funds through issue of new debentures if it proposes to list such new debentures on the Exchange.	Clause 11
7.	Intimation about material events	Intimation to the stock exchange about material events such as strike, lock out, changes in the general character of business, disruption due to natural calamity, revision in ratings, litigation with a material impact etc	Clause 12
8.	Designating company secretary or any other person as compliance officer	The compliance officer shall be responsible for monitoring compliance with the regulatory provisions, filing information in the EDIFAR and to designate an e-mail ID of the grievance redressal division/compliance officer	Clause 14
9.	Corporate Governance	— Boards' composition — Non-executive directors compensation and disclosures — Code of conduct — Constitution of Audit Committee — Meeting, power, role of Audit committee — Review of information by Audit Committee — Subsidiary companies — Disclosures — CEO/CFO Certification — Report on Corporate Governance — Compliance	Clause 22
10.	Consolidated Financial	— Publication of Consolidated Financial Statements, in case of subsidiaries	Clause 36

	statements in case of subsidiaries	— Annual report to contain related party disclosures and other necessary disclosures — To furnish cash flow statement — Directors report to contain certain disclosures	
11.	Quarterly Financial Results	— Furnishing of un-audited financial results — Limited review by statutory auditors — Intimation to stock exchange, before and after the meeting where unaudited quarterly results have been taken on record — Issue of press release about the above meeting etc	Clause 37
12.	EDIFAR filing	Filing of information and reports on the Electronic Data Information Filing and Retrieval	Clause 38

D. UNDER LISTING AGREEMENT FOR PRIVATELY PLACED DEBENTURES

Important Compliance requirements

Sl. No.	*Particulars*	*Details*	*Clause Ref No.*
1.	Debenture trustee	The Company shall have a debenture trustee for each debenture issued and listed by it on a exchange on a continuous basis	Clause 5
2.	Security	The Company shall create and maintain security ensuring adequate security cover at all times for secured debentures	Clause 7
3.	Information to the exchange	The company shall inform about attachment, prohibitory orders, any action that results in redemption, conversion, cancellation etc of debentures, change in the Board, Auditors, change in general character of business, alteration of capital, dividend etc	Clause 8
4.	Closure of books/record date	— The Company shall intimate atleast 21 days before the closure of book/ record date for the purpose of payment of	Clause 9

		interest/redemption as the case may be. — Gap between two book closures and/or record dates would be atleast 30 days.	
5.	Intimation to Exchange- declaration of issue of convertible debentures	At least 7 days in advance of the date of the meetings of its Board of Directors/ Council of issuer at which the recommendation or declaration of issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or any other matter affecting the interests of debenture holders is due to be considered.	Clause 10
6.	Intimation about issue new debentures	The Company shall intimate the Exchange in advance, of its intention to raise funds through issue of new debentures if it proposes to list such new debentures on the Exchange.	Clause 11
7.	Intimation about material events	Intimation to the stock exchange about material events such as strike, lock out, changes in the general character of business, disruption due to natural calamity, revision in ratings, litigation with a material impact etc	Clause 12
8.	Designating company secretary or any other person as compliance officer	The compliance officer shall be responsible for monitoring compliance with the regulatory provisions, filing information in the EDIFAR and to designate an e-mail ID of the grievance redressal division/ compliance officer	Clause 14
9.	Corporate Governance	Certain recommendatory provisions on Corporate Governance are given under this clause.	Clause 22
10.	Publication of Financial results	Publication of Audited/unaudited financial results in prescribed format	Clause 23

E. 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.

Securitised 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 Securitised 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.

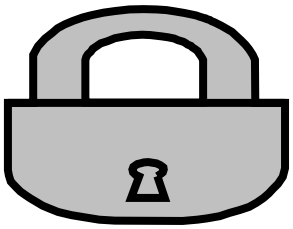
— Ensure to file necessary information/reports, post issue as directed by SEBI from time to time.

— 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

- A tradable form of a loan/debt is normally termed as Debt Instruments.
- Debt instruments are mainly regulated by
  - SEBI(ICDR) Regulations 2009
  - Listing Agreement for Debentures issued through public issue/Rights issue.
  - Listing agreement for privately placed Debentures
  - SEBI (Issue and Listing of Debt Securities) Regulations, 2008
  - SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008
  - The Companies Act, 1956
- 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.

SELF TEST QUESTIONS



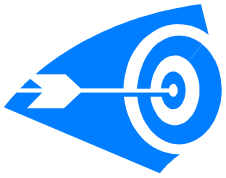
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Draft a note to the Board on the various compliances under SEBI(ICDR) Regulations 2009
2. XYZ Ltd wants to issue debenture thorough public issue and list the same in a stock exchange with nationwide terminal. Draft a compliance checklist for the Board of Directors of XYZ Ltd.
3. What are the various listing compliances under listing agreement for privately placed debentures?
4. What are the Corporate Governance requirements for a company which has listed its shares in a stock exchange through public issue?

STUDY IV

TAKEOVERS AND ACQUISITIONS

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- An overview mergers, amalgamations takeovers
- Concept of takeovers, its kinds etc.
- Regulatory framework governing mergers amalgamations and takeovers
- SEBI (SAST) Regulations, 2011
- Disclosures, exemptions public announcement etc relating to takeovers
- Regulatory checklist for acquirer, target company and merchant banker
- Cultural issues in mergers and takeovers
- Takeover Defenses
- Penalties

CORPORATE RESTRUCTURING THROUGH MERGERS ACQUISITIONS AND TAKEOVERS – AN OVER VIEW

Introduction

Takeovers, mergers and acquisition activities continue to accelerate. From banking to oil exploration and telecommunication to power generation, companies are coming together as never before. Not only this new industries like e-commerce and biotechnology have been exploding and old industries are being transformed. Corporate Restructuring through acquisitions, mergers, amalgamations, arrangements and takeovers has become integral to corporate strategy today.

Mergers

A merger has been defined as 'the fusion or absorption of one thing or right into another'. A merger has also been defined as an arrangement whereby the assets of two (or more) companies become vested in, or under the control of one company (which may or may not be one of the original two Companies), which has as its shareholders all or substantially all, the shareholders of the two companies.

In a merger, one of the two existing companies merges its identity into another existing company or one of more existing companies may form a new company and merge their identities into the new company by transferring their businesses and undertakings including all other assets and liabilities to the new company (hereinafter referred to as the merged company). The shareholders of the company or companies, whose identity/ies has/have been merged (hereinafter referred to as the merging company or companies, as the case may be) will have substantial shareholding in the merged company. They will be allotted shares in the merged company in exchange for the shares held by them in the merging company or companies, as the case may be, according to the shares exchange ratio incorporated in the scheme of merger as approved by all or the prescribed majority of the shareholders of the merging company or companies and the merged company in their separate general meetings and sanctioned by the court.

CATEGORIES OF MERGERS

Mergers may be broadly classified as follows:

(i) Cogeneric — within same industries and taking place at the same level of economic activity — exploration, production or manufacturing wholesale distribution or retail distribution to the ultimate consumer.

(ii) Conglomerate – between unrelated businesses

Cogeneric Mergers

Cogeneric mergers are of two types:

Horizontal Merger

This class of merger is a merger between business competitors who are manufacturers or distributors of the same type of products or who render similar or same type of services for profit. It involves joining together of two or more companies which are producing essentially the same products or rendering same or similar services or their products and services directly to compete in the market with each other. Horizontal mergers result into a reduction in the number of competing companies in an industry and increase the scope for economies of scale and elimination of duplicate facilities. However, their main drawback is that they promote monopolistic trend in the industrial sector. The acquisition in 1999 of Mobil by Exxon represented a horizontal merger.

Vertical Merger

In a vertical merger two or more companies are complementary to each other e.g. one of the companies is engaged in the manufacture of a particular product, the other is established and expert in the marketing of that product. In this merger the two companies merge and control the production and marketing of the same product.

A vertical merger may result into smooth and efficient flow of production and distribution of a particular product and reduction in handling and stockholding costs. It also poses a risk of monopolistic trend in the industry.

Conglomerate Merger

A conglomerate merger involves coming together of two companies in different industries i.e., the businesses of the two companies are not related to each other, neither horizontally nor vertically. They lack any commonality either in their end product, or in the rendering of any specific type of service to the society. This is the type of merger of companies which are neither competitors, nor complementaries nor suppliers of a particular raw material nor consumers of a particular product or consumable. A conglomerate merger is one which is neither horizontal nor vertical. In this the merging companies operate in unrelated markets having no functional economic relationship.

Mergers may further be categorised as:

Cash Merger

A merger in which certain shareholders are required to accept cash for their shares while other shareholders receive shares in the continuing enterprise.

Defacto Merger

Defacto merger has been defined as a transaction that has the economic effect of a statutory merger but is cast in the form of an acquisition of assets.

Down Stream Merger

The merger of parent company into its subsidiary is called down stream merger.

Up stream Merger

The merger of subsidiary company into its parent company is called an up stream merger.

Short-form Merger

A number of statutes provide special company rules for the merger of a subsidiary into its parent where the parent owns substantially all of the shares of the subsidiary. This is known as a short form merger. Short form mergers generally may be effected by adoption of a resolution of merger by the parent company, and mailing a copy of plan of merger to all shareholders of subsidiary and filing the executed documents with the prescribed authority under the statute. This type of merger is less expensive and time consuming than the normal type of merger.

Triangular Merger

Triangular merger means the amalgamation of two companies by which the disappearing company is merged into subsidiary of surviving company and shareholders of the disappearing company receive shares of the surviving company.

Reverse Merger

Reverse merger takes place when a healthy company amalgamates with a financially weak company. In the context of the provisions of the Companies Act, 1956, there is no difference between regular merger and reverse merger. It is like any other amalgamation. [For a detailed analysis of the concept of reverse merger, refer to Gujrat High Court judgment in Bihari Mills Ltd. case (1985) 58 Comp Cas 6].

Reverse merger can be carried out through the High Court route, but where one of the merging companies is a sick industrial company under SICA, such merger must take place through BIFR. On the amalgamation becoming effective, the sick company's name may be changed to that of the healthy company.

Reverse merger automatically makes the transferor-company entitled for the benefit of carry forward and set-off of loss and unabsorbed depreciation of the transferee-company. There is no need to comply with Section 72A of Income Tax Act.

Amalgamation

Amalgamation is an 'arrangement' or 'reconstruction'. Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or the amalgamated company. In case of amalgamation a new company may come into existence or an old company may survive while amalgamating company may lose its existence.

Takeover

Takeover means acquisition by one company of control over another, usually by buying all or a majority of its shares. A transaction or a series of transactions by which a person acquires control over the assets of a company is generally known as takeover of the company. On the other hand an arrangement whereby the assets of two companies vest in one is known as merger.

Regulatory Aspects

Amalgamations, mergers and takeovers are governed by the following Acts/ Regulations/Rules.

1. Section 390-396 A of Companies Act, 1956

2. Companies (Court) Rules, 1959
3. Listing Agreement
4. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
5. Securities Contracts Regulations Act, 1957
6. Income Tax Act, 1961

TAKEOVERS

Takeover has been defined as a business transaction whereby an individual or a group of individuals or a company acquires control over the assets of a company, either directly by becoming owner of those assets or indirectly by obtaining control of the management of the company. In the ordinary case, the company taken over is smaller but in a 'reverse takeover' a smaller company gains control over the larger company. This is different from 'merger' wherein the shareholding in the combined enterprise will be spread between the shareholders of the two companies. Normally the company which wants to takeover the other company acquires the shares of the target company either in a single transaction or a series of transactions. In case of amalgamation under Section 391-394 of the Companies Act, 1956 the amalgamating as well as amalgamated company have to apply to the High Court(s) for making order of amalgamation. However, the regulatory framework for controlling the takeover activities of a company consists of the Companies Act, 1956, Listing Agreement with Stock Exchanges and SEBI's Takeover Code.

Takeover Bid

In simple language a takeover is acquisition of shares, voting rights in a company with a view to gaining control over the management of the company.

A "takeover bid" is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquiring sufficient number of shares to give the offeror company, voting control of the target company. It is usually expressed to be conditional upon a specified percentage of shares being the subject-matter of acceptance by or before a stipulated date.

A takeover bid is a technique, which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

KINDS OF TAKEOVERS

(1) Friendly takeover;

(2) Hostile takeover.

Friendly Takeover

A friendly takeover is with the consent of taken over company. There is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company, which is referred to as friendly takeover bid.

Hostile Takeover

When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally persues efforts to gain control against the wishes of existing management such acts of acquirer are known as 'takeover raids' or hostile 'takeover bids'. The main distinction between a friendly takeover and hostile takeover is whether there is a mutual understanding between the acquirer and the taken over company. When there is a mutual understanding, it is friendly takeover otherwise it is termed as hostile takeover.

In a takeover, the taking over company has two options, viz., (I) to merge both companies into one and operate both the undertakings as a single entity, and (ii) to keep the takenover company a separate and independent company, with changed management, changed policies or even with a changed name.

Takeover may be of different types depending upon the intention of the management of the taking over company.

1. A takeover may be a straight takeover which is accomplished by the management of the taking over company by acquisition of shares of another company with an intention to maintain and operate the takeover company as an independent legal entity.

2. Another type of takeover may be with an intention of capturing the ownership of the takenover company in order to merge both companies into one and operate business and undertakings of both the companies as a single legal entity.

3. A third type of take over is the takeover of a sick industrial company for the purpose of revival of its business. This is accomplished by an order of the Board for Industrial and Financial reconstruction (BIFR) under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985

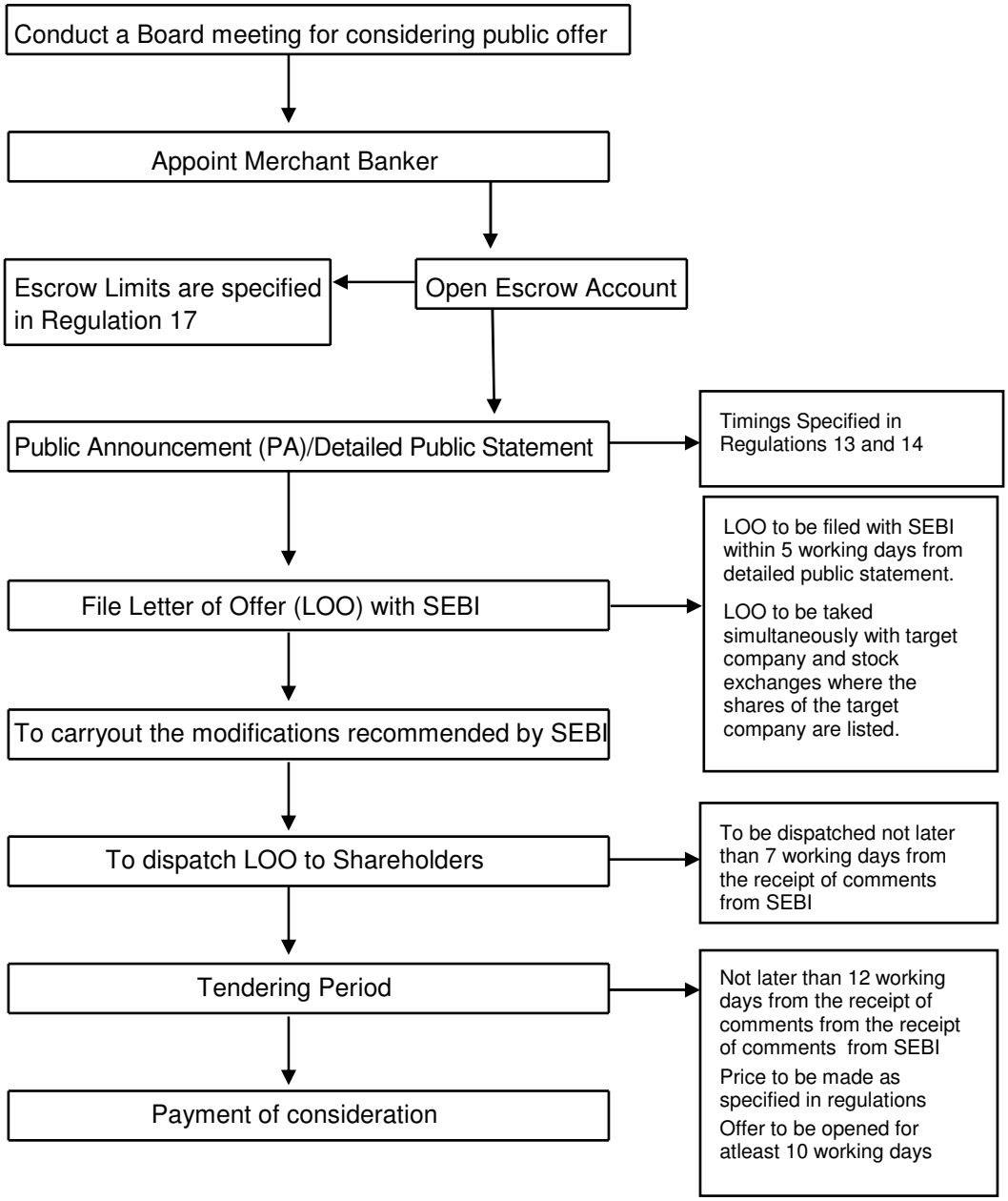
4. Bail out takeover is substantial acquisition of shares in a financially weak company not being a sick industrial company, in pursuance to a scheme of rehabilitation approved by a public financial institution or a scheduled bank (hereinafter referred to as the lead institution). The lead institution is responsible for ensuring compliance with the provisions of the SEBI (Substantial Acquisition and Takeovers) Regulations, 1997, which regulate the bail out takeovers.

An overview of international comparison on Regulatory Process on takeovers.

Particulars	India	Newzea-land	Australia	Singapore	UK	USA
Regulators	SEBI	Takeover panel	Australian Securities Commis-sion	Securities Industry Council	Financial Services Authority	Securities and Exchange Commis-sion
Threshold limit	25%	20%	20%	30%	30%	—
Creeping acquisition limit	5% for share-holders holding 25% to maximum permis-sible non-public share-holding	To acquire 50% or more first and 5% over a 12 moth period	3% in 6 months	1% in 6 months applicable to shareholders holding shares between 30% and 50%	—	—
Public announcement	Required	Required	Required	Required	Required	Required
Letter of offer	Required to be sent	Required to be sent	Required to be sent (Target response statement)	Required to be sent	Required to be sent	Required to be sent
Pricing formula	Specified	Not specified	Specified	Specified	Specified	—
Competitive bid	Allowed	Allowed	Allowed	Allowed	Allowed	
Consideration	Cash/ securities	Cash/ securities	Cash/ securities	Cash/ securities	Cash/ cash alter-natives	Cash/ securities

TAKEOVER PROCESS UNDER SEBI (SAST) REGULATION 2011 – AN OVERVIEW

The following chart gives an overview of takeover process in India, when there is no competitive bid.



The important terms such as 'target company', 'control', 'Acquirer person acting in concert etc., open offer process, Disclosure requirements exemptions etc. can be referred at study 4 of the paper "Corporate Restructuring and Insolvency".

IV. 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.

List/details of documents to be obtained from target company is enclosed as ***Annexure A***.

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 if 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 Pubic 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.

Consideration-cash:

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 be 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 PA 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.

CULTURAL ISSUES ON MERGERS, ACQUISTIONS AND TAKE OVERS

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%).

Following are the key findings of the survey on human and cultural factors.

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. Lock 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.

TAKE OVER DEFENSES

Hostile takeovers directly made to the shareholders of target company has resulted in a multiple defensive strategies by corporate from being taken over by the company.

Few of the defensive strategies are as follows.

1. *Pac-man Defense*

   Under this strategy target company attempts to purchase the shares of acquirer company provided it has substantial cash flow or liquidable asset.

2. *White Knight*

   This is seeking another company (called white knight company) seeking merger, for rescuing the target company.

3. *Green Mail*

   This is repurchase of the stock by target company at a higher premium to avoid hostile takeovers.

4. *Poison pills*

   Creation of securities (which is also called poison pills) which provide their holders with special rights exercisable only after a period of time following the occurrences of triggering event.

5. Refusal by the Board to register a transfer is also being adopted as a defensive strategy.

ANNEXURE A

DETAILS/DOCUMENTS/INFORMATION REQUIRED FROM TARGET COMPANY

S. No.	Documents/Informations	Status
1.	Certified True Copy of Memorandum & Articles of Association	
2.	Address of the Registered office of the Company alongwith Phone and Fax no.(s) (Certified Copy of Form No. 18) along with an undertaking from the Company that the registered office of the Company is situated at_____ as on date.	
3.	Name of the Promoters of the Company as on date as per the definition provided in SEBI (SAST) Regulations.	
4.	The group to which it belongs.	
5.	Details of partly Paid Up Shares of the Company, if any.	
6.	Market Lot of Shares of the Company.	
7.	Composition of Board of Directors of the company along with their designation, date of appointment, education qualification/ Experience in no. of years, No. of shares held in the Company and residential address (Certified Copies of Form No. 32)	
8.	Name of company Promoted by Target Company, if any.	
9.	A note on the business activity of the company.	

10.	Audited Annual A/c's of last three years and latest quarter, if applicable, of the Company.	
11.	Status of stock exchange compliance (To be taken from all the Stock Exchanges where the securities of the Company are Listed) along with the date of suspension, if suspended.	
12.	Stock market data for last 6 months (To be taken from all the Stock Exchanges where the securities of the Company are Listed) and in case of infrequently traded, a certificate from the concerned Stock Exchange regarding the Last Traded Date and Price.	
13.	Status of compliance (Certified Copy of letters addressed to the Company and Stock Exchanges).	
14.	Latest shareholding pattern (Certified Copy of letters addressed to the Stock Exchanges).	
15.	No. of shareholders in public category.	
16.	Prospectus copy, including date of listing, date of permission for trading.	
17.	Details of any other issue (bonus/right/preferential)	
18.	Proof of payment of listing fee with all Stock Exchanges.	
19.	Whether shares are in DEMAT Mode, if yes, name of the Depositories.	
20.	Approvals/NOC from FIs/Banks etc.	
21.	Details of litigations pending against the Company.	
22.	Copy of RBI approval for allotment of Shares to NRI shareholders.	

23.	Undertaking regarding non prohibition from dealing in securities by SEBI.	
24.	Details of merger, De-merger, spin off etc. during last 3 years of Target Company.	
25.	List of shareholders as on date along with their shareholding.	
26.	Copy of Income Tax Return of all the directors & Promoters for the last three years.	
27.	Income Tax Filing of the Company.	
28.	Details of Other Companies promoted by the promoters & directors of the Company alongwith an undertaking from each director stating that no other company other than those specified have been promoted by them.	
29.	Name of Compliance Officer of the company along with his address and contact numbers.	
30.	Figures of the Audited Financial Results of the last 3 years and of the latest Quarter, if applicable in the prescribed Format.	
31.	Complete list of investments by the Target Company.	
32.	Capital Structure of the Company since inception.	
33.	Copy of Disclosure as the case may be filed with the Stock Exchange(s) (after entering into SPA).	
34.	Copy of agreement with the Registrar/DP and his registration details (i.e. certified copy of registration certificate obtained from SEBI and a declaration that they are not prohibited by SEBI from dealing in securities).	
35.	Annual Return along with all annexures (floppy, List of shareholders etc.) filed with ROC.	

36.	Up to date ROC filing including approved DINs for all directors.	
37.	All registrations, regulatory licenses and approvals.	
38.	Nature of Operations and relevant statutory approvals.	
39.	Fixed assets details.	
40.	Listing Compliances and updated stock exchanges files.	
41.	Shareholding of the promoters along with the list of promotes, PACs and their group and any changes in shareholding and disclosures thereof. Whether the applicable provisions of the Chapter II of Takeover Code have been complied with by the **Promoters, Directors, Sellers and any other major Shareholder**.	
42.	Declarations, confirmations, undertakings and other documents under SEBI.	
43.	Listing confirmation letters from all stock exchanges.	
44.	Details of changes in Board of Directors since inception, DOB, Qualifications, experience, date of appointment.	
45.	Capital Structure since inception of the Company.	
46.	SEBI file and penalties, show-cause notices, and prosecution past and pending.	
47.	Other relevant papers, if any.	

ANNEXURE B

CHECK LIST FOR TAKEOVER

Documents and Details to be furnished:

Acquirer/PAC:

1. Name, address and phone nos., of all Acquirers and PACs.

2. Present shareholding, if any, of the acquirer/PAC in the Target Company.

3. Brief Background of Acquirer(s) including PAC.

   The Acquire is a Company incorporate under Companies Act, 1956 to carry on the business of non banking financial activity and registered with Reserve Bank of India vide Certificate No……..

4. Copy of Agreement if any between acquirers and PACs:

5. In case acquirer(s) is a company(ies):

   (i) Name of its promoters and/or persons having control over it as the case may be, and the group to which they belong.

   (ii) Name and Residential Addresses of Board of Directors of acquirer along with their experience, qualifications, date of appointment.

Name	*Address*	*Qualification*	*Experience*	*DOA*

   (iii) Name, Address (Registered and Corporate Office) and Phone Nos.

   (iv) Certificate of incorporation, Memorandum and Articles of Association of the Acquirer, in case Acquirer is a company.

   (v) Brief History & Major areas of Operations: Non Banking Finance Company.

   (vi) Identity of promoters and/or persons having control over such company.

   (vii) Whether any Director of the Acquirer is a Director on the Board of Target Company.

   (viii) Please submit the audited accounts of the last three years.

   (ix) In case more than six months have elapsed since the last audited accounts then furnish the un-audited financials duly certified by the Auditor.

   (x) Please give details of the major contingent liabilities and the reasons for rise/all in the total income and Profit After Tax in the relevant years.

(xi) Whether the Company had become a Sick Industrial Company anytime since its inception, if so, details thereof.

4. In case the acquirer is an individual:

   (i) Principal areas of business and relevant experience.

   (ii) Net worth duly certified by a Chartered Accountant.

   (iii) Positions held on the Board of Directors of any listed company.

   (iv) Name(s) of the company(ies) where the individual is a full time Director.

5. If the acquirer made any acquisitions earlier in the target company including acquisitions made through open offers, please furnish the details of changes in Shareholding pattern of the Target Company pursuant to such acquisition. What is the Status of compliance with the applicable provisions of the takeover code and any other statutory requirements?

6. If the Acquirer was required to comply with applicable provisions of Chapter II of Takeover Regulation (Disclosures), please provide details of the compliance including whether the said provisions were complied with the specified time.

7. What is the Relationship, if any, between the acquirer and Person acting in concert with it.

8. A brief write-up on Line of business and experience.

9. Whether the Acquirers intend to dispose or otherwise encumber any assets of Target Company in succeeding two years except in ordinary course of business of the target company.

10. What is the future plan about Target Company; please specify the same and how acquirer proposes to implement such future plans. Will be provided.

11. Any Statutory approvals, which are required for the purpose of acquisition of shares under the offer and also the status of the applications made in that regard.

12. Whether any approval is required from FIs/Banks for the offer.

13. Any other details pertaining to the offer or acquisition prior to offer, which is considered relevant from the shareholders' point of view.

14. Sources of Finance for the acquisition: Internal Resources.

15. Certificate from a Chartered Accountant certifying the adequacy of financial resources of the acquirer for fulfilling all the obligations under the offer.

16. General Risk Factors related to the open offer, and probable risks involved in associating with the Acquirer.

17. Names of One English National Daily, Hindi National Daily and Regional Daily in which the Acquirer wishes to publish Public Announcements.

Documents and Details to be furnished:

Target Company:

1. Name of the Target Company:

2. Recent name changes, if any:

3. Date of incorporation:

4. Address of registered office and corporate office along with its telephone and fax numbers.

5. Brief history & Main areas of operations.

   Non Banking Financial Company

6. Certificate of incorporation, Memorandum and Articles of Association.

7. Please provide the locations and other details of the manufacturing facilities:

8. Please provide the Share Capital Structure of the Company in the following format:

Paid up Equity Shares of Target Company	*No. of Shares/ voting rights*	*% of shares/ voting rights*
Fully paid up equity shares		
Partly paid up equity shares		
Total paid up equity shares		
Total voting rights in Target company		

9. Details of any partly paid shares:

10. Name of the Stock Exchange where the shares are listed, the category in which the shares are traded.

11. The annualized trading turnover in the respective SE during the preceding Six months in the following format:

Name of stock exchange(s)	*Total no. of shares traded during the 6 calendar months prior to the month in which PA was made*	*Total No. of listed Shares*	*Annualized Trading turnover (in terms of % to total listed shares)*

12. Details of shares in Lock-in:

13. Provide details (as per the format given below) as to how the current capital structure was built since inception. Also disclose the status of compliance with the applicable provisions o Takeover Code

Date of allotment	*No. and % of shares issued*	*Cumulative paid up capital*	*Mode of allotment*	*Type of Issue (viz. Rights, Prefer-ential, Public Issue etc.)*	*Identity of allotees (pro-moters/ ex-pro-moters/ others)*	*Status o comp-liance*

14. Whether the trading in the shares of the Company has been suspended in any Stock Exchange? Please specify and substantiate the steps taken to regularize the trading:

15. In case of Non-listing of some or all the shares of the Company at any Stock Exchange, please disclose the particulars thereof and the steps taken to regularize the listing. Please provide the copies of Listing Approvals.

16. Details of any outstanding convertible instruments and whether the same has been taken into account for calculating the total voting rights.

17. Shareholding of the promoters along with the list of promoters, PACs and their group and any changes in shareholding and disclosures thereof. Whether the applicable provisions of the Chapter II of Takeover Code (Disclosures) have been complied with by the Promoters, Directors, Sellers and any other major Shareholders within the specified time.

18. Whether the applicable provisions of the Chapter II of Takeover Code have been complied with by the Company within the specified time.

19. Compliance Status with Listing Agreement requirements (details to be provided year-wise since listing). Details of penal actions taken by SE, if any.

20. Give the Composition of the Board of Directors along with details of their qualification, experience, date of appointment, etc.

    Composition of Board of Director

Sl. No.	*Name*	*DOA*	*Experience*	*Qualification*

21. Was there any spin-off, merger or de-merger during the last 3 years.

22. Any change of name since its inception. Converted from Private to Public Co.

23. Dates of listing.

24. Please submit the audited accounts of the last three years.

25. In case more than six months have elapsed since the last audited accounts then furnish the un-audited financials duly certified by the Auditor for the said period.

26. Please give details of the major contingent liabilities and the reasons for rise/ fall in the total income and Profit After Tax in the relevant years.

27. Pre and post acquisition shareholding of the target company.

28. Status of corporate governance.

29. Any pending litigations, details thereof.

30. Whether the Company had become a Sick Industrial Company anytime since its inception, if so, details thereof.

31. A brief note on Line of business of Target Company. Non Banking Financial Company.

32. Name and other details of Compliance Officer of the Target Company.

33. Details of Return of Net worth, Book Value, EPS and PE Multiple, PE Multiple of Industry.

34. Market Lot of Shares in physical form.

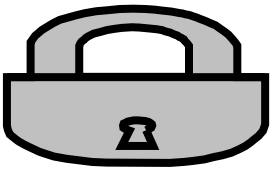
35. Quotations from stock exchange for last 26 weeks average of weekly high and low of price of Company's shares and last 2 weeks daily average of high and low of the shares, before the date of public announcement, at the Stock Exchanges where the shares of the Company are listed (For this purpose quotations can be directly obtained from the respective Exchanges and copies thereof may be submitted to Merchant Banker).

LESSON ROUND UP

- A friendly takeover is with the consent of taken over company. There is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company, which is referred to as friendly takeover bid.
- When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management such acts of acquirer are known as 'takeover raids' or hostile 'takeover bids'.

- SEBI (SAST) Regulations, 2011 requires the acquirer to make a public announcement and a public offer on acquisition of a certain percentage of shares or voting rights in a company. However, certain circumstances have been provided in regulation 10, subject to which if an acquirer acquires the specified percentage of shares or voting rights, he would be exempted from the requirement of making an open offer to the existing shareholders of the company
- Any acquirer, who acquires shares or voting rights which (taken together with shares or voting rights, if any, held by him) would entitle him to more than specified percentage of shares or voting rights, shall disclose at every stage the aggregate of his shareholding or voting rights in that company to the company and to the stock exchanges where shares of the target company are listed.
- Trigger point is a point where provisions of SEBI (SAST) Regulations, 2011 i.e. takeover code gets triggered and the acquirer is required to follow public announcement and other requirements as mentioned in the regulations in respect of further acquisition.
- An acquirer who intends to acquire shares which alongwith his existing shareholding would entitle him to exercise 25% or more voting rights, can acquire such additional shares only after making a public announcement (PA) to acquire atleast additional 26% of the voting capital of Target Company from the shareholders through an open offer.
- An acquirer who holds 25% or more but less than maximum permissible non-public sareholdings can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31 only after making a public announcement to acquire atleast additional 20% shares of target company from the shareholders through an open offer.
- There are several obligations/compliances to be fulfilled by the acquirer, target company and merchant banker at the time of taking over a company.

SELF TEST QUESTIONS



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

1. Briefly explain the takeover process.

2. When an acquirer is required to make a public announcement and what are its contents?

3. Describe the procedure for operation of escrow account?

4. What transactions are exempted from takeover?

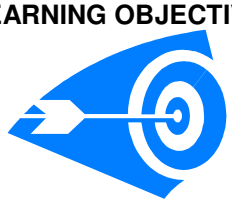
5. Draft a check list for the Board of Directors of Acquirer Company in respect of takeover.

6. As a Merchant Banker, describe the Plan of Action for a takeover?

STUDY V

COMPLIANCE OF LISTING AGREEMENT

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- Legal provisions of listing agreement
- Important aspects of listing agreement such as publication requirements, compliance under clause 49, intimations to be sent to stock exchanges, minimum public holding, takeovers etc
- Penalty provisions in respect of non compliance
- Certification by Practicing Company Secretary – Stock Exchange Requirements
- Time based/event based listing compliances

I. INTRODUCTION

Under Section 9 of Securities Contracts (Regulation) Act, 1956, government has conferred such power to recognized stock exchanges to list the securities and to make necessary bye-laws.

The listing of securities is ensured by way of an agreement called listing agreement which is entered into between a stock exchange and the issuing company. Listing of securities at stock exchanges provides for free transferability and ready marketability securities of the Company. The listing rules and regulations have been designed to safeguard the interests of investors and to ensure transparency through disclosures, proper supervision and control over the dealings in the conduct of listed companies in India whose securities can freely be traded through SEBI.

Listing agreement is of great importance as it provides all the terms and conditions to be complied by the company whose securities are listed on the stock exchange. Listed agreement is executed under the common seal of a company.

The Listed companies are required to make continuous disclosures to stock exchanges.

IMPORTANT COMPLIANCES UNDER LISTING AGREEMENT

1. In-principle approval before further issue of shares

- The company is required to obtain 'in-principle' approval for listing from the exchanges having nationwide trading terminals where it is listed, before issuing further shares or securities.
- Where the company is not listed on any exchange having nationwide

trading terminals, it agrees to obtain such 'in-principle' approval from all the exchanges in which it is listed before issuing further shares or securities.

Let us Remember

Every time the listed company issues further shares, it has to obtain in-principle approval from stock exchanges where the shares of the company are listed.

2. Annual General Meeting & Book Closure

- The Company is required to close its Transfer Books for purposes of
  - (a) declaration of dividend or
  - (b) issue of right or bonus shares or
  - (c) issue of shares for conversion of debentures or of shares arising out of rights attached to debentures or
  - (d) for such other purposes as the Exchange may agree to or require.
- The company has to close its Transfer Books at least once a year at the time of the Annual General Meeting if they have not been otherwise closed at any time during the year.
- The Company is required to give to the Exchange the notice in advance of at least 7 days, or of as many days as the Exchange may from time to time reasonably prescribe, stating the dates of closure of its Transfer Books (or, when the Transfer Books are not to be closed, the date fixed for taking a record of its shareholders or debenture holders) and specifying the purpose or purposes for which the Transfer Books are to be closed (or the record is to be taken) and to send copies of such notices to the other recognised stock exchanges in India.
- The minimum time gap between the two book closures and/or record dates has to be atleast 30 days.

Let us Remember

- The company has to close its Transfer books atleast once an year.
- The minimum time gap between the two book closures and/or record dates has to be atleast 30 days.

3. Intimation/submissions to Stock Exchange

- The Company is required to notify the Exchange of any attachment or prohibitory orders restraining the Company from transferring securities.
- The company is required to intimate to the stock exchange within 15 minutes of closure of Board meeting, by Letter/fax/telegram the following
  - (a) all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment;

(b) the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for the dividend, even if this calls for qualification that such information is provisional or subject to audit.

(c) the decision on Buyback of Securities.

(d) short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by way of right shares to be offered to the shareholders or debenture holders, or in any other way;

(e) short particulars of the reissue 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 to;

(f) short particulars of any other alterations of capital, including calls;

(g) any other information necessary to enable the holders of the listed securities of the Company to appraise its position and to avoid the establishment of a false market in such listed securities.

Is required to notify the exchange at least 2 days in advance of the date of the meeting of its Board of Directors at which the the proposal for buy-back is considered, recommendation or declaration of a dividend or convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend or the issue of right is due to be considered and will recommend or declare all dividend and/or cash bonuses at least five days before commencement of the closure of its transfer books or the record date fixed for the purpose.

— The Company is required to notify the Exchange at least twenty-one days in advance of the date on and from which the dividend on shares, interest on debentures and bonds, and redemption amount of redeemable shares or of debentures and bonds will be payable and will issue simultaneously the dividend warrants, interest warrants and cheques for redemption money of redeemable shares or of debentures and bonds, which shall be payable at par at such centres as may be agreed to between the Exchange and the Company and which shall be collected at par, with collection charges, if any, being borne by the Company, in any bank in the country at centres other than the centres agreed to between the Exchange and the Company, so as to reach the holders of shares, debentures or bonds on or before the date fixed for payment of dividend, interest on debentures or bonds or redemption money, as the case may be.

— The company is required to file any scheme/petition proposed to be filed before any Court or Tribunal under sections 391,394 and 101 of the Companies Act, 1956, with the stock exchange, for approval, at least a month before it is presented to the Court or Tribunal.

— In the event of the Company granting any options to purchase any shares of the Company, the Company is required to notify the

Exchange—

(a) of the number of shares covered by such options, of the terms thereof and of the time within which they may be exercised;

(b) of any subsequent changes or cancellation or exercise of such options.

— The Company should not make any change in the form or nature of any of its securities that are listed on the Exchange or in the rights or privileges of the holders thereof without giving twenty one days' prior notice to the Exchange of the proposed change and making an application for listing of the securities as changed if the Exchange shall so require.

— The Company should promptly notify the Exchange of any proposed change in the general character or nature of its business, of any change in the Company's directorate, of any change of Managing Director, Managing Agents or Secretaries and Treasures of any change of Auditors appointed to audit the books and accounts of the Company.

— The Company is required to forward to the Exchange promptly and without application six copies of the Statutory and Directors' Annual Reports, Balance Sheets and Profit and Loss Accounts and of all periodical and special reports as soon as they are issued and one copy each to all the recognised stock exchanges in India; six copies of all notices, resolutions and circulars relating to new issue of capital prior to their despatch to the shareholders;) three copies of all the notices, call letters or any other circulars including notices of meetings convened u/s 391 or section 394 read with section 391 of the Companies Act, 1956 together with Annexures thereto, at the same time as they are sent to the shareholders, debenture holders or creditors or any class of them or advertised in the Press;) copy of the proceedings at all Annual and Extraordinary General Meetings of he Company; three copies of all notices, circulars, etc., issued or advertised in the press either by the Company, or by any company which the Company proposes to absorb or with which the Company 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 shareholders or debenture holders or creditors or any class of them and copies of the proceedings at all such meetings.

— The Company is required to forward to the Exchange copies of all notices sent to its shareholders with respect to amendments to its Memorandum and Articles of Association and will file with the Exchange six copies (one of which will be certified) of such amendments as soon as they shall have been adopted by the Company in general meeting.

— The Company is required to intimate 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.

— The company is required to inform to 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.

4. Minimum Holdings

- The company is required to comply with the requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957.
- Where the issuer company is required to achieve the minimum level of public shareholding specified in Rule 19(2)(b) and/or Rule 19A of the Securities Contracts (Regulation) Rules, 1957, it shall adopt any of the following methods to raise the public shareholding to the required level:-
  (a) issuance of shares to public through prospectus; or
  (b) offer for sale of shares held by promoters to public through prospectus; or
  (c) sale of shares held by promoters through the secondary market. Such sale requires prior approval of the Specified Stock Exchange. Where the shares are listed on a stock exchange having nation wide trading terminals, then such stock exchange would be Specified Stock Exchange. Where the shares are listed on stock exchange not having nationwide trading terminals, the designated stock exchange would be the speicifed stock exchange.

Let us Remember

Every Listed Company is required to comply with the requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957 with respect to minimum public holdings.

Public holding may be enhanced to minimum requirement through public issue, offer for sale and sale through secondary market. Such Sale through secondary market requires prior permission of stock exchange

6. Company Secretary as Compliance Officer

- The Company is required to appoint the Company Secretary to act as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Company's Board in each meeting.
- The compliance officer will directly liaise with the authorities such as SEBI, Stock Exchanges, Registrar of Companies, etc., and investors with respect to implementation of various clauses, rules, regulations and other directives of such authorities and investor service and complaints of related matter.
- He is also responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements and reports filed

under clause 52 pertaining to Corporate Filing and Dissemination System (CFDS), and also for ensuring that such information is in conformity with the applicable laws and the listing agreement.

7. Financial results/Publications

1. Preparation and Submission of Financial Results

— The company has an option either to submit audited or unaudited quarterly and year to date financial results to the stock exchange within forty-five days of end of each quarter (other than the last quarter), subject to the following:

(i) In case the issuer opts to submit unaudited financial results, they shall be subjected to limited review by the statutory auditors of the issuer (or in case of public sector undertakings, by any practicing Chartered Accountant) and such limited reviewed results (financial results accompanied by the limited review report) shall be submitted within forty-five days from the end of the quarter.

(ii) In case the company opts to submit audited financial results, they shall be accompanied by the audit report.

— The issuer shall submit audited financial results for the entire financial year, within sixty days of the end of the financial year. The issuer shall also submit the audited financial results in respect of the last quarter alongwith the results for the entire financial year, with a note that the figures of last quarter are the balancing figures between audited figures in respect of the full financial year and the published year to date figures upto the third quarter of the current financial year

— If the company has subsidiaries, -

(iii) it may, in addition to submitting quarterly and year to date stand alone financial results to the stock exchange under item (c) i.e. within forty-five days of the end of the quarter, also submit quarterly and year to date consolidated financial results within forty-five days from the end of the quarter; and

(iv) while submitting annual audited financial results prepared on stand-alone basis under item (d), it shall also submit annual audited consolidated financial results to the stock exchange within sixty days from the end of the financial year.

— As a part of its audited or unaudited financial results for the half-year, the company shall also submit by way of a note, a statement of assets and liabilities as at the end of the half-year.

— However, when a company opts to submit un-audited financial results for the last quarter of the financial year, it shall, submit a statement of assets and liabilities as at the end of the financial year only along with the audited financial results for the entire financial year, as soon as they are approved by the Board."

— The financial results covered under this sub-clause shall be submitted to the stock exchange within fifteen minutes of conclusion of the meeting of the Board or Committee in which they were approved pursuant to sub-clause (II), through such mode as may be specified by the stock exchange.

— In case the company has subsidiaries and it opts to submit consolidated

financial results as mentioned at (e) above, it may submit the consolidated financials as per the International Financial Reporting Standards (IFRS) notified by the International Accounting Standards Board.

— The company shall ensure that the limited review/audit reports submitted to the stock exchanges on a quarterly/annual basis shall be given only by an auditor who has subjected himself to the peer review process of Institute of Chartered Accountants of India (ICAI) and holds a valid certificate issued by the Peer Review Board of the ICAI.

2. Manner of approval and authentication of the financial results

— The quarterly financial results submitted shall be approved by the Board of Directors of the company or by a committee thereof, other than the audit committee. When the quarterly financial results are approved by the Committee they shall be placed before the Board at its next meeting:

— While placing the financial results before the Board, the Chief Executive Officer and Chief Financial Officer of the company, by whatever name called, shall certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading.

— The financial results submitted to the stock exchange shall be signed by the Chairman or managing director, or a whole time director. In the absence of all of them, it shall be signed by any other director of the company who is duly authorized by the Board to sign the financial results.

— The limited review report to be placed before the Board of directors or the Committee before being submitted to the stock exchange where the variation between unaudited financials and financial amended pursuant to limited review exceeds 10%. When the limited review report is placed before the Committee they shall also be placed before the Board at its next meeting.

— The annual audited financial results shall be approved by the Board of Directors of the company and shall be signed.

3. Intimation of Board Meeting relating to financial results

— The company is required to give prior intimation of the date and purpose of meetings of the Board or Committee in which the financial results will be considered at least seven clear calendar days prior to the meeting (excluding the date of the intimation and date of the meeting).

— The Company is also required to issue a public notice in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated.

4. Publication of financial results in newspapers

The company shall, within 48 hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated:

— Where the company has opted to submit audited financial results, it shall

also publish the qualifications or reservations, if any, expressed by the auditor together with the audited results

— Where the company has submitted consolidated financial results in addition to stand-alone financial results, it shall have an option to publish either stand-alone financial results or consolidated financial results in the newspapers, subject to the following:

(i) It shall intimate the stock exchange in the first quarter of the financial year or within such extended period as may be specified by SEBI in this regard and shall not change the same during the financial year;

(ii) In case the company changes its option in any subsequent year, it shall furnish comparable figures for the previous year in accordance with the option exercised for the current year;

(iii) It shall give a reference in the newspaper publication, to the places, such as the company's website and stock exchanges' websites, where the standalone results of the company are available.

5. Other issue requirements relating to financial results

— Where there is a variation between the unaudited quarterly or year to date financial results and the results amended pursuant to limited review for the same period, and –

(a) the variation in net profit or net loss after tax is in excess of 10% or Rs.10 lakhs, whichever is higher; or

(b) the variation in exceptional or extraordinary items is in excess of 10% or Rs.10 lakhs, whichever is higher

— The company shall submit to the stock exchange an explanation of the reasons for variations, while submitting the limited review report. The explanation of variations so submitted shall be approved by the Board of Directors:

— If the auditor has expressed any qualification or other reservation in respect of audited financial results submitted or published under this clause, the company shall disclose such qualification or other reservation and impact of the same on the profit or loss, while publishing or submitting such results.

— If the auditor has expressed any qualification or other reservation in his audit report or limited review report in respect of the financial results of any previous financial year or quarter which has an impact on the profit or loss of the reportable period, the company shall include as a note to the financial results –

(i) how the qualification or other reservation has been resolved; or

(ii) if it has not been resolved, the reason therefor and the steps which the company intends to take in the matter.

— If the company has changed its name suggesting any new line of business, it shall disclose the net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business separately in the financial results and shall continue to make such disclosures for the three years succeeding the date of change in name.

— If the company had not commenced commercial production or commercial operations during the reportable period, the company shall, instead of submitting financial results, disclose the details of amount raised, the portions thereof which is utilized and that remaining unutilized, the details of investment made pending utilisation, brief description of the project which is pending completion, status of the project and expected date of commencement of commercial production or commercial operations.

8. Statement of deviations and appointment of monitoring agency.

The company has to appoint a monitoring agency to monitor utilisation of proceeds of public/rights issue and deviations if any in the usage of funds has to be intimated to the stock exchange on quarterly basis, and such statement of deviation has to be filed with quarterly/annual financial results filed under clause 41. It should also be published in news papers simultaneously with financial results after placing the same before audit committee.

9. Shareholding Pattern

The company is required to file shareholding pattern with the Exchange as under:

- on a quarterly basis, within 21 days from the end of each quarter, in the format specified.
- One day prior to listing on its securities on the stock exchanges
- Within 10 days of any corporate restructuring of the company resulting in a change exceeding +/- 2% of the total paid-up capital.

Let us Remember

In addition to quarterly shareholding pattern the company has to file shareholding pattern one day prior to listing and at the time of corporate restructuring resulting in change exceeding +/- 2% of paid up capital.

10. Uniform procedure for dealing with unclaimed shares

- The unclaimed shares to be credited to a demat suspense account opened by the issuer with one of the depository participants.
- Any corporate benefit in terms of securities, accruing on unclaimed shares such as bonus shares, split etc., also to be credited to such account.
- Details of shareholding of each individual allottee whose shares have been credited to such suspense account to be properly maintained by the issuer.
- The allottee's account to be credited as and when he/she approaches the issuer, after undertaking the proper verification of identity of the allottee.
- The voting rights of these shares to remain frozen till the rightful owner claims the shares.
- Details of shares in aggregate in the suspense account including freeze on their voting rights, to be disclosed in the Annual Report as long as there are shares in the suspense account
- Where the shares are issued in physical form pursuant to a public issue or any other issue, which remain unclaimed, the issuer is required to transferred all the shares to one folio in the name of unclaimed suspense account after sending three reminders to the applicant.

- The company is required to disclose the specified details on unclaimed suspense account in its annual report.

11. Corporate Governance

Clause 49 of the Listing Agreement contains provisions relating to Good Corporate Governance practices. The salient features of clause 49 are given below.

1. Independent Director

The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.

Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive Director, at least half of the Board should comprise of independent directors.

If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, atleast one-half of the board of the company should consist of independent directors.

'Independent director' means a non-executive director of the company who:

(a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;

(b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;

(c) has not been an executive of the company in the immediately preceding three financial years;

(d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:

  (i) the statutory audit firm or the internal audit firm that is associated with the company, and

  (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.

(e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;

(f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.

(g) is not less than twenty one years of age.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be. However, if the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the

case may be, the requirement of replacement by a new independent director within the period of 180 days shall not apply.

2. Nominee Directors

Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

3. Non executive directors' compensation and disclosures

All fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and require previous approval of shareholders in general meeting. However, prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees without approval of the Central Government.

4. Board Meetings

The Board shall meet at least four times a year with a maximum time gap of four months between any two meetings. The Clause prescribes a list comprising minimum information to be placed before Board of Directors.

5. No of Directorships

A director shall not be 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. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

6. Code of conduct

The Board shall lay down a code of conduct for all Board Members and senior management of the Company and the same to be posted on the website of the company. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

7. Subsidiary Companies

(i) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non-listed Indian subsidiary company.

(ii) The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

(iii) The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

The term "material non-listed Indian subsidiary" means an unlisted subsidiary,

incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

The term "significant transaction or arrangement" means any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

8. Certificate from a Company Secretary in Practice / Auditors

The company shall obtain a certificate from either the auditors or practicing 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. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

9. Report on Corporate Governance

There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The clause also prescribes suggested list of items to be included in this report.

10. CEO/CFO certification

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 shall certify 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.

11. Audit Committee

(a) Requirement of Constitution of Audit Committee

All listed companies shall have a qualified and independent Audit Committee.

The Audit Committee shall meet at least four times in a year and not more than four months shall elapse between two meetings.

(b) No of Directors

The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

(c) Chairman of audit Committee

The Chairman of the Audit Committee shall be an independent director and shall be present at Annual General Meeting to answer shareholder queries;

(d) Special invitees

The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee.

(e) Company Secretary

The Company Secretary shall act as the secretary to the audit committee.

(f) Quorum of Audit Committee

The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

(g) Powers of Audit Committee

The audit committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.

2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

(h) Role of Audit Committee

The role of the audit committee shall include the following:

(a) Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

(b) Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.

(c) Approval of payment to statutory auditors for any other services rendered by the statutory auditors.

(d) Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:

1. Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of section 217 of the Companies Act, 1956
2. Changes, if any, in accounting policies and practices and reasons for the same
3. Major accounting entries involving estimates based on the exercise of judgment by management
4. Significant adjustments made in the financial statements arising out of audit findings
5. Compliance with listing and other legal requirements relating to financial statements
6. Disclosure of any related party transactions
7. Qualifications in the draft audit report.

(e) Reviewing, with the management, the quarterly financial statements before submission to the board for approval

(f) Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.

(g) Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.

(h) Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

(i) Discussion with internal auditors any significant findings and follow up there on.

(j) Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

(k) Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

(l) To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

(m) To review the functioning of the Whistle Blower mechanism, in case the same is existing.

(n) Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

(i) Review of information

The Audit Committee shall mandatorily review the following information:

— Management discussion and analysis of financial condition and results of operations;
— Statement of significant related party transactions submitted by the management;
— Management letters/letters of internal control weaknesses issued by the statutory auditors;
— Internal audit reports relating to internal control weaknesses; and
— The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee.

12. Disclosures

The clause requires the company to make disclosures on the following aspects.

1. Basis of related party transactions
2. Disclosure of Accounting Treatment
3. Board Disclosures on Risk management
4. Proceeds from public issues, rights issues, preferential issues etc.
5. Remuneration of Directors
6. Management
7. Disclosures to Shareholders

13. Non-Mandatory Requirements

1. The Board

A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a company.

2. Remuneration Committee
   (i) The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
   (ii) To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.
   (iii) All the members of the remuneration committee could be present at the meeting.
   (iv) The Chairman of the remuneration committee could be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.
3. Shareholder Rights

   A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of shareholders.
4. Audit qualifications

   Company may move towards a regime of unqualified financial statements.
5. Training of Board Members

   A company may train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.
6. Mechanism for evaluating non-executive Board Members

   The performance evaluation of non-executive directors could be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer Group evaluation could be the mechanism to determine whether to extend / continue the terms of appointment of non-executive directors.
7. Whistle Blower Policy

   The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

12. Corporate Filing and Dissemination System (CFDS)

The Company is required to file on the CFDS, such information, statements and reports as may be specified by the Participating Stock Exchanges.

13. Agreement with media companies

The issuer company is required to intimate the stock exchange and disseminate the information through its website on its agreement with media companies and/or their associates with respect to shareholding of such media company in the issuer company, details of nominee of such media company in the Board of issuer company, any management control, potential conflict of interest arising out o such agreements, advertisement with media company for the purpose of advertising, publicity etc.

14. Maintenance of website

The company is required to maintain and update a functional website containing the basic information about the company.

The time based, event based compliance check list under listing agreement is given as Annexure A and B respectively.

PENALTY FOR NON-COMPLIANCE OF LISTING AGREEMENT

The penal provisions for non-compliance of the conditions of the Listing Agreement are governed by Clause 23(2) and Clause 23E of the Securities Contract (Regulation) Act, (SCRA) 1956.

Clause 23(2) states that any person who fails to comply wit the provisions of Section 21 (conditions for listing) shall without prejudice to any award of penalty by Adjudicating Officer 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.

Clause 23E of SCRA states that if any company fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it shall be liable to a penalty not exceeding twenty five crore rupees.

Apart from the above, a recognized stock exchange may suspend or withdraw admission to dealings in the securities of a company or body corporate either for a breach of or non-compliance with, any of the conditions of admission to dealings or for any other reason, to be recorded in writing, which in the opinion of the stock exchange justifies such action.

The Stock Exchanges may delist companies with have been suspended for a minimum period of six months for non-compliance with the Listing Agreement.

Let us Remember

Penalty for non compliance of listing agreement is imprisonment for a term which may extend to ten years or with fine which may extend to twenty five crore rupees or with both.

IV. CERTIFICATION BY PRACTISING COMPANY SECRETARY – LISTING AGREEMENT

1. Certificate under clause 47(c)

   A certificate from a practicing company secretary that all transfers has been completed within the stipulated time.

2. Certification under clause 49

   A certificate from the auditor of the company or from a practicing company secretary regarding compliance of conditions of corporate governance as stipulated in this clause.

ANNEXURE A

EVENT BASED COMPLIANCES

Clause No. of the Listing Agree-ment	*Provisions of the Listing Agreement*	*Compliance requirements*
(1)	*(2)*	*(3)*
13	In case of any attachment or prohibitory orders restraining the Company from transferring securities out of the names of the registered holders, the Company is required to furnish to the Exchange particulars of the number of securities so affected, the distinctive numbers of such securities and the names of the registered holders thereof.	Promptly notify the Exchange
16	Where the company closes the transfer books for declaration of dividend or bonus shares or issue of shares for conversion of debentures or of shares arising out of rights attached to debentures	7 days advance notice required
16	The Company on whose stocks, derivatives are available or whose stocks form part of an index on which derivatives are available, notice of corporate actions like mergers, demergers, splits and bonus shares	Notice period of 7 days to Exchanges

(1)	*(2)*	*(3)*
19(a)	The Company is required to give prior intimation of the Board Meeting where Buyback of securities, declaration or recommendation of dividend or issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend is due to be considered	2 days in advance intimation to the Stock Exchange
19(b)	In case the proposal for declaration of bonus is communicated to the Board of Directors of the company as part of the agenda papers	To give notice simultaneously to the Stock Exchanges (No prior intimation to the Exchange is required about the Board Meeting in case the declaration of Bonus by the Company is not on the agenda of the Board Meeting)
20	The Company will immediately on the date of the Board Meeting held to consider or decide the following: (a) all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment; (b) the total turnover, gross profit/ loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for the dividend, even if this calls for qualification that such information is provisional or subject to audit. (c) The decision on Buyback of Securities	Intimate to the Exchange within 15 minutes of the closure of the Board Meetings by Letter/ fax (or, if the meeting be held outside the City of Mumbai, by fax/telegram)

(1)	(2)	(3)
22	The Company will immediately on the date of the meeting of the Board of Directors held to consider or decide the following: (a) short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by way of right shares to be offered to the shareholders or debenture holders, or in any other way; (b) short particulars of the reissue 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 to; (c) short particulars of any other alterations of capital, including calls; (d) any other information necessary to enable the holders of the listed securities of the Company to appraise its position and to avoid the establishment of a false market in such listed securities.	Intimate to the Exchange within 15 minutes of the closure of the Board Meetings by Letter/fax (or, if the meeting be held outside the City of Mumbai, by fax/telegram)
24(d)	SEBI acknowledgement card/ observations received on draft prospectus, certificate from lead merchant banker ensuring positive compliance with SEBI ICDR regulations 2009	Immediately on the receipt of acknowledgement card from SEBI
24(f) /24(i)	The Company is required to file any scheme/petition proposed to be filed before any Court or Tribunal under Sections 391, 394 and 101 of the Companies Act, 1956	To be filed with the stock exchange for approval at least a month before it is presented to the Court or Tribunal. Along with the draft scheme of amalgamation the company is also required to file an Auditors certificate to the effect that the accounting treatment contained in the scheme is in compliance with all Accounting Standards Specified by the Central Government in Section 211(3c) of Companies Act, 1956

(1)	*(2)*	*(3)*
25	In the event of the Company granting any options to purchase any shares of the Company, the Company will notify the following— (a) of the number of shares covered by such options, of the terms thereof and of the time within which they may be exercised; (b) of any subsequent changes or cancellation or exercise of such options.	Promptly notify the Exchange
26	The Issuer will not select any of its listed securities for redemption otherwise than pro rata or by lot and will furnish any information requested in reference to such redemption.	Promptly furnish the Exchange
27	The Company will notify the following— (a) any action which will result in the redemption, cancellation or retirement in whole or in part of any securities listed on the Exchange; (b) the intention to make a drawing of such securities, intimating at the same time the date of the drawing and the period of the closing of the Transfer Books (or the date of striking of the balance) for the drawing; (c) the amount of security outstanding after any drawing has been made.	Promptly notify the Exchange
28	The Company is required to intimate the Exchange prior to making any change in the form or nature of any of its securities that are listed on the Exchange or in the rights or privileges of the holders thereof	21 days' prior notice to the Exchange of the proposed exchange and making an application for listing of the securities as changed if the Exchange shall so require.
29	The Company is required to notify any proposed change in the general character or nature of its business.	Promptly notify the Exchange

(1)	(2)	(3)
30	The Company will notify the following: (a) any change in the Company's directorate by death, resignation, removal or otherwise; (b) any change of Managing Director, Managing Agents or Securities and Treasures; (c) any change of Auditors appointed to audit the books and accounts of the Company	Promptly notify the Exchange
31	The Company is required to forward— (a) six copies of the Statutory and Directors' Annual Reports, Balance Sheets and Profits & Loss Accounts and of all periodical and special reports as soon as they are issued and one copy each to all the recognized stock exchanges in India; (b) six copies of all notices, resolutions and circulars relating to new issue of capital prior to their dispatch to the shareholders; (c) three copies of all the notices, call letters or any other circulars including notices of meetings convened u/s 391 or Section 394 read with Section 391 of the Companies Act, 1956 together with Annexures thereto, at the same time as they are sent to the shareholders, debenture holders or creditors or any class of them or advertised in the Press; (d) copy of the proceedings at all Annual and Extraordinary General Meetings of the Company;	Forward promptly to the Exchange

(1)	(2)	(3)
	(e) three copies of all notices, circulars, etc., issued or advertised in the press either by the Company, or by any company which the Company proposes to absorb or with which the Company proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, reconstruction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the press in regard to meetings of shareholders or debenture holders or creditors or any class of them and copies of the proceedings at all such meetings.	Forward promptly to the Exchange
33	The Company is required to forward copies of all notices sent to its shareholders with respect to amendments to its Memorandum and Articles of Association and will file with the Exchange six copies (one of which will be certified) of such amendments.	Forward to the Exchange as soon as they shall have been adopted by the Company in general meeting.
34	listing on its securities on the stock exchanges Corporate restructuring of the company resulting in a change exceeding +/- 2% of the total paid-up capital.	One day prior to listing Within 10 days of any corporate restructuring
35	The Company will keep the Exchange information of events such as strikes, lock-outs, closure on account of power cuts, etc.	The Exchange to be informed both at the time of occurrence of the event and subsequently after the cessation of the event.

(1)	(2)	(3)
36	The Company to keep the Exchange informed of all the events which will have bearing on the performance/operations of the company as well as price sensitive information	Immediately inform the Exchange
47(a)	The Company is required to appoint a Compliance Officer	Inform on appointment and as and when there is change in the Compliance Officer
47(e)	The Company is required to appoint Registrar & Transfer Agents (RTA)	Inform if there is any change along with the MOU signed with RTA
51	File the following information, statements and reports on the Electronic Data Information Filing and Retrieval (EDIFAR) website maintained by National Information Centre (NIC), on-line, in such manner and format and within such time as may be specified by SEBI: 1. Full version of annual report including the balance sheet, profit and loss account, director's report and auditor's report; cash flow statements; half yearly financial statements and quarterly financial statements. 2. Corporate governance report. 3. Shareholding pattern statement. 4. Statement of action taken against the company by any regulatory agency. 5. Such other statement, information or report as may be specified by SEBI from time to time in this regard.	File promptly the statements with the Exchange.
52	Electronic filing of information through Corporate Filing and Dissemination System(CFDS)	Information as may be specified by the participating exchanges.

ANNEXURE B

TIME BASED COMPLIANCE

Month of Compliance/ due dates	*Provisions of the Listing Agreement (Clause No. of the Listing Agreement)*	*Compliance requirements*
(1)	*(2)*	*(3)*
January 1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificates etc. to be placed before the Committee
15th January	Quarterly Compliance Report on Corporate Governance to be prepared by the company and signed by the Compliance Officer or Chief Executive Officer of the Company (49(VI)(ii))	To be submitted to the Stock Exchange within 15 days from the end of each quarter
21st January	The Company is required to file the quarterly shareholding pattern in the revised format indicating the shares pledged or otherwise encumbered (35)	With the Stock Exchange within 21 days from the end of the quarter
Before the end of February 1st Week	Notice of Board Meeting for approval of quarterly results to be sent by the Company and a public notice in this regard (41)	To the Stock Exchange at least 7 days prior to the Board Meeting Public notice regarding Board Meeting in at least one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated.
Before February 2nd week	Approval of Quarterly Results by the Board of Directors Submission of Financial Results with the stock Exchange(Audited Financial Results or unaudited financial results +a copy of limited review report)	To be approved by Board/Board Committee(to be ratified by the Board it is approved by a committee) Within 15 minutes of the conclusion of the Board Meeting

(1)	(2)	(3)
	Publication of Quarterly results	Within 48 hours of the conclusion of the Board Meeting atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated..
Before February 2nd Week	Company required to publish material deviations in the use of proceeds of public/rights issue 43A)	To be filed along submission of financial results
February 1/15	Shareholders'/Investors' Transfer/Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
March 1/15	Shareholders'/Investors' Transfer/Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
15th April	Quarterly Compliance Report on Corporate Governance to be prepared by the company and signed by the Compliance Officer or Chief Executive Officer of the Company (49(VI)(ii))	To be submitted to the Stock Exchange within 15 days from the end of each quarter
21st April	Declaration from the Promoters in respect of their holding as on 31st March under SEBI (SAST) Regulations (40B)	To be given to the Company within 21 days from the end of financial year
21st April	The Company is required to file the quarterly share-holding pattern in the revised format indicating therein, the details of the shares pledged or otherwise encumbered (35)	With the Stock Exchange within 21 days from the end of the quarter

(1)	*(2)*	*(3)*
30th April	Listing Fees to be paid by the Company [38(a)]	Annual Listing fees to be paid to the Stock Exchange computed on the basis of the capital of the Issuer as on March 31 and worked out as provided in the Listing Agreement
30th April	Submission of Audit report from a Practising Company Secretary. This is required to be submitted to the Company by the Registrar & Transfer Agent (RTA) (47(c))	Within 1 month from the end of quarter, to be submitted to the Exchange 24 hours of the receipt of the certificate by the Company
Before May 1st week	Notice of Board Meeting for approval of quarterly results to be sent by the Company and a public notice in this regard (41)	To intimate the Stock Exchange at least 7 days prior to the Board Meeting Public notice regarding Board Meeting in atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated.
Before May 2nd week	Approval of Quarterly Results by the Board of Directors Submission of unaudited/audited Financial Results with the stock Exchange(being last quarter) Publication of Quarterly results	To be approved by Board/Board Committee Within 15 minutes of the conclusion of the Board Meeting Within 48 hours of the conclusion of the Board Meeting atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated..

(1)	*(2)*	*(3)*
Before May 2nd week	Company required to publish material deviations in the use of proceeds of public/rights issue 43A)	To be filed along submission of financial results
May 1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
30th May	Approval of Quarterly Results(audited) by the Board of Directors Submission of audited Financial Results with the stock Exchange(being last quarter) Publication of Quarterly results	To be approved by Board/Board Committee Within 15 minutes of the conclusion of the Board Meeting Within 48 hours of the conclusion of the Board Meeting atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated..
June 1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
July	Declaration from the Promoters in respect of their holding as on record date under SEBI (SAST) Regulations (40B))	To be given to the Company on the record date for the purpose of dividend. (Reg. 8 of SEBI (SAST) Regulations)
July	Submission of yearly disclosure to the stock exchanges under SEBI (SAST) Regulations (40B)	On the record date for the purpose of dividend (Reg. 8 of SEBI (SAST) Regulations)

(1)	*(2)*	*(3)*
15th July	Quarterly Compliance Report on Corporate Governance to be prepared by the company and signed by the Compliance Officer or Chief Executive Officer of the Company [49(VI)(ii)]	To be submitted to the Stock Exchange within 15 days from the end of each quarter
21st July	The Company is required to file the quarterly shareholding pattern in the revised format indicating therein the details of shares pledged or otherwise encumbered (35)	With the Stock Exchange within 21 days from the end of the quarter
April – September(on Annual General Meeting)	Dispatch of Annual Report by the Company (31)	Six copies to each of the Stock Exchanges where the Company is listed and one copy each to all the recognized stock exchanges in India, as soon as it is issued to the shareholders
April – September(on Annual General Meeting)	Certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance to be obtained by the company and submitted [49(VII)(i)]	As part of the Annual Report and separately along with the Annual Report to be submitted to the Stock Exchange
Before the end of August 1st Week	Notice of Board Meeting for quarterly results to be sent by the Company and a public notice in this regard (41)	To the Stock Exchange at least 7 days prior to the Board Meeting Public notice regarding Board Meeting in atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated.

(1)	(2)	(3)
Before August 2nd week	Approval of Quarterly Results by the Board of Directors Submission of Financial Results with the stock Exchange(Audited Financial Results or unaudited financial results +a copy of limited review report) Publication of Quarterly results	To be approved by Board/Board Committee Within 15 minutes of the conclusion of the Board Meeting Within 48 hours of the conclusion of the Board Meeting atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated..
Before August 2nd Week	Company required to publish material deviations in the use of proceeds of public/rights issue 43A)	To be filed along submission of financial results
August 1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
September1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
October1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
15th October	Quarterly Compliance Report on Corporate Governance to be prepared by the company and signed by the Compliance Officer or Chief Executive Officer of the Company [49(VI)(ii)]	To be submitted to the Stock Exchange within 15 days from the end of each quarter

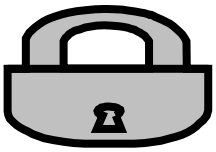
(1)	(2)	(3)
21st October	The Company is required to file the quarterly shareholding pattern in the revised format indicating therein the details of the shares pledged or otherwise encumbered (35)	With the Stock Exchange within 21 days from the end of the quarter
30th October	Submission of Audit report from a Practicing Company Secretary. This is required to be submitted to the Company by the Registrar & Transfer Agent (RTA) (47(c))	Within 1 month from the end of quarter, to be submitted to the Exchange 24 hours of the receipt of the certificate by the Company
November 1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee
Before the end of November 1st Week	Notice of Board Meeting for quarterly results to be sent by the Company and a public notice in this regard (41)	To the Stock Exchange at least 7 days prior to the Board Meeting Public notice regarding Board Meeting in atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated.
Before November 2nd week	Approval of Quarterly Results by the Board of Directors Submission of Financial Results with the stock Exchange(Audited Financial Results or unaudited financial results +a copy of limited review report) Publication of Quarterly results	To be approved by Board/Board Committee Within 15 minutes of the conclusion of the Board Meeting Within 48 hours of the conclusion of the Board Meeting atleast one English Daily news paper circulating whole of or substantially whole of India and in one daily news paper published in the language of the region, where the registered office of the Company is situated..

(1)	*(2)*	*(3)*
Before November 2nd Week	Company required to publish material deviations in the use of proceeds of public/rights issue 43A)	To be filed along submission of financial results
December1/15	Shareholders'/Investors' Transfer/ Grievance Committee Meeting to be held by the Company (8, 41 & 49)	Approval and processing of Transfer, Transmission, Demat and issue of Duplicate Share Certificate etc. to be placed before the Committee

LESSON ROUND UP

- The listing of securities with the stock exchanges is ensured by way of entering into a listing agreement between the stock exchange where the securities are proposed to be listed and the issuing company.
- The process of listing includes initial listing, final listing, enlisting of securities openly for trading and continuous listing (i.e. to remain listed).
- Any listed company is required to comply with the provisions of listing agreement which are time based/event based.
- The Company is required to appoint the Company Secretary to act as Compliance Officer under clause 47(a) of the listing agreement.
- The listing agreement includes compliances pertaining to intimations to stock exchanges, publication of financial results, shareholding patter, corporate governance matters, allotment, refund, share transfer related matters, etc.

SELF TEST QUESTIONS



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

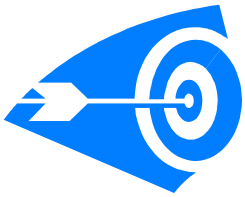
1. Under what circumstances the company files shareholding pattern with stock exchanges?

2. Briefly explain the points to be checked relating to publication of financial results.
3. What are the listing requirements under clause 49 of the listing agreement?
4. What are the various intimations/submissions which are to be made to the stock exchange?

STUDY VI

INTERNAL AUDIT OF DEPOSITION PARTICIPANTS

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- An overview of Depository System
- Legal framework for Depository Participants
- Role of Depository Participants
- Objective and scope of Internal Audit of Depository Participants
- Check list on Internal Audit of Depository Participants

DEPOSITORY SYSTEM - AN OVERVIEW

The Depository System functions very much like the banking system. A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients. A Bank transfers funds between accounts whereas a Depository transfers securities between accounts. In both systems, the transfer of funds or securities happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.

In the depository system, share certificates belonging to the investors are to be dematerialised and their names are required to be entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies' register are replaced by the name of depository as the registered owner of the securities. The depository, however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and is subject to all the liabilities in respect of the securities held by a depository. Shares in the depository mode are fungible and cease to have distinctive numbers. The transfer of ownership changes in the depository is done automatically on the basis of delivery v. payment.

In the Depository mode, corporate actions such as IPOs, rights, conversions, bonus, mergers/amalgamations, subdivisions & consolidations are carried out without the movement of papers, saving both cost & time. Information of beneficiary owners is readily available. The issuer gets information on changes in shareholding pattern on a regular basis, which enables the issuer to efficiently monitor the changes in shareholdings.

The Depository system links the issuing corporates, Depository Participants

(DPs), the Depositories and clearing corporation/ clearing house of stock exchanges. This network facilitates holding of securities in the soft form and effects transfers by means of account transfers.

Depository Participant

Just as a brokers act an agent of the investor at the Stock Exchange; a Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository. The Depository Participant maintains securities account balances and intimate the status of holding to the acc 169 lder from time to time. According to SEBI guidelines, Financial Institutions lil s, custodians, stockbrokers etc. can become participants in the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the Depository can be compared to a Bank, DP is like a branch of that bank with which an account can be opened. The main characteristics of a depository participant are as under:

— Acts as an Agent of Depository
— Customer interface of Depository
— Functions like Securities Bank
— Account opening
— Facilitates dematerialisation
— Instant transfer on pay-out
— Credits to investor in IPO, rights, bonus
— Settles trades in electronic segment

LEGAL FRAMEWORK FOR DEPOSITORY PARTICIPANTS

The legal framework for a depository system has been laid down by the Depositories Act, 1996 and is regulated by SEBI. The depository business in India is regulated by –

— The Depositories Act, 1996
— The SEBI (Depositories and Participants) Regulations, 1996
— Bye-laws of Depository
— Business Rules of Depository.

Apart from the above, Depositories and Depository participants are also governed by certain provisions of:

— The Companies Act, 1956
— The Indian Stamp Act, 1899
— Securities and Exchange Board of India Act, 1992
— Securities Contracts (Regulation) Act, 1956
— Benami Transaction (Prohibition) Act, 1988
— Income Tax Act, 1961
— Bankers' Books Evidence Act, 1891

The legal framework for depository system as envisaged in the Depositories Act, 1996 provides for the establishment of single or multiple depositories. Any body to be

eligible for providing depository services must be formed and registered as a company under the Companies Act, 1956 and seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfillment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

Under the Depositories Act, 1996:

(i) Section 2(1)(g) of the Depositories Act, 1996 defines a participant to mean a person registered under Sub-section (1A) of section 12 of the SEBI Act, 1992. Section 12(1A) of the SEBI Act, 1992 provides that no DP shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration granted by SEBI in accordance with the regulations made by SEBI.

(ii) Section 4 provides that a Depository shall enter into an agreement with one or more DPs as its agents and such an agreement shall be in such form as specified by the bye-laws of the Depository.

(iii) Section 5 provides that any person may avail of Depository services by executing an agreement through a DP with the Depository.

(iv) Section 7(1) provides that every Depository shall on receipt of intimation from a DP, register the transfer of security in the name of transferee.

(v) Section 16 provides that in event of any loss being caused to the beneficial owner by the negligence of the Depository or the DP, the Depository shall in the first place indemnify the beneficial owner and where the loss has been caused by the DP, the Depository shall recover the loss from it.

(vi) Section 18 – The DP can be called upon by the SEBI to furnish such information relating to the securities held in a depository as may be required. Also its affairs can be inspected by any person so authorized by SEBI.

(vii) Section 19A to 19G – Under these sections a DP is liable to penalty for failure to furnish information/return; enter into agreements; redress Investors' grievances; make delay in dematerialisation or issue of certificates of securities; failure in reconciliation of records; and failure to comply with directions issued by SEBI etc.

Under the SEBI (Depositories and Participants) Regulations, 1996

(i) Regulation 6A stipulates that for the purpose of determining whether an applicant or the depository and participant is a fit and proper person the Board may take into account the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

(ii) Regulations 16 and 17 deal with registration of DPs. It is stipulated that an application for grant of a certificate of registration shall be made to SEBI in form E through each Depository in which the applicant proposes to act as a participant accompanied by the prescribed fees. The Depository shall forward the application to SEBI not later than 30 days along with its recommendations

and certifying that the applicant complies with the eligibility criteria including adequate infrastructure as provided for in these regulations and the bye-laws of the depository. Regulation 18 provides for furnishing of further information, clarifications to SEBI or personal attendance of the applicant or the depository to which the applicant is to be admitted as a participant.

(iii) Regulation 19 stipulates the categories of entities which are eligible for being registered as DPs viz. Banks, Financial Institutions, Stock Brokers etc.

For the purpose of grant of certificate of registration, the Board shall take into account all matters which are relevant to or relating to the efficient and orderly functioning of a participant and in particular, whether the applicant complies with the following requirements, namely: -

(a) the applicant belongs to one of the following categories,-

(i) a public financial institution as defined in Section 4A of the Companies Act, 1956 (1 of 1956);

(ii) a bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iii) a foreign bank operating in India with the approval of the Reserve Bank of India;

(iv) a State Financial Corporation established under the provisions of Section 3 of the State Financial Corporations Act, 1951 (63 of 1951);

(v) an institution engaged in providing financial services, promoted by any of the institutions mentioned in sub-clause (i), (ii), (iii), (iv) jointly or severally;

(vi) a custodian of securities who has been granted a certificate of registration by the Board under Sub-section (1A) of Section 12 of the Act;

(vii) a clearing corporation or a clearing house of a stock exchange;

(viii) a stock broker who has been granted a certificate of registration by the Board under Sub-section (1) of Section 12 of the Act:

Provided that the stock-broker shall have a minimum net worth of rupees 50 lakhs and the aggregate value of the portfolio of securities of the beneficial owners held in dematerialised form in a depository through him, shall not exceed 100 times of the net worth of the stock broker.

Provided further that if the stock broker seeks to act as a participant in more than one depository, he shall comply with the criteria specified in the first proviso separately for each such depository; or

Provided further that where the stockbroker has a minimum networth of Rupees Ten crore, the limits on the aggregate value of the portfolio of securities of the beneficial owners held in dematerialized form in a depository through him shall not be applicable.

(ix) a non-banking finance company, having a net worth of not less than rupees fifty lakhs:

Provided that such company shall act as a participant only on behalf of itself and not on behalf of any other person;

Provided further that a non-banking finance company may act as a participant on behalf of any other person, if it has a networth of Rs. 50 crores in addition to the networth specified by any other authority]

(x) a registrar to an issue or share transfer agent who has a minimum net worth of rupees ten crores and who has been granted a certificate of registration by the Board under Sub-section (1) of Section 12 of the Act.

(b) the applicant is eligible to be admitted as a participant of the depository through which it has made the application to the Board;

(c) the applicant has adequate infrastructure, systems, safeguards and trained staff to carry on activity as a participant; and

(cc) the applicant is a fit and proper person.

(d) the grant of certificate of registration is in the interests of investors in the securities market.

(iv) Regulation 20 stipulates that the certificate of registration as a DP shall be granted by SEBI in Form F. The grant of this certificate shall be subject to the following conditions:

— The DP shall pay the prescribed registration fee within 15 days of receipt of intimation from the SEBI specified in Part A of the Second Schedule, in the manner specified in Part B. The DP shall also pay Annual fees specified in part A of the Second Schedule in the manner specified in Part B thereof.

— The DP shall comply with the provisions of the SEBI Act 1992, the Depositories Act 1996, the Bye-laws of the Depository, agreements and these Regulations.

— The DP shall redress the grievances of the beneficial owners within 30 days of the date of the receipt of the complaint and keep the Depository informed about the number and the nature of redressal.

Also, the depository through which an application for certificate of registration has been forwarded, should hold a certificate of commencement of business under Regulation 14. If any information previously submitted by the participant to the SEBI is found to be false or misleading in any material particular or if there is any change in such information participant shall forthwith inform the SEBI in writing.

(v) Regulation 20A provides that a DP, shall abide by the code of conduct as specified in the third schedule.

(vi) Regulation 21 stipulates that the certificate of registration shall be valid for a period of 5 years from the date of its issue or renewal.

(vii) Regulation 22 stipulates that 3 months before the expiry of the period of validity of a certificate, the DP shall (if it so desires) make an application for renewal in Form E through the Depository in which he is a participant in the same manner as if it were a fresh application for registration.

(viii) Regulations 23 and 24 provide that if the application for registration under regulation 16 or 19, has been rejected the DP should cease to carry on any activity as such unless, SEBI has, in the interest of investors in the securities market permitted the DP to carry on its activities undertaken prior to the receipt of intimation of refusal.

(ix) Regulation 41 provides that every DP shall enter into an agreement as a participant on his behalf in the manner specified by the Depository in its Byelaws.

(x) Regulation 42 provides that:

— Separate accounts shall be opened by every DP in the name of each of the beneficial owners and the securities of each beneficial owner shall be segregated and shall not be mixed up with the securities of other beneficial owners or with the participant's own securities.

— The DP shall register the transfer of securities to or from a beneficial owner's account only on receipt of instructions from the beneficial owner and thereafter confirm the same to the beneficial owner in a manner specified by the Byelaws of the Depository.

— Every entry in the beneficial owner's account shall be supported by electronic instructions or any other mode of instruction received from the beneficial owner in accordance with the agreement with the beneficial owner.

(xi) Regulation 43 provides that every DP shall provide statements of account to the beneficial owner in such form and in such manner and at such time as provided in the agreement with the beneficial owner.

(xii) Regulation 44 provides that every DP shall allow a beneficial owner to withdraw or transfer from his account in such manner as specified in the agreement with the beneficial owner. Also, according to Regulation 33, every depository can allow any participant to withdraw or transfer its account, if the request for such withdrawal or transfer is in accordance with stipulated conditions.

(xiii) Regulation 45 provides that every DP shall maintain continuous electronic means of communication with the Depository.

(xiv) Regulation 47 provides that every DP shall reconcile its records with every Depository in which it is a participant on a daily basis.

(xv) Regulation 48 provides that every DP shall submit periodic returns to SEBI and to the Depository in the format specified by SEBI or the Byelaws of the Depository.

(xvi) Regulation 49 provides that every DP shall maintain the following records and documents:

(a) records of all the transactions entered into with a depository and with a beneficial owner;

(b) details of security dematerialised, rematerialised on behalf of beneficial owners with whom it has entered into an agreement;

(c) records of instructions received from beneficial owners and statements of account provided to beneficial owners; and

(d) records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be.

Further, the DP shall intimate SEBI about the place where the records and documents are maintained. It shall make available for the inspection of the depository in which it is participant. The DP shall preserve records and documents for a minimum period of 5 years.

(xvii) Regulation 50 provides that where records are kept electronically by a DP, it shall ensure that the integrity of the data processing systems is maintained at all times and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with and in the event of loss or destruction, ensure that sufficient back up of records is available at all times at a different place.

(xviii) Regulation 51 stipulates that if a DP enters into an agreement with more than one depository, it shall maintain records specified in Regulation 49 separately in respect of each depository.

(xix) Regulation 52 provides that a DP shall not assign or delegate its functions to any other person without the prior approval of the depository.

(xx) Regulation 53B provides that the grievances of the beneficial owners shall be redressed within thirty days of receipt of complaint and the depository shall be informed about the number and nature of grievances redressed and remaining pending.

(xxi) Regulation 54 provides that:

(1) Any beneficial owner, who has entered into an agreement with a DP, shall inform the DP of the details of the certificate of security which is to be dematerialised, and shall surrender such certificate to the DP;

Provided that where a beneficial owner has appointed a custodian of securities, then he may surrender the certificates of security to the DP through his custodian of securities.

(2) The DP shall, on receipt of information under sub-regulation (1), forward such details of the certificate of security to the depository and shall confirm to the depository that an agreement has been entered into between the DP and the beneficial owner.

(3) The DP shall maintain records indicating the names of beneficial owners of the securities surrendered, the number of securities and other details of the certificate of security received.

(4) The DP shall within seven days of receipt of security certificate furnish to the issuer, details specified in sub-regulation (2) along with the certificate of security referred to in sub-regulation (1).

(xxii) Regulation 58 provides that:

(1) If a beneficial owner intends to create a pledge on a security owned by him, he shall make an application to the depository through the DP who has his account in respect of such securities.

(2) The DP after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.

(3) The depository after confirmation from the pledgee that the securities are available for pledge with the pledger shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the DPs of the pledger and the pledgee.

(4) On receipt of the intimation under sub-regulation (3) the DPs of both the pledgor and the pledgee, shall inform the pledgor and the pledgee respectively of the entry of creation of the pledge.

(5) If the depository does not create the pledge, it shall send along with the reasons as intimation to the DPs of the pledger and the pledgee.

(6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if pledger or the pledgee makes an application to the depository through its DP:

Provided that no entry of pledge shall be cancelled by the depository without prior concurrence of the pledgee.

(7) The depository on the cancellation of the entry of pledge shall inform the DP of the pledger.

(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.

(9) After amending its records under sub-regulation (8) the depository shall immediately inform the DPs of the pledger and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledger and pledgee, respectively.

(10) (a) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).

(b) The provisions of sub-regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation:

Provided that the depository before registering the hypothecation as a beneficial owner shall obtain the prior concurrence of the hypothecator.

(11) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a DP without the concurrence of the pledgee or the hypothecatee as the case may be.

According to Regulation 58A, a depository or a participant or any of their employees shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real time or non-real time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice. In case, an employee of the depository or the participant is rendering such advice, he shall also, disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

According to Regulation 58B, a depository and a participant shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors' grievances. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.

Understanding of certain concepts

(a) Dematerialisation;

(b) Rematerialisation;

(c) Corporate Actions/Benefits; and

(d) Pledge/Hypothecation.

Dematerialisation

Dematerialisation is a process of conversion of physical certificates into electronic balances. Before the process of dematerialisation is set in motion some essential prerequisites need to be considered as under:

(a) An investor must open an Account with a DP.

(b) Only the securities eligible for demat can be dematerialised.

(c) The securities must be in the name of the account holder and owned by him.

(d) A separate demat requisition form (DRF) is required for each issuer.

(e) A separate DRF is required for lock-in and lockfree securities.

(f) The DRF form must be signed by all the joint holders.

Rematerialisation

Rematerialisation means the conversion of dematerialised holdings back into the physical certificates.

In a simplified form the process of Rematerialisation could be explained hereunder:

(a) Investor to submit the Rematerialisation Request Form (RRF) to the DP.

(b) DP to electronically intimate the Depository.

(c) DP to submit RRF to the Registrar/Issuer Company.

(d) Depository confirms rematerialisation request to the Registrar/Issuer Company.

(e) Registrar/Issuer Company verifies particulars, prints certificates and intimates the Depository.

(f) Depository updates Accounts and downloads details to DP.

(g) Registrar/Issuer despatches certificates to the investor.

Corporate Actions

Corporate actions are benefits given by a company to its members. Corporate benefits/actions would include rights issues/bonus issues, dividend payments, interest payments etc. [i.e. both monetary and non-monetary benefits].

Whenever a corporate action is announced, the issuer or its registrar and transfer agent, should inform its depository just after the day of communication of the same to the relevant stock exchange(s). The depository should then inform the participants, through a circular about the relevant action, the no-delivery period, the cut-off date and the procedure to be followed by the participants. The participants, upon receiving such information, should ensure that:

(i) the changes in tax status, bank details, change of address etc in the beneficial owner's accounts are updated in advance of the book closure record date.

(ii) all positions in the transitory accounts e.g. Clearing accounts and intermediary accounts are cleared and balances lying therein are transferred to the relevant beneficiary accounts in advance of the book closure/relevant dates.

(iii) while transferring securities to the clearing accounts, only the settlement number in which the securities will ultimately be settled is mentioned, rather than the settlement number in respect of which there is no-delivery.

(iv) it remains connected till end-of-day processing on the record date or the business date immediately prior to book closure.

On the basis of the particulars of the holding of beneficial owners received from the depository as of the cut-off date, the issuer or its registrar and transfer agent would distribute dividend, interest and other monetary benefits directly to the beneficial owners.

Pledge/Hypothecation

Securities held in a depository account can be pledged or hypothecated against a loan, credit, guarantee etc, availed by the beneficial owner of such securities. For this, it is imperative that both the parties to the agreement, have a beneficiary account with a depository. It is however not necessary that both of them have their depository account with the same participant or same depository. If a beneficial owner intends to create a pledge on a security, owned by him Regulation 58 of SEBI (Depositories and Participants) Regulations, 1998 have to be borne in mind. We here analyse the respective byelaws and Business Rules of NSDL in this context:-

If a Client intends to create a pledge on a security owned by him, he shall make an application in this regard in the form specified in the Business Rules to the Depository through the Participant, who has his account in respect of such securities.

The pledgor and the pledgee must have an account in the Depository to create a pledge. However, the pledgor and the pledgee may hold an account with two different Participants.

The Participant after satisfaction that the securities are available for pledge shall

make a note in its records, of the notice of pledge, and forward the application to the Depository.

The Depository, after receiving confirmation from the Participant of the pledgee through an application made by the pledgee to the Participant in the form specified in Business Rules in this regard, shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the Participants of pledgor and pledgee.

On receipt of the intimation above, the Participants of both the pledgor and the pledgee shall inform the pledgor and the pledgee respectively of the entry of creation of the pledge.

If the Depository does not create the pledge, it shall within fifteen days of the receipt of application send alongwith the reasons, an intimation to the Participants of the pledgor and the pledgee

The pledgor or pledgee may request cancellation of the entry of pledge made by making an application in the form specified in this regard in the Business Rules to the Depository through its Participant.

The Participant shall make a note in its records, of the cancellation of the entry of pledge and forward the request to the Depository

The Depository, after receiving prior confirmation from the Participant of the pledgee through an application made by the pledgee to the Participant in the form specified in Business Rules in this regard, shall cancel the entry of pledge made and send an intimation of the same to the Participants of pledgor and pledgee.

The pledgee may invoke the pledge made, subject to the provisions of the pledge document, by making an application in the form specified in this regard in the Business Rules, to the Depository through its Participant.

The Participant shall make a note in its records, of the request of invocation of the entry of pledge and forward the request to the Depository.

The Depository, on receipt of a relevant request, shall invoke the pledge and amend its record accordingly to register the pledgee as a beneficial owner of the securities and shall thereafter, send intimation of the same to the Participants of the pledgor and the pledgee.

On receipt of the intimation above, the Participants of both the pledgor and the pledgee shall inform the pledgor and the pledgee respectively of the invocation of pledge.

If the Client intends to create a hypothecation on the securities owned by him, he may do so in accordance with the provisions aforesaid which shall apply mutatis mutandis apply in such cases of hypothecation, except that the Depository shall invoke the entry of hypothecation made after receiving confirmation from the Participant of the hypothecator through an application made by the hypothecator to the Participant in the form specified in this regard in the Business Rules.

No transfer of security in respect of which a notice or entry of pledge or

hypothecation is in force shall be effected by a Participant without the prior concurrence of the pledgee or the hypothecatee as the case may be

AGREEMENT TO WHICH THE DEPOSITORY PARTICIPANT IS A PARTY

A DP is required to enter into two important agreements in course of demat trading.

1. Agreement with the Depository; and
2. Agreement with the Investor.

1. Standard Agreement with the Depository (NSDL)/(CDSL)

Important clauses needing compliance on part of the DP are :-

(a) Adherence to the SEBI Act 1992, the SEBI (Depositories and Participants) Regulations 1996, Byelaws and the Business Rules of the Depository.

(b) Payment of requisite fees and charges as prescribed.

(c) Compliance with valid instructions of the investor and ensuring that holdings of the DP do not comingle with those of its clients.

(d) DP to reconcile its own records with the Depository on a daily basis.

(e) DP to maintain such Hardware and Software Systems as are stipulated by the Depository.

(f) DP to maintain Insurance mechanism and coverage as stipulated by the depository.

(g) DP to contribute to the Investor Protector fund, the Participant Fund and any other fund established to protect the interests of the clients as may be prescribed by the Depository.

(h) DP to comply with accounting, audit, financial requirements, submission of returns, internal controls, audit control measures as stipulated by the Depository.

(i) DP to notify the Depository within 7 days of any change in the details set out in the application form submitted to the Depository at the time of admission or furnished from time to time.

(j) DP to resolve investor grievances and submit a report to the SEBI and the Depository within the time stipulated by the SEBI Regulations.

2. Standard agreement with the Investor

Important clauses needing compliance by DP are as under:

(a) The DP shall strictly adhere to the instructions of the client with regard to transfer to and from the Accounts of the Client.

(b) The DP shall provide a statement of Accounts to the client at fortnightly intervals unless otherwise agreed.

(c) The DP shall resolve all legitimate grievances of the client within a period of 30 days.

The two Depository service provides in India, viz.,

(1) National Securities Depository Ltd. (NSDL) and

(2) Central Depository Services (India) Limited (CDSL)

These Depositories have allowed Company Secretaries in whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).

INTERNAL AND CONCURRENT AUDIT - NSDL

As per Bye Law 10.3, every Participant shall ensure that an internal audit in respect of its depository operations is conducted at intervals of not more than six months by a qualified Chartered Accountant or a Company Secretary holding a Certificate of Practice and a copy of the internal audit report shall be furnished to the Depository."

As prescribed vide Circular no. NSDL/POLICY/2006/0021 dated June 24, 2006, activities related to account opening, control and verification of Delivery Instruction Slips (DIS) are subject to concurrent audit which must be completed by the next working day. If such audit cannot be completed by next working day due to large volume, it must be completed within a week.

The Chartered Accountants, Company Secretaries or Cost and Management Accountants who are engaged in Internal Audit or Inspection of the Participant in respect of its depository operations, should not have any conflict of interest with the said Participant.

Objective of audit as per NSDL Circular No. NSDL/policy/2009/O/05 dated Nov. 10, 2009

Following are the broad objectives of internal audit of depository operations:

1. (i) To assure the management that the operations of the Participants are in compliance with the requirements of The Depositories Act, 1996, SEBI (Depositories and Participants) Regulations, 1996, NSDL Bye Laws and Business Rules, its agreement with the Client and NSDL and various circulars issued by NSDL from time to time.

   (ii) To assure management that the DPM is managed and maintained in a manner that there is no threat to business continuity, integrity of data processing system is maintained at all times and methods are put in place to ensure that records are not lost, destroyed or tampered with or in the event of loss or destruction of data, sufficient backup of records is available at all times.

   (iii) To assure management that the capacity of computer system, staff strength and internal procedures are commensurate with the level of business activity.

   (iv) To assure management that the business operations of the Participants are conducted in a manner that the foreseeable risks are addressed with appropriate internal control mechanism.

   (v) To assure management that the business operations of the Participants are conducted as per the operations manual and in strict adherence with NSDL prescribed procedures.

2. Audit program should cover all facets of the depository operations. Auditor may expand the scope of audit/add more audit points to achieve the objectives listed above. Participants are advised to extend full co-operation to their auditors to enable them to perform an effective audit. All circulars/guidelines issued by NSDL/SEBI from time to time and other information/records desired by the auditors should be made available to them within reasonable time.

3. Participants should submit the audit report to NSDL as per schedule given below.

Audit Period	**Due date for submission of report to NSDL**
April 1 to September 30	November 15
October 1 to March 31	May 15

4. New Participants which are operatonal for less than three months in an audit period can submit audit report for that audit period with the audit report for next audit period. For example, if a Participant is made operational by NSDL on July 2, 2009, then it can submit single audit report for the period July 2, 2009 – March 31, 2010.

5. As prescribed vide Circular no. NSDL/POLICY/2006/0021 dated June 24, 2006, activities related to account opening, control and verification of Delivery Instruction Slips (DIS) are subject to concurrent audit which must be completed by the next working day. If such audit cannot be completed by the next working day due to large volume, it must be completed within a week. The guidelines provided in *Annexure 1* in respect of these activities are applicable for concurrent audit as well.

6. Participants can appoint same auditor for concurrent and internal audit. If both are performed by the same auditor, then consolidated report must be submitted instead of two separate reports. If two audits are being performed by different auditors, then two separate reports should be submitted.

7. The guidelines provided in this circular are applicable for audit period October 1, 2009 to March 31, 2010 and onwards. Audit report for period April 1, 2009 to September 30, 2009 may be submitted as per existing guidelines (i.e. guidelines provided in Circular no. NSDL/POLICY/20008/0077 dated November 3, 2008) or as per the new guidelines provided in this circular.

8. Internal and/or concurrent audit reports which are not as per guidelines will be treated as non submission of the report. NSDL reserves the right to advise a Participant to change its auditor if quality of the report is not satisfactory or if the audit is not carried out as per the guidelines.

9. A training program will be conducted for internal/concurrent auditors by NSDL shortly. Schedule and details of the program will be communicated to the Participants. Participants may request their auditors to take benefit of the training program.

10. Participants may encourage their auditors to acquire certification under NCFAAM – NSDL Depository Operations module.

The detailed checklist as prescribed by NSDL for internal/concurrent Audit Checklist

1 Audit of Account Opening

Sl. No.	Audit Areas	Auditor's Obser-vations	Auditor's Remarkes	Manage-Ments Comments
1.1	Whether proof of identity and proof of address have been obtained for all accounts as per SEBI and NSDL guidelines?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
1.2	Whether PANs are obtained for all the accounts, wherever applicable?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
1.3	Whether PANs are verified with the database of Income Tax Department for all the accounts?	☐ Yes No ☐	If no, then number of accounts with discrepancies must be mentioned here	
1.4	Whether the in-person verification of the account holders has been done before activation of the account as per the NSDL guidelines?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
1.5	Whether prescribed DP-Client agreement has been executed for all the accounts?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
1.6	Whether a separate DP-Client agreement has been executed with clients who want to hold warehouse receipts in their accounts?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
1.7	Whether data entered in DPM systems matches with the details mentioned in the account opening form?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
1.8	Whether signature of account holder(s) as given in the account opening form has been scanned in the DPM system clearly and correctly?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	

1.9	Whether all account opening forms are completely filled?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	

2 Client Data Modification

2.1	Whether client's request for changes in data (e.g. address, signature, bank details, nomination) have been processed as per prescribed procedure?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
2.2	Whether client's request for closure/ freezing/unfreezing of account have been processed as per prescribed procedure?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	

3 Denat/remat request

3.1	Whether the demat requests have been accepted and processed as per the prescribed procedure?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
3.2	Whether date of receiving the demat request and date of forwarding the documents to Issuer/Registrar & Transfer Agent have been recorded correctly?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
3.3	Whether demat requests received have been sent to Issuer/Registrar & Transfer Agents within seven days from the date of receipt of the request from the account holder?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
3.4	Whether there are sufficient provisions/arrangements for safe keeping of security certificates received from account holders for dematerialization and certificates received after rejection of the demat request from Issuer/Registrar & Transfer Agent?	☐ Yes ☐ No		
3.5	Whether any demat request was rejected due to error attributable to Participant?	☐ Yes ☐ No		
3.6	Whether Participant has taken necessary corrective and preventive measures to avoid rejection attributable to Participants?	☐ Yes ☐ No		
3.7	Number of remat request processed during the audit period			
3.8	Whether the remat requests have been accepted and processed as per the prescribed procedure?	☐ Yes ☐ No		

4 Delivery Instruction Slip (DIS)

4.1	***Issuance of DIS***			
4.1.1	Whether physical inventory of DIS booklets is reconciled with the DIS issue records periodically?	☐ Yes ☐ No		
4.1.2	Whether the DIS issued to the client has pre-stamped client ID and pre-printed unique serial number?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.1.3	Whether DIS booklets have been issued on receipt of requisition slips signed by all the joint holders?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.1.4	Whether issuance of loose DIS to account holder is done as per prescribed procedure?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.1.5	If DIS booklet is handed over to the authorized person other then account holder, then whether the signature of authorized person and his proof of identity are verified before issuance of DIS booklet?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.1.6	Whether DIS (booklet or loose) issued to account holder is immediately updated in back office or issuance register?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	

4.2 Verification of DIS

4.2.1	Whether date and time stamp is affixed on both Participant and client copy of DIS received?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.2	Whether Participant affixes 'late stamp' on DIS received beyond the prescribed deadline time?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.3	Whether Participant verifies that the DIS received from client was actually issued to same client ID?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.4	Whether serial number of all the executed DISs (irrespective of whether executed	☐ Yes	If no, then number of cases	

	through back office or directly in DPM system) and DISs reported as lost/misplaced/stolen by the account holder are blocked in the back office or in the DIS issuance register to prevent any re-acceptance?	☐ No	with discrepancies must be mentioned here	
4.2.5	Whether DIS(s) given by the account holder are available fo all instructions executed in DPM system (instruction other than those given by account holders through Speed-e-/electronically)?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.6	Whether signature(s) on DIS match with the signature(s) scanned in the DPM system?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.7	Whether corrections/cancellation on DIS, if any, are authenticated by the client (all holders for joint accounts)?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.8	Whether Participant accepts instructions by fax from account holder?	☐ Yes ☐ No		
4.2.9	Whether original DIS has been received within three working days for all faxed instructions?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.10	Is there a system in place to prevent multiple execution of the same instruction, in case fax instructions are accepted?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.11	Whether Participant has obtained an indemnity from account holder who want to give instruction over fax?	☐ Yes ☐ No Not applicable	If no, then number of cases with discrepancies must be mentioned here	
4.2.12	If Participant is accepting delivery instruction in form of an annexure to a DIS, whether it is done as per the prescribed procedure?	☐ Yes ☐ No Not applicable	If no, then number of cases with discrepancies must be mentioned here	
4.2.13	Whether information under columns “Consideration” and “Reason/Purpose” are mentioned for off market instructions?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	

4.2.14	Whether Participant follows maker-checker system to process the instructions?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.15	Whether there is an additional level of verification for high value instructions (instruction with value over Rs. 5 lakhs)?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.16	Whether there is an additional level of verification for instructions received for dormant accounts?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
4.2.17	Whether instructions executed in the DPM system are as per DIS?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	

5. Transaction Statement

5.1	Whether transaction statements are generated from back office or DPM system?			
5.2	If generated from back office, whether the details match with statement generated from DPM system?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
5.3	Whether transaction statements are provided to the account holders as per prescribed frequency?	☐ Yes ☐ No	If no, then number of cases with discrepancies must be mentioned here	
5.4	If Participant does not send transaction statement on quarterly basis to client holding account with no transaction and no security balance, then whether the relevant guidelines have been followed?	☐ Yes ☐ No		
5.5	If Participant is sending transaction statement through internet (web based/email), then whether the relevant guidelines have been followed?	☐ Yes ☐ No		

6. Compliance under Prevention of Money Laundering Act, 2002 (PMLA)

6.1	Whether Participant has adopted a policy to comply with its obligations under PMLA?	☐ Yes ☐ No		
6.2	Whether Participant has appointed a 'Principal Officer' as required under PMLA?	☐ Yes ☐ No		
6.3	Whether there is a mechanism to deal appropriately with the alerts forwarded by NSDL?	☐ Yes ☐ No		

7. Operations Manual

7.1	Whether Participant has prepared a Operation Manual?	☐ Yes ☐ No	If no, then point no. 7.2 to 7.5 are not applicable	
7.2	Whether Operation Manual covers all depository activities?	☐ Yes ☐ No	If no, then mention the areas not covered in operations manual	
7.3	Whether Operation Manual is updated as and when required?	☐ Yes ☐ No	If no, then mention when is it updated	
7.4	Whether Operation Manual is available to persons who need to refer iti?	☐ Yes ☐ No	If no, then mention how is the work done by those persons	
7.5	Whether procedures mentioned in the Operation Manual are followed?	☐ Yes ☐ No	If no, then give details here	

8. Maintenance of record and documents

8.1	Whether Participant has outsourced record keeping activity (partly or fully)?	☐ Yes ☐ No	If yes, then the name of the agency/firm and nature of arrangement must be mentioned here	
8.2	If yes, whether NSDL's approval has been obtained?	☐ Yes ☐ No		
8.3	Whether Participant has informed NSDL about place(s) of record keeping?	☐ Yes ☐ No		

9. Service centre

9.1	Whether NSDL's approval has been obtained for all the service centres opened during the audit period?	☐ Yes ☐ No	If no, then details of non compliance must be mentioned here	
9.2	Whether prescribed procedure has been followed for any service centre closed/terminated during the audit period?	☐ Yes ☐ No	If no, then details of non compliance must be mentioned here	
9.3	Whether contact details of all the service centres available on the NSDL website are correct?		If no, then details of non compliance must be mentioned here	
9.4	Whether NCDO/NCFM-Depository Module qualified person is appointed at each service centres?	☐ Yes ☐ No	If no, then details of non compliance must be mentioned here	
9.5	Whether internal audit has been conducted at any service centre?	☐ Yes ☐ No	If no, then mention count of centres audited and locations thereof.	

10. Status of compliance for deviation/observation noted in latest NSDL inspection and internal/econcurrent audit report

10.1	Whether Participant has taken adequate preventive and corrective measures in respect of deviation noted during latest NSDL inspection?	☐ Yes ☐ No	If no, then details of the non compliance must be mentioned here	
	Whether Participant has taken adequate preventive corrective measures in respect of deviations noted during the latest internal/concurrent audit?	☐ Yes ☐ No	If no, then details of the non compliance must be mentioned here	
	Comment on the issues for which NSDL has specifically sought auditor's certification in audit report			

11. Billing

11.1	Whether all account holder are billed as per the agreed schedule of charges?	☐ Yes ☐ No		
11.2	Whether Participant has given atleast one month's prior notice for any modification in the schedule of charges?	☐ Yes ☐ No		

12. Back Office

12.1	If Participant is using any back office software for depository operations, then whether balances as per back office are reconciled on a daily basis with DPM system?	☐ Yes ☐ No		

13. Miscellaneous areas

13.1	Whether all transmission cases have been processed as per prescribed procedure?	☐ Yes ☐ No	If no, then number of accounts with discrepancies must be mentioned here	
13.2	Whether there is any supplementary agreement/letter of confirmation/power of attorney obtained/executed with account holder which are in contravention to prescribed DP-Client agreement/NSDL guidelines?	☐ Yes ☐ No		
13.3	Whether Participant has collected requisite documents to claim waiver of settlement fees?	☐ Yes ☐ No		
13.4	Whether pledge and hypothecation instructions are processed as per prescribed procedure?	☐ Yes ☐ No		
13.5	Whether Participant has executed software utilities provided by NSDL on a monthly basis and taken appropriate action in respect of the exceptions identified?	☐ Yes ☐ No		
13.6	Whether all investors' grievances have been redressed?	☐ Yes ☐ No	If no, then give details of grievances pending redressal here	
13.7	Whether forms in use for various activities are as prescribed?	☐ Yes ☐ No	If no, then mention the forms and the discrepancies observed therein.	
13.8	Comment on improvements made in the operations since last audit			

14. System areas

14.1	Whether hardware and software installed on machines used for depository operations are as per the specifications mentioned in the latest Form B submitted to NSDL?	☐ Yes ☐ No	If no, then mention the mismatch	
14.2	Whether Participant is taking backup on a daily basis?	☐ Yes ☐ No		
14.3	Whether one copy of data backup is maintained at local site and another at remote site?	☐ Yes ☐ No		

14.4	Whether a separate set of backup media for even/odd dates (or day wise) is maintained to ensure that corruption of one media does not result in loss of all backups for that day?	☐ Yes ☐ No		
14.5	If backup is taken on a media other than DAT, NSDL's approval for this has been obtained?	☐ Yes ☐ No		
14.6	Whether updated anti virus is installed on the server and all the client machines?	☐ Yes ☐ No		
14.7	Whether ASR set/ERD is prepared as per prescribed guidelines?	☐ Yes ☐ No		
14.8	Whether robocopy feature is working on one client machine?	☐ Yes ☐ No		
14.9	Whether all the software installed on server and client machines are licensed?	☐ Yes ☐ No		
14.10	Whether RAID has been configured as per the prescribed guidelines?	☐ Yes ☐ No		
14.11	Whether database reorg and shrinking are done as per the prescribed guidelines?	☐ Yes ☐ No		
14.12	Whether scheduled switch to fall back connectivity is done and the record thereof is maintained?	☐ Yes ☐ No		
14.13	Whether all the hardware/equipments used for depository operations are covered under AMC/warranty?	☐ Yes ☐ No	If no, then mention whether the Participant has given the prescribed undertaking to NSDL?	
14.14	Whether UPS/alternate power arrangement is available for all the hardware/equipments used for depository operations?	☐ Yes ☐ No		
14.15	Whether adequate physical and logical access restrictions for usage of system are in place?	☐ Yes ☐ No		

14.16	Whether backup of back office data is taken?	☐ Yes ☐ No		
14.17	If back office is directly connected to DPM system, whether it is in accordance with NSDL guidelines?	☐ Yes ☐ No		
14.18	Whether atleast one staff managing the systems is NSDL trained?	☐ Yes ☐ No		

Management's Comment - Mandatory if auditor's observation is negative.

Audit Report in Electronic Form:

The Audit report may also be given in the electronic form and in the prescribed format . The auditors must sign the report using a class II or class III digital signature certificate (DSC) issued in his/her name and valid in terms of provisions of Information Technology Act, 2000 and rules framed there under

It may be noted that there are three types of digital signature certificates, viz., class I, class 2 and class 3

Class 1: These certificates do not hold any legal validity as the validation process is based only on a valid e-mail ID and involves no direct verification

Class 2: Here, the identity of a person is verified against a trusted, pre-verified database.

Class 3: This is the highest level where the person needs to present himself or herself in front of a Registration Authority (RA) and prove his/ her identity.

Internal and Concurrent Audit-CDSL

Internal Audit

The DP should ensure that an internal audit is conducted for the period ending 31st March and 30th September in respect of its operations relating to CDSL by an independent qualified Chartered Accountant or a Company Secretary in practice. A copy of the Internal Audit report should be furnished to CDSL by 15th May for half year ended 31st March and 15th November for half year ended 30th September.

Concurrent Audit

The DPs are required to conduct the concurrent audit of risk prone areas (as specified by CDSL from time to time) of their CDSL operations. The concurrent audit should be conducted by an independent firm of qualified Chartered Accountants or Company Secretaries holding a Certificate of Practice.

The internal and /or concurrent audit of risk prone areas of the DP should be conducted by an independent qualified Chartered Accountant or Company Secretary in practice. At least one person conducting the internal and /or concurrent audit of risk prone areas should be either BCCD(BSE Certificate on Central Depository)

certified or should have participated in the training programme conducted by CDSL. The report should contain a declaration to that effect.

Consolidated Report of Internal and Concurrent Audit

The DP shall submit only one report covering the 'Concurrent Audit of Risk Prone Areas' and 'Internal Audit Report'. If the Internal and Concurrent Auditor is the same for a DP, the internal auditor would specifically confirm 100% checking of areas to be covered under concurrent audit of risk prone areas.

If the Internal and Concurrent Auditor is different for a DP, the consolidated concurrent audit report for the six months should be attached along with the internal audit report.

Audit of Reconciliation of capital

Regulation 55A as inserted by SEBI (Depositories and Participants) (Second Amendment) Regulations, 2003 provides that every issuer shall submit an audit report on quarterly basis to the concerned stock exchanges audited by a qualified Chartered Accountant or practising company secretary, for the purposes of reconciliation of total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

Activities to do

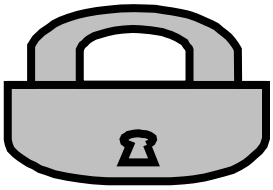
1. Reading and referring to Compliance Manual NSDL and CDSL
2. Reading and understanding the provisions of Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations 1996.

LESSON ROUND UP

- Just like a broker who act as an agent of the investor at the Stock Exchange; a Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository.

- The two Depository service provides in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDS) have allowed Company Secretaries in whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).
- The depository business in India is regulated by –
  - — The Depositories Act, 1996
  - — The SEBI (Depositories and Participants) Regulations, 1996
  - — Bye-laws of Depository
  - — Business Rules of Depository.
- Internal Audit of depository participants broadly covers the following ares:
  1. Account opening/closing/freezing/defreezing.
  2. Dematerialisation/Rematerialisation.
  3. Dealing with B.Os.
  4. Regulatory Compliances.
  5. Transfer/transmission.
  6. Internal Control etc.

SELF TEST QUESTIONS



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

1. State the role of Depository Participants (DPs).
2. Describe the scope and objectives of Internal Audit of Depository Participants.
3. Describe the terms ‘Corporate Action’, Dematerialisation and ‘rematerialisation’
4. Describe the procedure for conducting internal audit of depository participants.

STUDY VII

ISSUE OF DEPOSITARY RECEIPTS

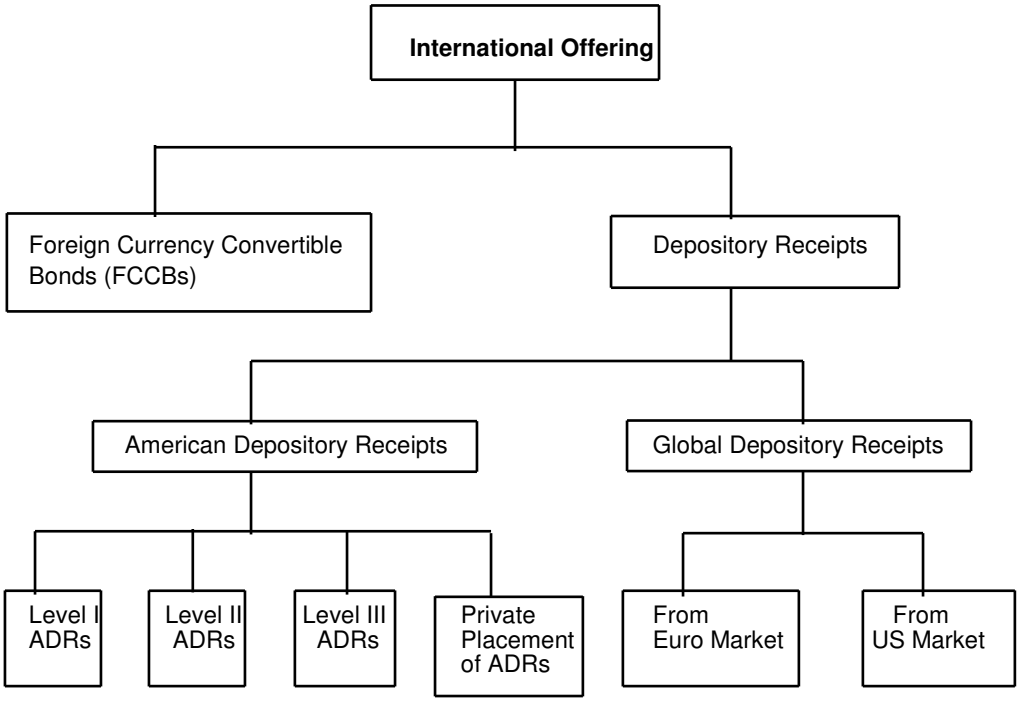
LEARNING OBJECTIVE

The objective of this study lesson is to enable the students to understand

- Concept and types of Depositary Receipts
- Sponsored Global Depositary Receipts/Global Depositary 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 Depositary Receipts/American Depositary 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.

Depositary Receipts (DRs) are negotiable securities issued outside India by a Depositary 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 Depositary 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 Satyam, 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 GDPs

- 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)*

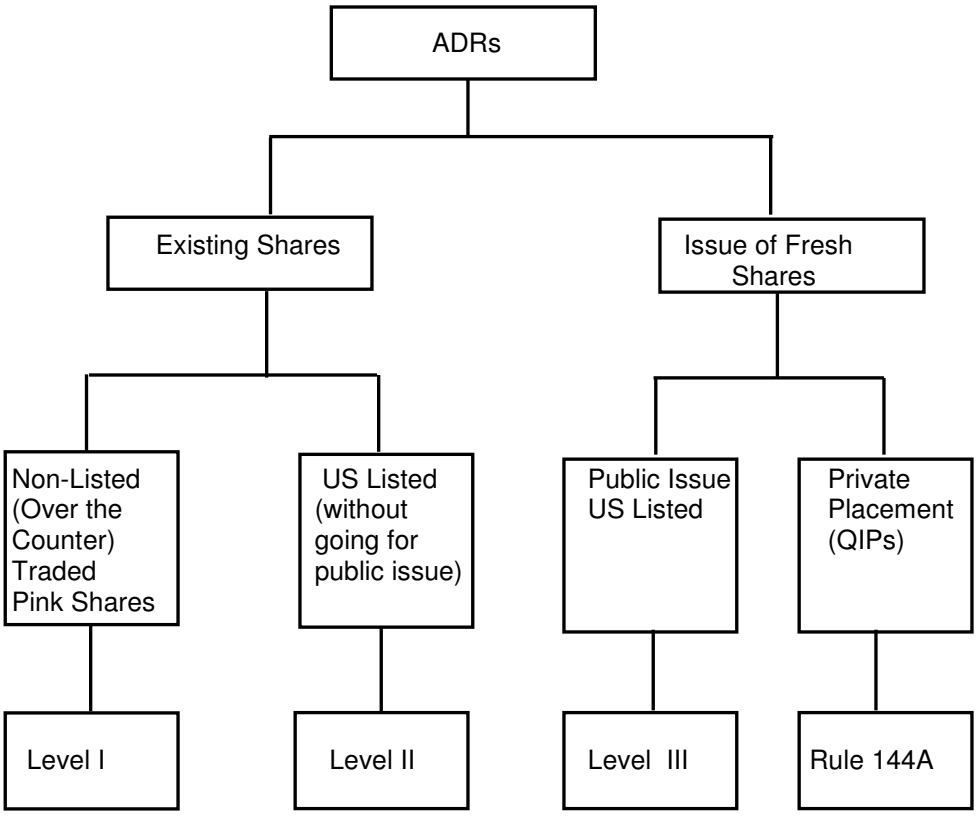
This is the least expensive level to provide for issuance of shares in ADR form in the US. The company issuing ADRs has to comply with the SEC registration requirements but can be exempted from full SEC reporting requirements under certain circumstances. It can only be traded over-the counter and cannot 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 Depositary Receipts (Privately placed for QIBs and cannot be bought on the public exchanges or over the counter.)



2. Global Depositary 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 Depositary 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 Depository 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.

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 Depositary Receipts in India are made under Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary 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 Depository Receipts) and rule 144A depositary receipts (i.e. depository 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 depository 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 depository bank against the deposit of securities of an Indian Company. The information is prepared by the company under the guidance of the depository bank at the inception of either an unsponsored or sponsored program. This has to be signed by both Issuer and depository and to be declared as effective before issuance of DRS. The depository 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 depositary 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 gets 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.

Particulars	*Level I ADR*	*Level II ADR*	*Level III ADR*	*Private Placement*
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 Depositary 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 Department of Company 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

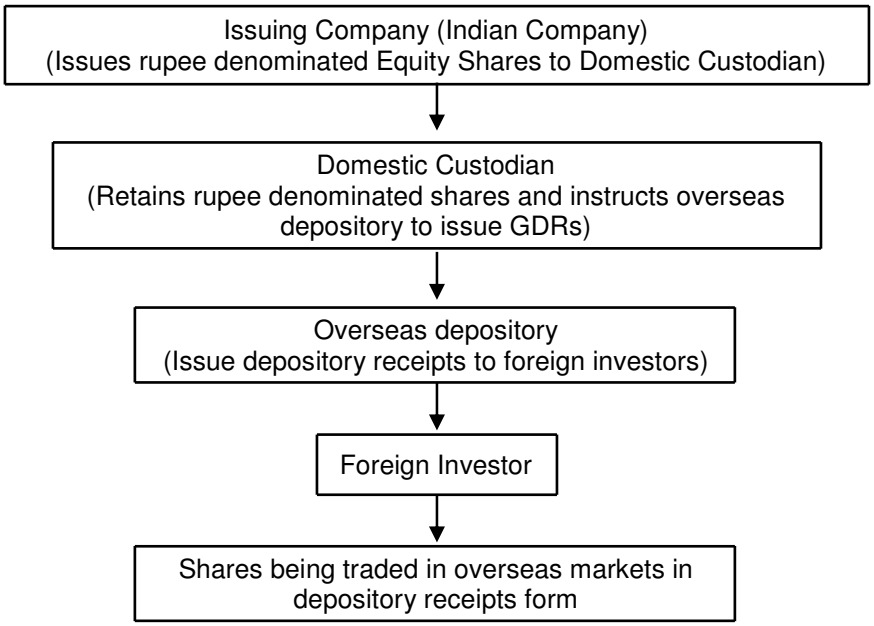
It covers registration documents in form F-6, form for registration of securities in form F-1 and F-6 for registration and

4. Process involved in the issue of GDRs

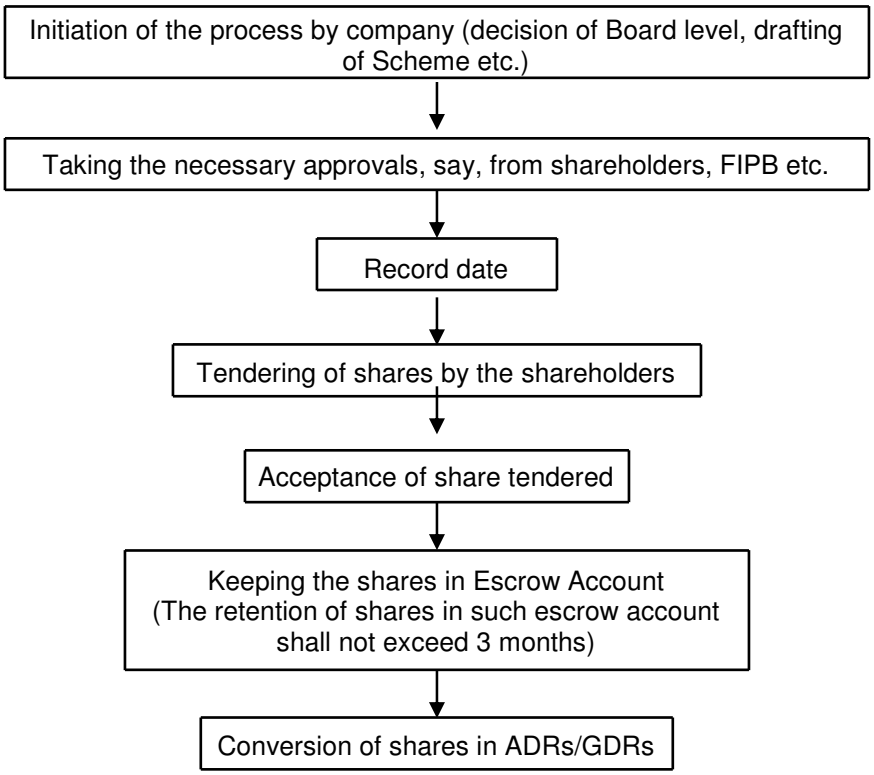
Following are the broad steps involved in GDR issue

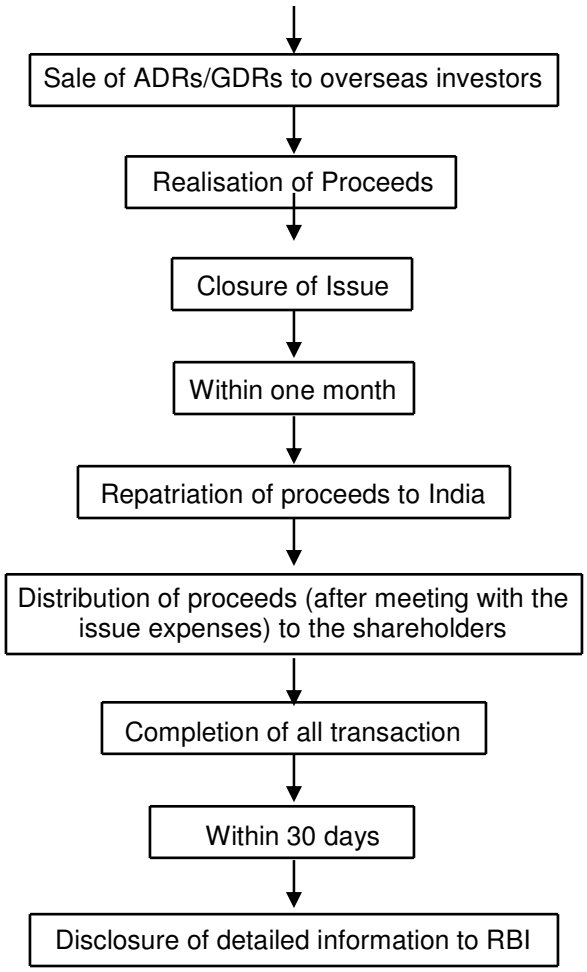
1. Indian company would issue rupee denominated shares to a depositary outside India, where the GDRs are proposed to be issued.
2. Indian custodian would keep these securities in his custody.
3. The investment banker would organize road shows for marketing the issue.
4. The foreign Depositary would issue 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 Depositary Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary 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 Depositary Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary 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(DIP) Guidelines 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 Depositary 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 Depositary Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993.

Further unlisted companies, which have already issued Global Depositary Receipts/Foreign Currency Convertible Bonds in the international market, would now require to list in the domestic market on making profit beginning financial year 2005-06 or within three years of such issue of Global Depositary Receipts/Foreign Currency Convertible Bonds, whichever is earlier.

5. Pricing

Listed Companies

Check whether the pricing of Global Depositary 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.

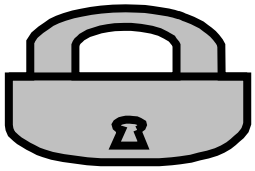
(b) Check whether re-issue of redeemed GDRs have complied with FEM (Transfer or Issue of Security by a person Resident Outside India) Regulations, 2000.

LESSON ROUND UP

- Global Depositary Receipts means any instrument in the form of a Depositary receipt or certificate (by whatever name it is called) created by the Overseas Depositary 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 Depositary receipts or certificates
- Overseas Depositary Bank means a bank authorised by the issuing company to issue global Depositary 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.

SELF TEST QUESTIONS



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

1. What are the various options for a company issuing Global Depositary Receipts?
2. Describe the SEC requirements in respect of GDRs proposed to be listed in US exchanges?
3. Write short notes on
   (a) Pink Sheets
   (b) Domestic Custodian Bank
   (c) Overseas Depositary
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?

STUDY VIII

INDIAN DEPOSITORY RECEIPTS

LEARNING OBJECTIVE

The objective of this study lesson is to enable the students to understand

- 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

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 Depositary 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

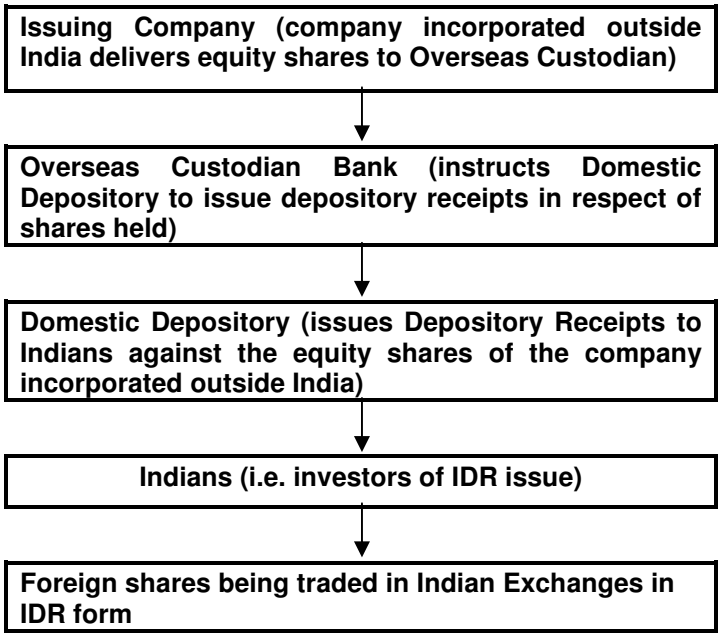
country outside India and which acts as custodian for the equity shares of Issuing Company, against which IDRs are proposed to be issued by having a custodial arrangement or agreement with the Domestic Depository or by establishing a place of business in India.

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



Recently Standard Chartered PLC came up with the IDRs and are being traded at BSE and NSE.

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 Rs. 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 FEMAAct, 1999

Q. What is the minium application amount for IDRs?

A. Minimum application amount in an IDR issue shall be Rs. 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 (Rule 4)

(a) 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;

(b) 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;

(c) 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;

(d) 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

(a) Check whether the issuing company has obtained prior permission from the SEBI for issuing IDRs.

(b) 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

(c) 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.

(d) 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.

(e) 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 authorizeed the domestic depository to issue IDRs.

(f) 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.

(g) 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

(a) Check whether the company has complied with FEMA and exchange control requirements in respect of redemption of IDRs especially with respect to provisions relating to export of foreign exchange.

(b) Check whether the following procedure has been followed while redemption of IDRs.

1. The resident holder of IDR contact Domestic Depository to redeem IDRs subject to the provision of FEMA.
2. Domestic Depository request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of Indian resident for being sold directly on behalf of Indian Resident or being transferred in the books of issuing company in the name of Indian Resident and
3. A copy of such request has to be sent to the issuing Company for information.

However, the IDRs issued by an issuing company may be purchased, possessed and transferred by a person other than a person resident in India if such Issuing Company obtains specific approval from Reserve Bank of India in this regard or complies with any policy or guidelines that may be issued by RBI on the subject matter

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.

Fungibility

The Indian depository Receipts shall not be automatically fungible into underlying equity shares of issuing company.

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.

(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. EDIFAR System

Check whether the company has filed necessary documents in the EDIFAR system.

6. 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.

7. 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.

8. 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.

9. Audit Qualifications

Check whether there are any qualifications in the Audit report? If so check whether it is published along with audited financial statements.

10. 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.

11. 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.

12. Equivalent Information

Check whether the Company has provided any information simultaneously, that was furnished to international exchanges

13. 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:

— 23(2) – imprisonment of 10 years or fine of Rs. 25 crores or both for non-compliance of conditions of listing.

— 23E of SCRA, 1956 – failure to comply with conditions of listing or delisting or committing a breach thereof – Rs. 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.

ANNEXURE A

LISTING AGREEMENT FOR IDRs - HIGHLIGHTS

Reference	*Subject matter*	*Requirement*
Clause 1	Share allotment; advices of rights entitlement	Allotment should be made simultaneously and that in the event of its being impossible to issue letters of regret at the same time, a notice to that effect will be inserted in the press so that it will appear on the morning after the letters of allotment have been posted; advices of rights entitlement, wherever applicable, should be issued simultaneously.
Clause 2	Intimation of date of Board Meeting	The Issuer is required to notify 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, proposal for declaration of any bonus issue etc.
Clause 3	Intimation after Board Meeting	The Issuer is required to, immediately after the meeting of its Board of Directors has been held to consider or decide the same, intimate to the Stock Exchange, (within 15 minutes of the closure of the board meeting) by phone, fax, telegram, e-mail about decision on

		recommendation/declaration of dividend, matters such as the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year etc.,
Clause 4	Intimation to stock exchange on dividend payment	The Issuer is required to notify the stock exchange at least twenty-one days in advance of the date on and from which the dividend on shares will be payable .
Clause 6	Intimation to Stock Exchange about increase of capital, re-issue of forfeited shares etc.,	The Issuer is required to within 15 minutes of the closure of any board meeting intimate to the Stock Exchanges by phone, fax, telegram, e-mail about short particulars of any increase of capital, 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, 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.
Clause 8	In-principal Approval/filing of certain documents with stock exchange on further issues	The issuer is required to obtain 'in-principle' approval for listing from the exchanges where its IDRs are listed, before issuing further IDRs. The issuer is required to submit documents such as copy of SEBI's observation letter on prospectus, due diligence report from domestic depository etc.
Clause 11	Intimation to Stock exchange on matters pertaining to constitution of Board, Auditor, Compliance Officer etc.	The issuer is required to notify promptly to the stock exchange about change in the constitution of Board, Managing Director, Compliance officer, Auditor, Domestic Depository etc.,
Clause 12	Forwarding copies of notices, annual reports etc to stock exchange	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 etc.,
Clause 14	Filing of shareholding pattern	The issuer is required to file with the Exchange the shareholding pattern on a quarterly basis within 15 days of end of the quarter in the prescribed form.
Clause 15		The Issuer is required to intimate 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.
Clause 20	Intimation on Variation on projected and actual profitability statement	The Issuer is required furnish 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.
Clause 23	Appointment of Company Secretary, undertaking of due diligence etc.	The Issuer is required to : (a) appoint the Company Secretary of the Issuer as Compliance Officer who will directly liaise with the authorities such as SEBI, Stock Ex-changes, 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. (b) undertake 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. (c) furnish a copy of agreement or MOU entered into with overseas custodian bank, domestic depository, merchant banker and RTA to the stock exchange

Clause 24	Corporate Governance	Requirements on (a) Composition of the Board (b) Non-executive directors' compensation and disclosures (c) Other provisions as to Board and Committees (d) Code of Conduct for the Board (e) Audit Committee, its meeting powers, role (f) Subsidiary companies (g) Disclosures (h) CEO/CFO Certification (i) Report on Corporate Governance (j) Compliance Certificate from Practising Company Secretary or auditors
Clause 34-38	Disclosure & publication of financial results	Disclosure depends on whether issuer opts to comply with Indian GAAP/US GAAP/ International Financial Reporting Standard (IFRS)
Clause 39	Equivalent information	Information furnished to any international stock exchanges has to be furnished to Indian Stock Exchanges where IDRs are listed.

Listing agreement for IDR issuers having its registered office situated in a country, the securities market regulator of which is a signatory to MMOU of IOSCO

In order to reduce the additional regulatory or cost burden to the issuers, it has been decided by SEBI to simplify the listing requirements applicable to the issuers from the countries which are the signatories of Multilateral Memorandum of Understanding (MMOU) of International Organization of Securities Commissions (IOSCO). Accordingly, SEBI has drafted a model listing agreement for IDR issuers having its registered office situated in a country, the securities market regulator of which is a signatory to MMOU of IOSCO. With respect to most of the provisions especially Corporate Governance requirements and disclosure of periodical results, the issuer is allowed to follow the home country requirements provided equitable treatment is given to the IDR holders vis-à-vis holders of equity shares. For the issuing companies from other jurisdictions, the existing model listing agreement for IDRs shall continue to apply till further advice in this regard.

Highlights

1. The Company should for all corporate actions (except those which are not permitted by Indian laws), will treat holders of IDRs (hereinafter referred to as

"IDR Holders"), in a manner equitable with the holders of its equity shares in the home country;

2. The issuing company is required to notify the stock exchange at the same time it intimates to any other exchange, where its equity shares are listed, regarding the meeting, at which matters such as the recommendation or declaration of dividend or rights issue or issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend and any decision on buy back of equity shares of the issuing company, are due to be considered.
3. The issuing company is required to intimate to the stock exchange after the meeting of its Board of Directors has been held to consider or decide the following, at the same time and to the extent it intimates the same to the listing authority in its home country or other jurisdictions where its securities may be listed, by electronic filing:
   (a) all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or cash bonus; and
   (b) the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for any dividend, even if this calls for qualification that such information is provisional or subject to audit.
4. The issuing company is required to notify the stock exchange at least seven working days in advance of the record date for the corporate actions like rights, bonus, splits and payment of any dividend to IDR Holders. The issuing company further agrees that the process for setting a record date for any corporate action will be disclosed in the offer document and prior intimation will be provided to the stock exchange and in the media if this process changes.
5. The issuing company is required to pay the dividend as per the timeframe applicable in its home country or other jurisdictions where its securities are listed, whichever is earlier, so as to reach the IDR Holders on or before the date fixed for payment of dividend to holders of its equity share or other securities.
6. The issuing company is required to promptly disclose to the stock exchanges the following by electronic filing:
   (a) short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by rights issue of equity shares, or in any other manner;
   (b) 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;
   (c) short particulars of any other alterations of capital, including calls; and
   (d) any other information necessary to enable the IDR Holders to appraise the issuing company's position and to avoid the establishment of a false market in IDRs;

7. The issuing company is required to declare that the underlying equity shares, against which the IDRs are issued, have been/will be listed in its home country before the listing of IDRs in the stock exchange;
8. The issuing company is required to obtain 'in-principle' approval for listing from the stock exchanges where its IDRs are listed, before issuing further IDRs and to make an application to the stock exchange for the listing such further IDRs;
9. The issuing company agrees that it will promptly notify the stock exchange at the same time where it notifies to comply with listing requirements of home country or other jurisdictions where its securities may be listed any change in the Board, Auditors etc.
10. The company is to required to forward the Annual Report/notices etc at the same time and as to the extent that it discloses to holders of securities in its home country or in other jurisdictions where such securities are listed.
11. The issuing company agrees to file with the stock exchange the pattern of IDR Holders on a quarterly basis within 15 days of end of the quarter in the prescribed form.
12. The issuing company is required to comply with the Corporate Governance provisions as applicable in its home country and other jurisdictions in which its equity shares are listed. Further the issuing company hereby agrees to file a comparative analysis of the corporate governance provisions that are applicable in its home country and in the other jurisdictions in which its equity shares are listed along with the compliance of the same vis-à-vis the corporate governance provisions applicable to Indian listed companies. The said report shall be filed at the time of filing the annual reports with stock exchange.
13. The Company is required to comply with Indian GAAP or International Financial Reporting Standards (IFRS) or US GAAP in the preparation and disclosure of its financial results.

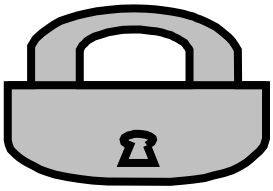
LESSON ROUND UP

- 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



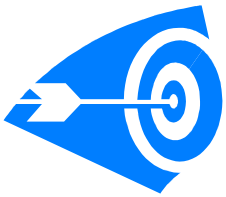
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What do you mean by Indian Depository Receipts. Briefly explain the salient features of Companies (Issue of Indian Depository Receipts) Rules, 2004.
2. What are the procedures for making an issue of Indian Depository Receipts?
3. Explain the procedure for carrying out due diligence of IDR issue.

STUDY IX

SETTING UP OF BUSINESS UNITS AND JOINT VENTURES IN INDIA

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- Concept and types of foreign investments in India
- Various entry options available for foreign investment
- Foreign Direct Investment Policy
- Procedure for setting up of joint venture
- Checklist in respect of setting up joint ventures
- Setting up of Branch, Liaison and project offices

I. FOREIGN INVESTMENTS IN INDIA

Introduction

A series of ambitious economic reforms aimed at deregulating the economy and stimulating foreign investment has moved India firmly into the front runners of the rapidly growing Asia Pacific Region and unleashed the latent strength of a complex and rapidly changing nation. Today India is one of the most exciting emerging markets in the world. Skilled managerial and technical manpower that matches the best available in the world and a middle class whose size exceeds the population of the USA or the European Union, provide India with a distinct cutting edge in global competition. India's time tested institutions offer foreign investors a transparent environment that guarantees the security of their long term investments. These include a free and vibrant press, a well established judiciary, a sophisticated legal and accounting system and a user friendly intellectual infrastructure. India's dynamic and highly competitive private sector has long been the backbone of its economic activity and offers considerable scope for foreign direct investment, joint ventures and collaborations.

Before setting up a business entity, the foreign investor has to consider the factors such as the eligibility, fund raising avenues, special concessions, tax implications, different options in terms of form of business such as company, branch office etc, incentives and exemptions available, industry specific requirement, specific area requirements (State laws) etc.

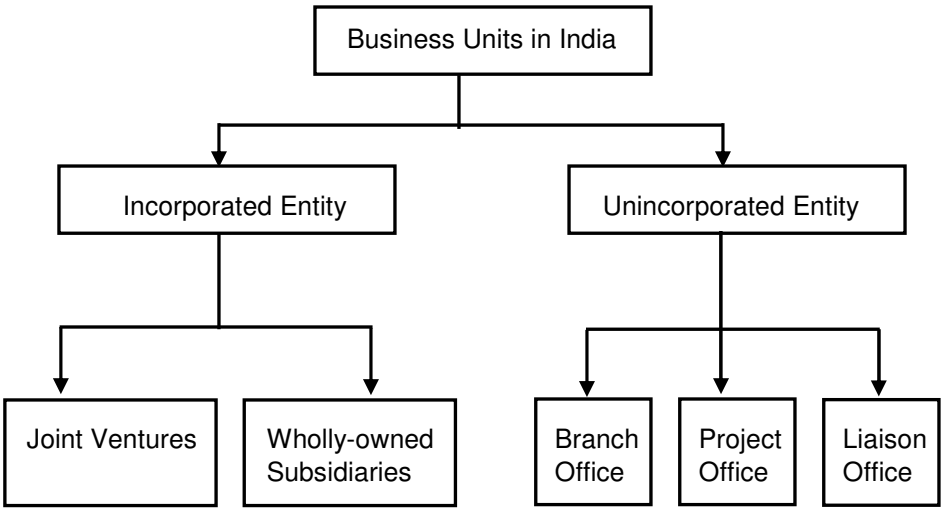
Statutory Basis

Foreign Direct Investment by non-resident in resident entities through transfer or

issue of security to person resident outside India is a 'Capital account transaction' and is regulated under FEMA, 1999 and its regulations. Keeping in view the current requirements, the Government from time to time comes up with new regulations and amendments/changes in the existing ones through order/allied rules, Press Notes, etc. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India makes policy pronouncements on FDI through Press Notes/ Press Releases which are notified by the Reserve Bank of India as amendment to notification No.FEMA 20/2000-RB dated May 3, 2000. These notifications take effect from the date of issue of Press Notes/ Press Releases, unless specified otherwise therein. The procedural instructions are issued by the Reserve Bank of India vide A.P.Dir. (series) Circulars. The regulatory framework over a period of time thus consists of Acts, Regulations, Press Notes, Press Releases, Clarifications, etc.The Circular 1 of 2010 issued by this Department on 31st March 2010 and consolidated into one document all the prior policies/regulations on FDI which are contained in FEMA, 1999, RBI Regulations under FEMA, 1999 and Press Notes/Press Releases/Clarifications issued by DIPP and reflected the current policy framework on FDI.. The present consolidation subsumes and supersedes all Press Notes/Press Releases/Clarifications/ Circulars issued by DIPP, which were in force as on September 30th, 2010, and reflects the FDI Policy as on October 1st, 2010. This Circular accordingly has taken effect from October 1, 2010. While this circular consolidates FDI Policy Framework, the legal edifice is built on notifications issued by RBI under FEMA. Therefore, any changes notified by RBI from time to time would have to be complied with and where there is a need / scope of interpretation, the relevant FEMA notification will prevail.

Entry Options

A foreign company planning to set up business operations in India has the following entry options:



WHO CAN INVEST IN INDIA?

A non-resident entity can invest in India, subject to the FDI Policy.

A citizen of Pakistan or an entity incorporated in Pakistan

What about citizens of Bangladesh, Nepal and Bhutan?

A citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI Policy, only under the Government route. NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

What about OCBs and FIIs?

OCBs have been derecognized as a class of Investors in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under the adverse notice of RBI can make fresh investments under FDI Policy as incorporated non-resident entities, with the prior approval of Government of India if the investment is through Government route; and with the prior approval of RBI if the investment is through Automatic route.

An FII may invest in the capital of an Indian company either under the FDI Scheme/Policy or the Portfolio Investment Scheme. 10% individual limit and 24% aggregate limit for FII investment would still be applicable even when FIIs invest under the FDI scheme/policy.

Foreign Direct Investment Policy in India

Taking journey from 1991-2010,The Government policy on Foreign Direct Investment now freely allows FDI in all sectors including the services sector, except a few sectors where the existing and notified sectoral policy does not permit FDI beyond a ceiling. FDI for virtually all items/activities can be brought in through the Automatic Route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through Government approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board (FIPB).

Foreign Direct Investment by non-resident in resident entities through transfer or issue of security to person resident outside India is a 'Capital account transaction' and Government of India and Reserve Bank of India regulate this under the FEMA, 1999 and its various regulations. Keeping in view the current requirements, the Government from time to time comes up with new regulations and amendments/changes in the existing ones through order/allied rules, Press Notes, etc. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce &Industry, Government of India makes policy pronouncements on FDI through Press Notes/ Press Releases which are notified by the Reserve Bank of India as amendment to notification No.FEMA 20/2000-RB dated May 3, 2000. The Government has issued FDI policy consolidating all the press notes, rules notifications etc., which is effective from April 01, 2010. This consolidated policy got updated through press note 2 dated September 30, 2010 by Department of Industrial Policy and Promotion

Definition of FDI under Consolidated Policy of Government Of India

Under the consolidated FDI policy issued by Government of India, '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.

Definition of FDI across countries is not comparable

OECD

As per OECD, the main financial instrument components of FDI are equity and debt instruments. Equity includes common and preferred shares (exclusive of non-participating preference shares which should be included under debt), reserves, capital contributions and reinvestment of earnings.

Dividends, distributed branch earnings, reinvested earnings and undistributed branch earnings are components of FDI income on equity.

Debt instruments include marketable securities such as bonds, debentures, commercial paper, promissory notes, non-participating preference shares and other tradable non-equity securities as well as loans, deposits, trade credit and other accounts payable/ receivable.

All cross-border positions and transactions related to these instruments, between enterprises covered by an FDI relationship other than between related financial intermediaries are included in FDI.

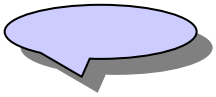
The interest returns on the above instruments are included in FDI income on debt. Positions and transactions in financial derivatives between entities in a direct investment relationship should be excluded from direct investment

UNCTAD

As per UNCTAD, the components of FDI are equity capital, reinvested earnings and other capital (mainly intra-company loans). Other than having an equity stake in an enterprise, there are many other ways in which foreign investors may acquire an

effective voice. Those include subcontracting, management contracts, turnkey arrangements, franchising, leasing, licensing and production-sharing.

Foreign Direct Investment – A restricted Definition in India!!!



Under FDI policy of India 'FDI' includes

- 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.
- GDRs and ADRs.

FDI does not include

- reinvested earnings dividend etc.
- Partly paid shares, warrants(Issue of these instruments requires government approval irrespective of sectoral cap)

Prohibited sectors for Foreign Investment

FDI is prohibited in the following activities/sectors:

(a) Retail Trading (except single brand product retailing)
(b) Lottery Business including Government /private lottery, online lotteries,etc.
(c) Gambling and Betting including casinos etc.
(d) Business of chit fund
(e) Nidhi company
(f) Trading in Transferable Development Rights (TDRs)
(g) Real Estate Business or Construction of Farm Houses
(h) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
(i) Activities/sectors not opened to private sector investment including Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems).

Besides foreign investment in any form, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also completely prohibited for Lottery Business and Gambling and Betting activities.

CALCULATION OF TOTAL FOREIGN INVESTMENT

Foreign Direct and Indirect Investment

Investment in Indian companies can be made both by non-resident as well as resident Indian entities. Any non-resident investment in an Indian company is direct foreign investment. Investment by resident Indian entities could again comprise of

both resident and non-resident investment. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it. The indirect investment can be a cascading investment i.e. through multi-layered structure also.

For the purpose of computation of indirect Foreign investment, Foreign Investment in Indian company shall include all types of foreign investments i.e. FDI; investment by FIIs(holding as on March 31); NRIs; ADRs; GDRs; Foreign Currency Convertible Bonds (FCCB); fully, compulsorily and mandatorily convertible preference shares and fully,compulsorily and mandatorily convertible Debentures regardless of whether the said investments have been made under Schedule 1, 2, 3 and 6 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations.All investment directly by a non-resident entity into the Indian company would be counted towards foreign investment.

Calculation of Total Foreign Investment.

(i) Counting the Direct Foreign Investment:

All investment directly by a nonresident entity into the Indian company would be counted towards foreign investment.

(ii) Counting of indirect foreign Investment:

It is not foreign indirect investment if 'owned and controlled' by resident Indian citizens and/or Indian Companies

The foreign investment through the investing Indian company would not be considered for calculation of the indirect foreign investment in case of Indian companies which are 'owned **and** controlled' by resident Indian citizens and/or Indian Companies which are owned and controlled by resident Indian citizens .

It is foreign indirect investment it is owned and controlled by non-resident Entities

If the investing company is owned **or** controlled by 'non resident entities', the entire investment by the investing company into the subject Indian Company would be considered as indirect foreign investment,

Exception

Provided that, as an exception, the indirect foreign investment in only the 100% owned subsidiaries of operating-cum-investing/investing companies, will be limited to the foreign investment in the operating-cum-investing/ investing company. This exception is made since the downstream investment of a 100% owned subsidiary of the holding company is akin to investment made by the holding company and the downstream investment should be a mirror image of the holding company. This exception, however, is strictly for those cases where the entire capital of the downstream subsidy is owned by the holding company.(Refer to illustration for clarity)

What is owned or controlled?

A company is considered as 'Owned' by resident Indian citizens if more than

50% of the capital in it is beneficially owned by resident Indian citizens and / or Indian companies, which are ultimately owned and controlled by resident Indian citizens;

An entity is considered as 'Owned' by 'non resident entities', if more than 50% of the capital in it is beneficially owned by non-residents.

A company is considered as "Controlled" by resident Indian citizens if the resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, have the power to appoint a majority of its directors in that company .

An entity is considered as 'Controlled' by 'non resident entities', if non residents have the power to appoint a majority of its directors

Illustration on calculation of foreign investmnet

To illustrate, if the indirect foreign investment is being calculated for Company X which has investment through an investing Company Y having foreign investment, the following would be the method of calculation:

(A) where Company Y has foreign investment less than 50%- Company X would not be taken as having any indirect foreign investment through Company Y.

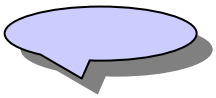
(B) where Company Y has foreign investment of say 75% and:

(i) invests 26% in Company X, the entire 26% investment by Company Y would be treated as indirect foreign investment in Company X;

(ii) Invests 80% in Company X, the indirect foreign investment in Company X would be taken as 80%

(iii) where Company X is a wholly owned subsidiary of Company Y (i.e. Company Y owns 100% shares of Company X), then only 75% would be treated as indirect foreign equity and the balance 25% would be treated as resident held equity. The indirect foreign equity in Company X would be computed in the ratio of 75: 25 in the total investment of Company Y in Company X.

Calculation of total foreign investment



Total foreign investment = Foreign Direct investment+ Foreign indirect investment

Foreign Direct Investment = All investment directly by a nonresident entity into the Indian company

Foreign Indirect Investment = All investment by Indian Company which are owned and controlled by non-residents.

FOREIGN INVESTMENT UNDER AUTOMATIC/APPROVAL ROUTES

Foreign Investment may be made under

- Automatic Route(Reporting of FDI to RBI)
- Approval route(with approval of Foreign Investment Promotion Board)

Under the Automatic Route, the foreign investor or the Indian company does not require any approval from the Reserve Bank or Foreign Investment Promotion Board for the investment.

Under the Government Route, prior approval Foreign Investment Promotion Board (FIPB) is required.

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

Reporting of Inflow

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 Rs.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 replaces 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 05.

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 prioritised.
  - (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.

It may be noted that the FDI policy aims at protecting the interests of joint venture partners of agreements entered into, prior to January 12, 2005. Where a non-resident investor has an existing joint venture/ technology transfer/ trademark agreement, as on January 12, 2005, new proposals in the same field for investment/technology transfer/technology collaboration/trademark agreement would have to be under the Government approval route through FIPB/ Project Approval Board. The onus to provide requisite justification that the new proposal would not jeopardize the existing joint venture or technology transfer/ trademark partner, would lie equally on the non-resident investor/ technology supplier and the Indian partner.

Foreign collaboration agreements, both financial and technical, entered into after January 12, 2005, have been exempted from this stipulation. This is because such joint venture agreements are expected to include a 'conflict of interest' clause, so as to safeguard the interests of joint venture partners, in the event of one of the partners desiring to set up another joint venture or a wholly owned subsidiary in the same field of economic activity.

JOINT VENTURES IN INDIA

Joint Ventures and Foreign Collaborations are important business models which become more popular with the opening up of the economies in the context of liberalization, competition and globalization.

A joint venture is a partnership through which two or more firms create a separate entity to carryout a particular economic activity in which each partner takes an active role in decision making. The essential features of joint ventures may be classified as:

(a) an agreement between the parties on common long term objectives such as production, sales, financing etc.

(b) pooling of assets, IPRs and other facilities for achievement of agreed objectives

(c) sharing of profits.

Joint ventures are considered appropriate when complementary needs exist between companies and there is compatibility with the strategies.

Joint Venture (JV) and Wholly Owned Subsidiary have been defined in the Foreign Exchange Management (Transfer and Issue of Foreign Security) Regulations, 2000 as under:

> Joint Venture (JV) means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment
>
> In recent years, the term "joint venture" has also been used interchangeably with a newer business vehicle called the "strategic alliance".

A strategic alliance is a specific form of collaboration between two or more companies. Strategic alliances with stronger overseas partners can provide a means of overcoming the problems of small size and lack of resources faced by some companies.

Features of a joint venture

Besides the requirement that a joint venture must have a contractual basis, there are certain additional requisites for the successful existence of a joint venture. Although its existence depends on the facts and circumstances of each particular case, generally the following factors must be present:

(a) Contribution by the parties in the form of money, property, effort, knowledge, skill and other assets to a common understanding;

(b) a joint property interest in the subject matter of the venture;

(c) a right of mutual control or management of the enterprise;

(d) expectation of profit;

(e) a right to participate in the profits;

(f) most usually, limitation of the objective to a single undertaking; and

(g) clear understanding of formation, performance and exit mechanism between joint venture parties.

How Does a Joint Venture Work?

— A successful joint venture is one where each partner contributes complementary skills and resources in an ongoing relationship offering mutual benefits.

— Much depends on what the two parties have to offer each other, and how these assets can be put together in a workable business structure.

— While there is no set formula for putting together a joint venture, a typical arrangement might be as follows:

1. One of the partners contributes, manufacturing technology, product know-how, patents (if any), business expertise, technical training and management.

2. The partner in the market may contribute an existing plant and facilities, local management and staff, knowledge of the local market(including distribution and sales resources), and relationships with the government, financial institutions and other groups.

3. Both partners contribute capital to establish the venture, ongoing financial support, responsibility for marketing key management decisions.

This would be particularly appropriate for joint ventures in developing countries where technology transfer is the major benefit sought by the local economy. The export of finished goods or materials may or may not be part of this package. By building a structure that reinforces each other's respective strengths, and creating synergy, a better overall result is obtained than could be achieved by each partner independently.

Preliminary considerations

— **Selection:** Selection of an appropriate co-venturer can have long lasting implications for the operation and success of the venture as the ability of the co-managing parties to co-exist and make unanimous decisions is essential to the success of a joint venture. The potential parties should identify their mutual interest and establish a common objective.

— **Setting out the objectives and expectations:** Setting out the objectives and expectations of the venture is pre-requisite. It is essential that the nature, scope and duration of the joint venture be identified.

— **Employ competent professionals:** Competent professional like CS, Legal experts experienced in drafting joint venture and strategic alliance agreements should be retained as consultants, to structure the deal with proper legal advice. Professionals can assist the parties to structure a legal agreement which reflects the deal and properly addresses the subject matter and should be able to assist the parties in understanding their strengths, intentions and problems and in ensuring that the parties' goals are compatible. They can also structure an agreement which can assist the parties in terminating the relationship with minimal disruption.

— **Negotiation:** It is appropriate that negotiations be conducted at the level of more senior management. It is desirable to have negotiating teams consisting of senior management together with management responsible for implementing the alliance. This will assist in establishing the requisite internal consensus.

— **Attitude:** Negotiations for alliances should not be entered into with an adverse approach to the opposing party. This is never productive or efficient in the negotiation of any normal commercial arrangement. Adversarial negotiations when entering into strategic alliance and joint venture agreements is always' disruptive and counterproductive.

— **MOU:** The next step is to prepare memorandum of understanding, setting out the objectives of the joint venture prior to finalising the joint venture agreement. The MOU may set out the key features of the proposed joint venture arrangements and can represent a broad outline of the definitive agreement. In addition to prescribing fundamental business terms, the MOU often provides for at least two other binding commitments, namely, for the exclusivity of negotiations for a stated period of time and confidentiality.

— **Due Diligence:** After the parties have agreed on the basic terms of the joint venture arrangement a fixed period of time is often set in which to conduct a detailed and comprehensive review of all information pertinent to the proposed business venture prior to the execution of the joint venture agreement. This process is referred to as "due diligence". !n technology-driven industries and other industries where intellectual property is an important element of the joint venture due diligence plays an essential role in evaluating the technology and intellectual property assets and assessing their validity.

Reasons for entering into a joint venture

Parties looking for an appropriate business vehicle often seek out a joint venture arrangement because of the benefits it affords with respect to the limitation of liability of the parties to the venture. The reasons for creating a joint venture could be stated as the ability to combine the strengths, expertise, technology, and know-how of separate businesses with a sharing of investment costs and risks.

The following list is a summary of other motivations for entering into a joint venture:

— A company may want to enter into a foreign market with which it is not familiar.

— The joint venture allows the parties to the venture to undertake a potentially speculative and high-risk endeavour without exposing assets to unlimited liability.

— The joint venturing parties can define at the outset of the project, the extent to which each shall be liable for costs and how the risks associated with the venture shall be allocated.

— A joint venture can offer flexibility in distributing operational responsibilities authority and facilitate use of the strengths of each party to the venture.

— A joint venture may be entered into for competitive considerations for example a joint venture with a potential competitor may reduce or eliminate competition.

Benefits of Joint Venture

— Sharing of risks;

— Access to technology/ R &D/markets;

— Access to foreign capital;

— Reduction of manufacturing costs and other overheads including expenditure on R & D;

— Complimentary skills/resources;

— New technology or products or capital.

— To kill competition.

Risk involved

A joint venture involves co-ownership and co-management. This may result in

disturbance in consultative decision-making. This is particularly true with respect to joint ventures where there is 50/50 ownership and/or control. This type of ownership or management structure lends itself to an increasing risk of deadlock amongst decision-makers. However, it is possible for parties contemplating entering into a joint venture to anticipate these decision-making hurdles and to provide safeguards or procedures to be followed to ensure that conflict amongst the participants in the venture does not paralyse the operation of the joint venture.

Critical Success Factors

Followings are the key factors in successful JV operation:

— Rapport between the two partners - get to know each other and fully recognise, understand and accept the other's requirements in advance.

— Communication channels must be kept open and agreed reporting timetables and format adhered to.

— Positive results for both partners with a reasonable and agreed timeframe.

One of the key attractions of joint ventures is their flexibility. They can be moulded and shaped in a variety of ways to suit the specific needs of the partners and of the markets. It is common to enter into a joint venture after tried other options such as on consortium arrangement etc., or many a casts, successful joint ventures are formed with known suppliers and subcontractors.

Disadvantages of a Joint Venture

— Potentially high capital cost plus ongoing financial support are required

— Profitable returns may take some time to achieve

— High level of commitment of staff and management takes time

— Time consuming (especially where a new venture is involved)

— Potential for conflict between joint venture partners

— Cultural differences and communications difficulties

— A minority equity position may work against partner

— Difficult to get out of it quickly, if desired

— Working in a different legal and commercial system

— Political risks in the country where the joint venture is based

Laws Applicable

— Companies Act, 1956;

— Partnership Act;

— Policy for Foreign Investment (FEMA Regulations); MRTP,

— Industrial Policy and procedures; SEBI Guidelines; contract Act etc.

— Competition Act, 2002

— Foreign Trade (Development and Regulation) Act, 1992

Structuring of JV

— Identify Strategic & Operational issues,

- Execution of MOU/ Principle terms,
- Due-diligence (legal & financial),
- Documentation

1. Strategic issues
   - To define objectives (whether the JV would be manufacturing, or simply marketing);
   - Key support from the Partners, on what terms ?
   - Key decisions how to be taken and implemented.
2. Operational Issues
   - Day-to-day management rights,
   - internal policy systems including reporting requirements,
   - Audit and information rights.
   - Deliberate and agree upon all strategic and operational issues;
3. Execute a formal Memorandum of Understanding/Principle terms of agreement, to cover atleast,
   - Objective of the JV,
   - Broad form of partnership;
   - Identify a way forward in the event of disagreement on any issue before closing.
4. Carry out due-diligence on the following:
   - Company's background and history,
   - Financial, Tax and Accounting,
   - Manufacturing, Marketing & Distribution,
   - Major contracts, licenses and approvals,
   - Corporate compliance,
   - Litigations by or against the company,
   - Ownership of assets including intellectual property.
   - Borrowings/loan documents.
   - IPR

Steps to a Joint Venture

1. Recognise your options - Identify different methods that can be adopted for entering into the venture
2. Determine the resources you can commit
   - Time
   - Money
   - People
3. Select and understand your market
   - Consumer research to pinpoint the opportunities

— Comprehensive assessment of the investment and legal environment to justify the risks and establish the costs of the proposed joint venture.

4. Determine a joint venture strategy
   — What type of joint venture
   — Where
   — With whom
   — What time-frame
   — How much will it cost
5. Determine the objectives of the joint venture
   — What do you hope to gain from the joint venture?
   — What does you partner hope to gain?
   — What will the joint venture actually do?
6. Select a Partner
   — Identify USP (Unique setting points) of both the parties
   — Compatibility is crucial
   — Take time to get to know each other
   — Understand each other's expectations
7. Exchange letters
8. Feasibility study:
   (a) Establish a business structure
      — What legal structure will the joint venture have - incorporated, unincorporated?
      — How will it work?
      — What is the equity basis?
      — Who is responsible for what?
      — What needs to be put in place?
   (b) Resolve investment and legal Issues - often a time consuming process
      — What rules and approvals must the joint venture comply with?
      — What tax implications are there?
      — How will the profits be remitted back.
   (c) Evaluate potential investment sites
      — Physical location of joint venture
      — What purchases will need to be made - land, buildings, equipment
   (d) Jurisdictions?
   (e) Dispute resolution mechanism.
9. Agreement in Principle
10. Negotiation
11. Finalising major points to be covered in the Agreement - Performance Targets and Exit Clauses - it is important to think about these at the

beginning of the relationship when you and your partner are on good terms.

12. Joint Venture Agreement
13. Staged implementation
14. Full operationalisation
15. Review
16. Expansion, if any
17. Steps if the Joint Venture Runs into Difficulties
    - Arbitration
    - Quitting
    - Dissolution

Joint Venture agreements and the Competition Act, 2002

(i) Licencing agreements

The provisions relating to anti-competitive agreements under the Competition Act, 2002 does not restrict the right of any person, to restrain any infringement of intellectual property rights or to impose such reasonable conditions as may be necessary for the purposes of protecting any of his rights which have been or may be conferred upon him under the following legislations relating to intellectual property right—

- the Copyright Act, 1957;
- the Patents Act, 1970;
- the Trade and Merchandise Marks Act, 1958 or the Trade Marks Act, 1999;
- the Geographical Indications of Goods (Registration and Protection) Act, 1999;
- the Designs Act, 2000;
- the Semi-conductor Integrated Circuits Layout-Design Act, 2000.

These, Intellectual property legislations confer exclusive rights on holders of patents, copyright, design rights, registered trademarks and other related rights protected by law. A holder of intellectual property rights is authorised to prevent any unauthorized used of its intellectual property and to exploit such property, in particular by licensing it to third parties. Thus, the technology transfer agreements which involves licensing of technology are outside the purview of Section 3 prohibition. It is presumed that such agreements usually improve economic efficiency and are pro-competitive as they can reduce duplication of research and development, strengthen the incentive for the initial research and development, spur incremental innovation, facilitate diffusion and generate product market competition.

However, licensing agreements may also be used for anti-competitive purposes, e.g. where two competitors use a licensing agreement to share out markets between themselves or where an important licence holder excludes competing technologies from the market.

(ii) Joint Venture Agreements

It has been clarified that any agreement entered into by way of joint ventures

shall not be prohibited by Section 3(1) of Competition Act, 2002 if such agreements increase efficiency in production, supply, distribution, storage, acquisition or control of goods or provisions of services.

SAMPLE CHECK-LIST ON JOINT VENTURES IN INDIA

Checklist – Financial Collaboration

Joint Venture in India can be either by setting up a new company or by investing into an existing company.

In either case, the following check list (not exhaustive) has to be looked into:

1. Check FEMA Provisions for investment in India i.e. Foreign Direct Investment Policy as well as FEMA Regulations. Investment in India is regulated by Reserve Bank of India through Notifications, Circulars and Press Notes within the broad framework of the FDI Policy.

   (a) *Prohibited Sectors:* RBI has specified certain sectors where investment is prohibited.

   (b) *Automatic Route:* Foreign Direct Investment is allowed in almost all sectors under Automatic route, within sectoral caps prescribed. RBI has prescribed Form FC-GPR for reporting shares issued to the Foreign Investors by an Indian company, not later than 30 days from the date of issue of shares.

   (c) *Approval Route:* Investment which does not qualify under Automatic route, has to go for government approval.

   Further, where such investment does not conform to policies of Government of India, a specific approval from Government must be sought. For example, there are Government guidelines on location of industrial units, or there are certain items like explosives or liquor that need an industrial licence. If the Indian company does not conform to the locational guidelines or small scale policy or needs an Industrial licence or investment beyond sectoral cap, then it cannot issue shares under the Automatic Route. If for any of the reasons mentioned above, the Indian company cannot issue shares to foreign investors under the Automatic Route, an application may be made to Secretariat for Industrial Assistance (SIA), Ministry of Commerce & Industry, Government of India, Udyog Bhavan, New Delhi or Foreign Investment Promotion Board (FIPB). (Form FC-IL has been prescribed for this purpose. However, a plain paper application is also accepted). If the unit is located in any of the Export Processing Zones, applications should be made to the Development Commissioner of the Export Processing Zone concerned.

2. Check whether Board resolution under section 292 as well as authorizing the Board to enter into Agreement and obtaining approvals from RBI/FIPB, as applicable has been passed

3. Check whether General Meeting resolution as required under Section 372A has been passed for inter-corporate investments, if required.

4. Check joint venture agreement is drafted meticulously

5. In case a new Company is being set up in India, the following steps has to be followed:
    1. Check Board resolution of the body corporate established abroad.
    2. Check the Constitution of the body corporate
    3. Check the Confirmation of inward remittance of the body corporate's shareholding amount
    4. Check the incorporation and other procedural matters.
6. In case the investment to be made in India is in an existing company:
    1. Check the Board resolution of the body corporate established abroad.
    2. Check the Constitution of the body corporate
    3. Check the Confirmation of inward remittance of the body corporate's shareholding amount
    4. In case fresh allotment of shares is being made, applicable Companies Act provisions and related SEBI guidelines as applicable FEMA regulations, are required to be complied with.
    5. In case transfer of shares is being made to the body corporate abroad, check that the transfer of shares guidelines specified in Notification No. FEMA 20/2000-RB dated 3rd May, 2000 as amended from time to time, are complied with. Obtain certificate from the Authorised Dealer in Form FC-TRS and record the details in the company's register of transfers.
    6. If there is a substantial acquisition of shares by the body corporate abroad in the Indian company, the SEBI takeover code also needs to be complied with.
    7. Check whether the Indian Company has reported the particulars of foreign inward remittance within 30 days of its receipt.
    8. Check whether the allotment is made within 180 days of in word remittance.
    9. Check whether the Company has filed form FC-GPR within 30 days of allotment.

V. SETTING UP OF BRANCH, LIAISON, PROJECT OFFICES

Foreign Companies can set up their operations in India through

— Liaison Office/Representative Office

— Project Office

— Branch Office

Liaison office acts as a channel of communication between the principal place of business or head office and Indian activities. Liaison office can not undertake any commercial activity directly or indirectly and can not, therefore, earn any income in India. Its role is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian

customers. It can promote export/import from/to India and also facilitate technical/ financial collaboration between parent company and companies in India. Approval for establishing a liaison office in India is granted by Reserve Bank of India (RBI).

Foreign Companies planning to execute specific projects in India can set up temporary project/site offices in India. RBI has now granted general permission to foreign entities to establish Project Offices subject to specified conditions. Such offices can not undertake or carry on any activity other than the activity relating and incidental to execution of the project. Project Offices may remit outside India the surplus of the project on its completion, general permission for which has been granted by the RBI

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes:

— Export/Import of goods
— Rendering professional or consultancy services
— Carrying out research work, in which the parent company is engaged.
— Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
— Representing the parent company in India and acting as buying/selling agents in India.
— Rendering services in Information Technology and development of software in India.
— Rendering technical support to the products supplied by the parent/ group companies.

It may be noted that retail trading activities of any nature is not allowed for a branch office in India.

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to subcontract these to an Indian manufacturer. Branch Offices established with the approval of RBI, may remit outside India profit of the branch, net of applicable Indian taxes and subject to RBI guidelines, permission for setting up branch offices is granted by the Reserve Bank of India (RBI).

No approval shall be necessary from RBI for a company to establish a branch/ unit in SEZs to undertake manufacturing and service activities subject to specified conditions.

Such Branch Offices would be isolated and restricted to the Special Economic Zone (SEZ) alone and no business activity/transaction will be allowed outside the SEZs in India, which include branches/subsidiaries of its parent office in India.

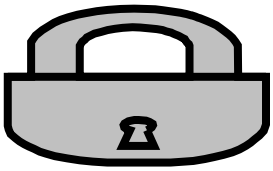
Application for setting up Liaison Office/ Project Office/ Branch Office may be submitted in form FNC 1, along with the following documents:

— English version of the Certificate/Registration or Memorandum and Articles of Association attested by Indian Embassy/Notary Public in the country of Registration.
— Latest Audited Balance Sheet of the applicant entity.

LESSON ROUND UP

- Foreign investment in India is governed by Foreign Direct Investment Policy and sub-section (3) of section 6 of the Foreign Exchange Management Act, 1999 read with Notification No. FEMA 20/2000-RB dated May 3, 2000, containing Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 which has been amended from time to time.
- Foreign investment in India is freely permitted in almost all sectors except for specified prohibited sectors.
- Foreign Direct Investments (FDI) can be made under Automatic Route and Government Route/Approval Route.
- Joint Venture in India can be either by setting up a new company or in an existing company.

SELF TEST QUESTIONS



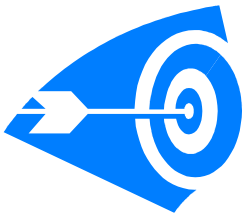
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Explain the possible entry routes for foreign investments in India?
2. Describe the points to be checked in case of foreign direct investment through automatic route.
3. What are the steps involved in joint ventures?
4. Elaborate the points to be checked while setting up a joint venture in India?
5. Write a note on setting up branch, liaison and project office in India.

STUDY X

SETTING UP OF BUSINESS UNITS AND JOINT VENTURES ABROAD

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- Concept and regulatory basis for setting up of business units and joint ventures outside India
- Eligibility and prohibitions
- Approvals required
- Routes of investment, reporting procedures etc
- General clauses to be included in joint venture agreements
- Procedural checks for different routes of investment

INTRODUCTION AND STATUTORY BASIS

Setting up of wholly owned subsidiaries (WOS) and Joint Ventures abroad is a Direct Investment which may take in the form of newly promoted foreign concerns or additional investment by Indian parties in the existing foreign concerns or investment for acquisition of overseas business.

Outbound Investment or Direct Investment outside India includes investment made by Indian Parties by way of contribution to the capital or subscription to the Memorandum of Association of foreign entity, setting up of joint ventures or wholly owned subsidiaries in overseas, direct investment under swap or exchange of shares arrangement, capitalization of exports, acquisition of a foreign company through tender procedure. Besides equity stake, Joint ventures may be reflected in the form of representation in the Board of foreign entity, supply of technical know how, capital goods etc to the foreign concern.

Investment in foreign securities is a permissible capital account transaction under schedule I of Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.

Setting up of WOS and Joint Ventures requires compliance with various laws in India and the laws and regulations of host country. In India, it is mainly regulated by Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2000 and amendments there on in addition to Companies Act, 1956, FEMA, 1999 and other relevant Acts.

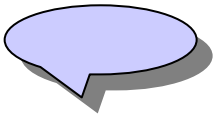
Some important Definitions under Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004

'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.

'Joint Venture' mean a foreign entity formed registered or incorporated in accordance with the laws and regulations of the host country in which the Indian Party makes a direct investment.

'Wholly owned subsidiary' means a foreign entity formed, registered or incorporated in accordance with the laws and regulation of the host country whose entire capital is hold by Indian party.

Outbound investments…..Some basics to remember



- Investment in foreign securities is a permissible capital account transaction under schedule I of Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.
- Mainly regulated by Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004.

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

(a) 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.

(b) Investment in Pakistan is not permitted under Automatic Route

(c) 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

(a) Approval from Board of Directors

(b) Shareholders of the Company

(c) Approval from Department of Economic Affairs, Ministry of Finance, if required

(d) Approval from Reserve Bank of India (pre/post facto)

DIRECT INVESTMENT OUTSIDE INDIA- AUTOMATIC ROUTE

(a) 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

(1) 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,

(2) No guarantee is 'open ended' i.e. the amount of the guarantee should be specified upfront, and

(3) 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 CategoryIMerchant 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:

(1) ADRs/GDRs are listed on any stock exchange outside India;

(2) The ADR and/or GDR issue for the purpose of acquisition is backed by underlying fresh equity shares issued by the Indian party;

(3) 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;

(4) 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.

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…..subject to prescribed conditions.

Method of Funding

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

(i) drawal of foreign exchange from an AD Bank in India;

(ii) capitalisation of exports;

(iii) swap of shares

(iv) utilisation of proceeds of External Commercial Borrowings (ECBs) / Foreign Currency Convertible Bonds (FCCBs);

(v) 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

(vi) balances held in EEFC account of the Indian party; and

(vii) 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

(i) out of funds held in RFC account;

(ii) as bonus shares on existing holding of foreign currency shares; and

(iii) when not permanently resident in India, out of their foreign currency resources outside India

DIRECT INVESTMENT OUTSIDE INDIA – APPROVAL ROUTE

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.

OTHER INVESTMENTS OUTSIDE INDIA

(a) Investment in Unincorporated entities Overseas in oil sector under the Automatic Route

(1) Investments in unincorporated entities overseas in the oil sector (i.e. for exploration and drilling for oil and natural gas, etc.) by Navaratna PSUs, ONGC Videsh Ltd. (OVL) and Oil India Ltd.(OIL) may be permitted by AD Category - I banks, without any limit, provided such investments are approved by the competent authority.

(2) Other Indian companies are also permitted under the Automatic Route to invest in unincorporated entities overseas in the oil sector up to 400 per cent of its net worth provided the proposal has been approved by the competent authority and is duly supported by certified copy of the Board resolution approving such

investment. Investment in excess of 400 per cent of the net worth of an Indian company shall require prior approval of the Reserve Bank.

(b) Capitalisation of exports and other dues

Indian parties are permitted to capitalise the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical knowhow, consultancy, managerial and other services within the ceilings applicable. Capitalisation of export proceeds remaining unrealised beyond the prescribed period of realization will require prior approval of the Reserve Bank.

Indian software exporters are permitted to receive 25 per cent of the value of their exports to an overseas software start-up company in the form of shares without entering into Joint Venture Agreements, with prior approval of the Reserve Bank.

(c) Investments in Financial Services Sector

According to Regulation 7 of Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000, Indian party seeking to make investment in an entity engaged in the financial sector should fulfill the following additional conditions:

(i) be registered with the appropriate regulatory authority in India for conducting the financial sector activities;

(ii) have earned net profit during the preceding three financial years from the financial services activities;

(iii) have obtained approval for investment in financial sector activities abroad from regulatory authorities concerned in India and abroad; and

(iv) have fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.

It may be noted that a step down subsidiary of JV / WOS investing in a financial services sector is also required to comply with the above conditions.

Trading in Commodities Exchanges overseas and setting up JV/WOS for trading in overseas exchanges will be reckoned as financial services activity and require clearance from the Forward Markets Commission.

(d) Acquisition Of A Foreign Company Through Bidding Or Tender Procedure

An Indian party may remit earnest money deposit or issue a bid bond guarantee for acquisition of a foreign company through bidding and tender procedure and also make subsequent remittances through an Authorised Dealer Category - I bank, in accordance with the provisions of Regulation 14 of Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2000.

In terms of the said Regulation 14, Authorised Dealer Category – I (AD)banks may, on being approached by an eligible Indian party and subject to the limits, allow remittance towards Earnest Money Deposit (EMD) to the extent eligible after obtaining Form A2 duly filled in or may issue bid bond guarantee on their behalf for participation in bidding or tender procedure for acquisition of a company incorporated outside India. On winning the bid, AD banks may remit the acquisition value after obtaining Form A2 duly filled in and report such remittance (including the amount

initially remitted towards EMD) to the Chief General Manager, Foreign Exchange Department, Central Office, Overseas Investment Division, Amar Building, 5th floor, Mumbai 400 001 in form ODI. AD Category – I banks, while permitting remittance towards EMD should advise the Indian party that in case they are not successful in the bid, they should ensure that the amount remitted is repatriated in accordance with Foreign Exchange Management (Realisation, Repatriation & Surrender of Foreign Exchange) Regulations, 2000

In cases where an Indian party, after being successful in the bid / tender decides not to proceed further with the investment, AD banks should submit full details of remittance allowed towards EMD / invoked bid bond guarantee, to the Chief General Manager, Foreign Exchange Department, Central Office, Overseas Investment Division, Amar Building, 5th floor, Mumbai 400 001.

In case the Indian party is successful in the bid, but the terms and conditions of acquisition of a company outside India are not in conformity with the provisions of Regulations, or different from those for which specific approval has already been obtained from RBI, the Indian entity should again obtain approval from the Reserve Bank by submitting form ODI.

(e) Investment Under Swap Or Exchange Of Shares Arrangements

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. Further, approval of the Foreign Investment Promotion Board (FIPB) will also be a prerequisite for investment by swap of shares.

AD Category – I banks are additionally required to submit to the Reserve Bank the details of transactions such as number of shares received / allotted, premium paid/received, brokerage paid/received etc., and also confirmation to the effect that the inward leg of transaction has been approved by FIPB and the valuation has been done as per laid-down procedure and that the overseas company's shares are issued/transferred in the name of the Indian investing company. AD Category – I bank may also obtain an undertaking from the applicants to the effect that future sale/transfer of shares so acquired by Non-Residents in the Indian company shall be in accordance with the provisions of Notification No. FEMA 20/2000-RB dated May 3, 2000 as amended from time to time(i.e Foreign Exchange Management(Transfer or Issue of Security by a person Resident outside India) Regulations, 2000.

(f) Overseas Investments By Proprietorship Concerns/ Unregistered Partnership

With a view to enabling recognized star exporters with a proven track record and a consistently high export performance to reap the benefits of globalization and liberalization, proprietorship concerns and unregistered partnership firms are allowed to set up a JV / WOS outside India with prior approval of the Reserve Bank subject to satisfying certain eligibility criteria.

An application in form ODI may be made to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Central Office, Amar Building 5th Floor, Fort, Mumbai 400 001, through the AD Category - I

bank. AD Category - I banks may forward the applications to the Reserve Bank along with their comments and recommendations, for consideration.

Investments by established proprietorship or unregistered partnership exporter firms will be subject to the following conditions:

(i) The Partnership/Proprietorship firm is a DGFT recognized Star Export House.

(ii) The AD Category – I bank is satisfied that the exporter is KYC (Know Your Customer) compliant, is engaged in the proposed business and meets the requirement as indicated at i) above.

(iii) Exporter has proven track record i.e. export outstanding does not exceed 10 per cent of the average export realization of preceding three financial years.

(iv) The exporter has not come under adverse notice of any Government agency like Enforcement Directorate, CBI and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India.

(v) The amount of investment outside India does not exceed 10 per cent of the average of three financial years export realization or 200 per cent of the net owned funds of the firm, whichever is lower.

(g) Overseas investment by registered trust / society

Registered Trusts and Societies engaged in manufacturing / educational sector / set up hospital in India are allowed make investment in the same sector(s) in a Joint Venture or Wholly Owned Subsidiary outside India, with the prior approval of the Reserve Bank. Trusts/Societies satisfying the eligibility criteria as given below may submit the application/s in Form ODI-Part I, through their AD Category - I bank/s, to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Central Office, Amar Building, 5th Floor, Fort, Mumbai 400 001, for consideration.

Eligibillty Criteria:

(a) Trust

(i) The Trust should be registered under the Indian Trust Act, 1882;

(ii) The Trust deed permits the proposed investment overseas;

(iii) The proposed investment should be approved by the trustee/s;

(iii) The AD Category – I bank is satisfied that the Trust is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;

(iv) The Trust has been in existence at least for a period of three years;

(v) The Trust has not come under the adverse notice of any Regulatory/ Enforcement agency like the Directorate of Enforcement, CBI etc.

(b) Society

(i) The Society should be registered under the Societies Registration Act, 1860.

(ii) The Memorandum of Association and rules and regulations permit the

Society to make the proposed investment which should also be approved by the governing body / council or a managing/executive committee.

(iii) The AD Category - I bank is satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;

(iv) The Society has been in existence at least for a period of three years;

(v) The Society has not come under the adverse notice of any Regulatory/ Enforcement agency like the Directorate of Enforcement, CBI etc.

In addition to the registration, the activities which require special license/ permission either from the Ministry of Home Affairs, Government of India or from the relevant local authority, as the case may be, the AD Category – I bank should ensure that such special license / permission has been obtained by the applicant.

DISINVESTMENT BY INDIAN PARTIES

(1) Indian parties may also disinvest without prior approval of the Reserve Bank, in any of the under noted categories:

(i) in case where the JV/WOS is listed in the overseas stock exchange;

(ii) in cases where the Indian promoter company is listed on a stock exchange in India and has a net worth of not less than Rs.100 crore; and

(iii) where the Indian Promoter is an unlisted company and the investment in the overseas venture does not exceed USD 10 million.

(2) The disinvestment shall be subject to the following conditions:

(i) the sale does not result in any write-off of the investment made;

(ii) the sale is effected through a stock exchange where the shares of the overseas JV/WOS are listed;

(iii) if the shares are not listed on the stock exchange and the shares are disinvested by a private arrangement, the share price is not less than the value certified by a Chartered Accountant/Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the JV/WOS;

(iv) the Indian party does not have any outstanding dues by way of dividend, technical know-how fees, royalty, consultancy, commission or other entitlements and / or export proceeds from the JV or WOS;

(v) the overseas concern has been in operation for at least one full year and the Annual Performance Report together with the audited accounts for that year has been submitted to the Reserve Bank;

(vi) the Indian party is not under investigation by CBI / DoE/ SEBI / IRDA or any other regulatory authority in India.

The Indian entity is required to submit details of the disinvestment through its designated AD Category – I bank within 30 days from the date of disinvestment. An Indian party, which does not satisfy the conditions laid down, shall have to apply to the Reserve Bank for prior permission.

IMPORTANT CLAUSES IN INTERNATIONAL JOINT VENTURES

A well drafted joint venture agreement should provide a comprehensive road map on the rights and obligations of parties to the agreement and minimizes disputes and complications. Though, the clauses of joint venture agreements cannot be tailor made before signing a joint venture agreement, clauses relating to the following may be addressed.

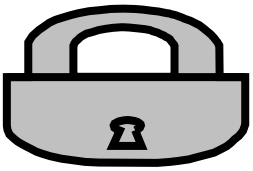
1. Objectivity
2. Terms and Tenure of the agreement
3. Proportion of holding
4. Managerial control
5. Appointment of Board Members
6. Restriction on sale
7. Arbitration
8. Governing Law
9. Force Majeure Clause
10. Right of first refusal
11. Representation and warranties
12. Clauses relating to patent and IPR issues.
13. Legal compliance
14. Time limits
15. Change of location
16. Change of control
17. Foreign Trade Rights
18. Indemnity Clause
19. Prohibition on assignment
20. Limitation of Liability
21. Confidentiality
22. Severability
23. Termination

LESSON ROUND UP

- Investment in foreign securities is a permissible capital account transaction under schedule I of Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.

- Setting up of WOS and Joint Ventures requires compliance with various laws in India and the laws and regulations of host country. In India, it is mainly regulated by Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 and amendments there on in addition to Companies Act, 1956, FEMA, 1999 and other relevant Acts.
- Indian parties are prohibited from making direct investment in a foreign entity engaged in real estate/banking business.
- 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.
- Investments in unincorporated entities overseas in the oil sector (i.e. for exploration and drilling for oil and natural gas, etc.) by Navaratna PSUs, ONGC Videsh Ltd. (OVL) and Oil India Ltd. (OIL) may be permitted by AD Category-I banks, without any limit, provided such investments are approved by the competent authority.
- 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.
- Indian parties are permitted to capitalise the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical knowhow, consultancy, managerial and other services within the ceilings applicable.
- A well drafted joint venture agreement should provide a comprehensive road map on the rights and obligations of parties to the agreement and minimizes disputes and complications.

SELF TEST QUESTIONS



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

1. What are the eligibility criteria for setting up Wholly Owned Subsidiary abroad?
2. Is ODI permitted in Pakistan? What are the Conditions with respect to Overseas Direct Investment?
3. What are the important clauses to be covered in the Join venture agreements?

4. What are the procedures with respect to overseas direct investment through approval route?
5. Can Shares acquired through ODI scheme be disinvested? If so, what are the procedures?

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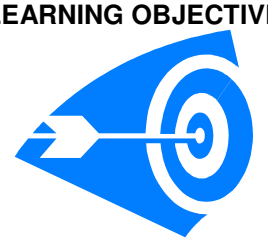
STUDY XI

LEGAL DUE DILIGENCE

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- The concept, scope, objectives and process of legal due diligence
- General aspects to be looked during legal due diligence process
- Possible hurdles in legal due diligence
- Role of Company Secretaries in legal due diligence

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 a corporate or other company which involves complete details about 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. Effect of 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 due diligence depends on the purpose and objectives of due diligence and 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 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.

Scope of Legal Due diligence

- Regulatory compliance (under The Companies Act, 1956, Income Tax Act, 1961, Pollution Control laws, Industry specific/area specific regulation, listing agreement if applicable, etc)
- Contractual compliance
- *Compliance under intra-corporate aspects*
- Financial Aspects
- Non Financial Aspects
- Cultural Aspects

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 betters 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 questionaires 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
- Management, BOD, control environment, Corp Governance etc
- 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. HR 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

- 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:

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VIII. ROLE OF COMPANY SECRETARIES IN LEGAL DUE DILIGENCE

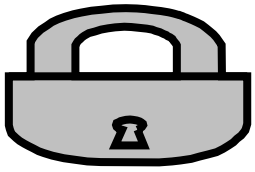
Company Secretary is a competent professional who comes in existence after exhaustive exposure provided by the Institute through compulsory coaching, examinations, rigorous training and continuing education programmes. The course curriculum includes papers on subjects such as Financial Management, Financial 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.

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STUDY XII

COMPLIANCE MANAGEMENT

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand

- The concept of compliance management
- Scope, significance and need for compliance management
- Risk of Noncompliance
- Compliance Management process
- Systems approach to compliance management
- Compliance in letter and spirit
- Role of Secretarial Audit, Knowledge management in Compliance Management System

I. 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

II. NEED FOR COMPLIANCE

Corporate accountability is on everyone's mind today. Business executive face significant pressure to comply with a steady steam of complex regulations. Many companies are adopting comprehensive compliance plans to address emerging regulatory paradigm and those that fail to address the new regulations risk losing business, paying hefty fines or incurring punitive restrictions on their operations.

As the organizations face mounting pressures that are driving them towards a structured approach to enterprise-wise compliance management, the key drivers of compliance management encompass, the complexity of today's business, dependency on IT and hitech processes, growth in business partner relationships. 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 adapting with compliance regimes, so as to ensure extended protection to investors, shareholders and other stakeholders. 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. Plummeting stock price and threat of de-listing of shares (in case of listed companies)
8. Attachment of bank accounts.

III. 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.

Since 1991, in USA, the companies that create, communicate, enforce, and promote effective compliance programs, as defined by the U.S. Federal Sentencing Guidelines for Organizations, have been given favorable treatment by the Department of Justice, even when misconduct by employees in their organizations has been proven. The resultant savings, in terms of mitigated fines, has totalled hundreds of millions of dollars.

IV. SCOPE OF CORPORATE COMPLIANCE MANAGEMENT

Corporate compliance management should broadly include compliance of :

— Corporate Laws
— Securities Laws
— Commercial Laws including Intellectual Property 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/ICWAI, 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 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

— Sarbanes-Oxley Act, 2002 and other legislations etc, wherever applicable.

— 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;
— Workmen's 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
— 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.

V. ROLE OF KNOWLEDGE MANAGEMENT IN COMPLIANCE MANAGEMENT

Knowledge Management is the process of identifying, capturing, organising, retrieving, compiling sharing and evaluating the information for strengthening the knowledge base. Knowledge Management is an effective tool for establishing effective corporate compliance management systems and practices in the organization as it helps in updating the regulatory compliance. .

A Structured Knowledge Management supports the corporate compliance

management in ensuring its effective implementation and maintenance through compliance checklists, emerging laws and its impact, backup support etc.

VI. 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.

Let us learn from Mitsibishi electric compliance programme

Chaired by an executive officer responsible for legal affairs, the Corporate Compliance Committee formulates across-the-board policies and action codes for the employees regarding corporate ethics and compliance activities in the Mitsubishi Electric Group worldwide. Established in 1991, the same year in which Nippon Keidanren created its Corporate Conduct Charter, the Corporate Compliance Committee hold regular meetings two times a year and extraordinary meetings as needed.

In April 2007, Missubishi Electric has further clarified the inextricable link between compliance and business promotion, reinforcing its primary compliance promotion systems in each division and the organizations that support them.

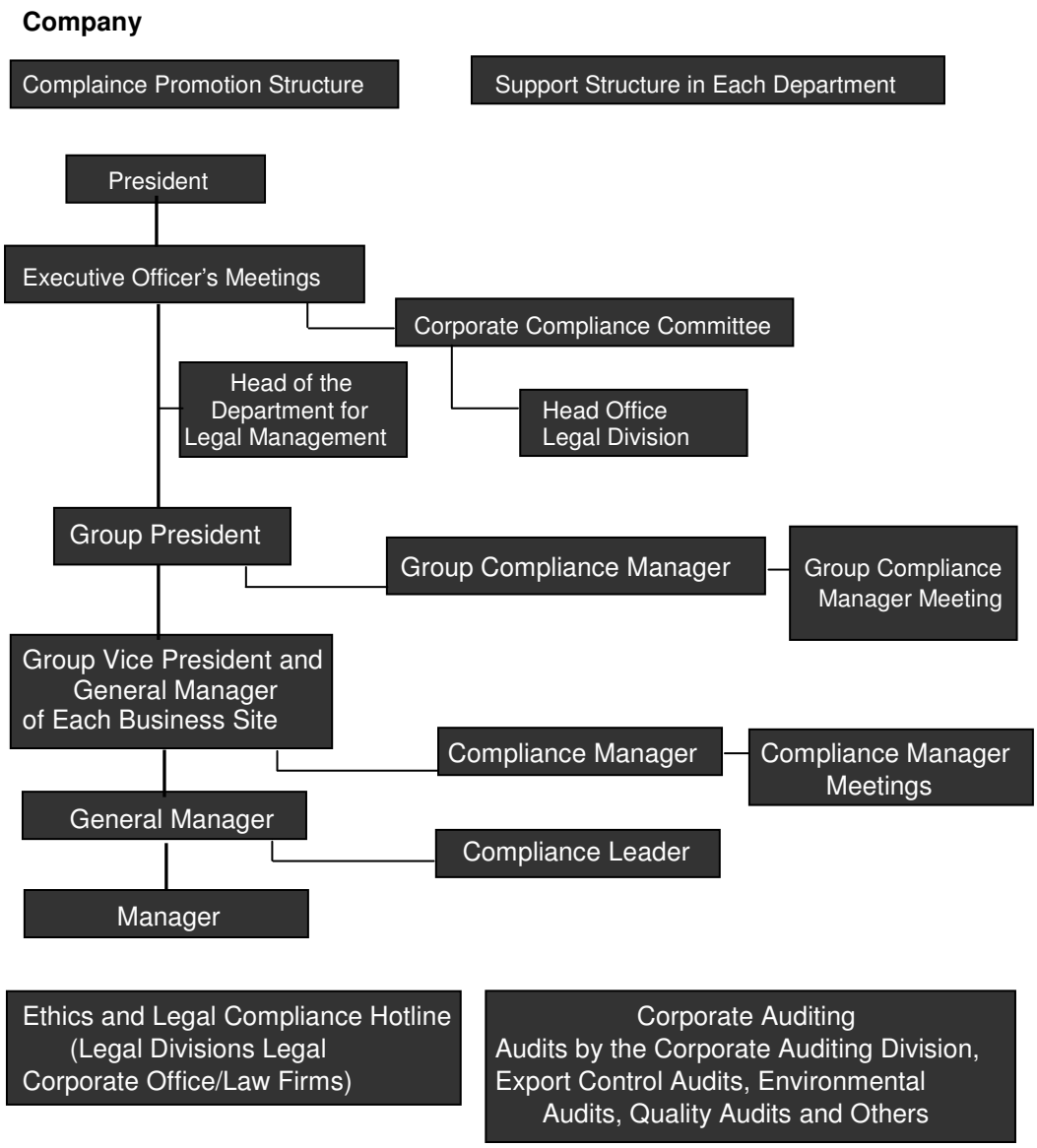
In each division and at each operational site, they have established a compliance promotion committee that determines specific measures regarding compliance in its own department. At the same time, at all organization levels in each business division and at each operational site, they have appointed group compliance managers, and compliance leaders, to regularly hold compliance coordinating meetings.

In April 2007, the title of "legal manager" was changed to "compliance manager" in order to promote compliance in a broader sense that includes corporate ethics as well as legal compliance.

In international operations, Mitsubishi Electric Group companies formulate their own corporate ethics codes based upon the Corporate Ethics and Compliance Code of Conduct, taking into account local laws, culture and customs. In addition,

compliance meetings are held in an effort to thoroughly entrench compliance concepts.

Compliance Promotion Structure



Mitsubishi Electric has set up an ethics and legal compliance hotline to prevent improper conduct before it occurs. The information communicated through the hotline is investigated by the Legal Division's Legal Compliance Office, and if improper conduct is discovered, the investigation division is requested to punish the perpetrator or institute corrective measures. Anonymity and other protections for the

whistleblower are prescribed in internal rules alongwith a prohibition against unfair treatment of whistleblower.

In April 2006, an external communication channel was set up at the offices of legal counsel in conjunction with enforcement of the Whistleblower Protection Act. These communication channels are open to affiliate companies in Japan as well.

The ethics and legal compliance hotline is explained in the Code of Conduct for Corporate Ethics and Compliance, which is distributed to each employee. As well as posters displayed in each department, the employees are acquainted with the communication channels through the Legal Division's intranet site and other information outlets.

Compliance Audits

The Auditing Division leads audits of corporate ethics and legal compliance at the business divisions of Mitsubishi Electric and affiliated companies in Japan and overseas. Following the auditing of Mitsubishi Electric and its affiliated companies in Japan and overseas, divisions are requested to make improvements if found in need of corrective actions.

Compliance Education Using Manifold Methods

Mitsubishi Electric conducts on-demand education regarding compliance through e-learning methods, group classes, and correspondence classes. They also hold compliance seminars accordingly. Managers in each division also distribute materials containing commonplace examples, practice lessons, and other information in an effort to prevent the occurrence of improper conduct.

Mitsubishi Electric's Legal Division and Associated Companies Division provide support for education at domestic Group companies to hold compliance seminars as necessary. Overseas, the companies run compliance training while taking into account local laws, regulations, culture and customs.

VIII. SECRETARIAL AUDITOR 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.

IX. THE SYSTEMS APPROACH

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.

X. COMPLIANCE WITH SPIRIT OF LAW (ETHICS)

In the context of corporate governance, compliance means obeying the law. Ethics is the intent to observe the spirit of law in other words, it is the expressed intent to do what is right. In the wake of recent corporate scandals, a program that strongly emphasizes both ethics and compliance is good business.

The Sarbanes-Oxley Act of 2002, along with related mandates by the Securities and Exchange Commission and new listing rules instituted by the major stock exchanges including India, raise the ante for ethical behavior and effective corporate compliance programs. Public companies and their senior executives and board members may be held accountable personally accountable in the case of the executives and board members not only for the financial reporting provisions of the legislations, but also for the aspects pertaining to ethics and corporate compliance. Companies and their leadership that adhere both to the letter and the spirit of the law can achieve substantial benefits.

An ethical compliance management programme ensures that the mechanisms are in place to provide early warning of deviations from guidelines and regulations. It

is essential to create or expand a culture of trust, enthusiasm, and integrity - critical attributes that can produce measurable results in terms of productivity, employee satisfaction, customer satisfaction, and, ultimately, brand equity.

XI. ROLE OF COMPANY SECRETARIES

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.

Illustration

An illustrative study on compliance management programme with hypothetical figures, is given below for better understanding.

Compliance with the regulatory acts not only protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner. A well drafted compliance management programme will function as a compliance solution that monitors the effectiveness of various controls applied to mitigate risks.

For example XYZ Ltd., a listed broking company may have compliance management programme covering the following aspects. It may be noted that this may not be a very comprehensive one.

Compliance Management Programme for XYZ Ltd.

I. Background of the company

XYZ Ltd. (herein after called 'the company') is a leading broking firm incorporated on 10th February, 1991, having its registered and corporate office located at Delhi and having 120 employees. The company was promoted by Mr. X, Mr. Y and Mrs. Z who are having experience in financial services sector for more than 25 years, 19 years, and 20 years respectively. The networth of the company as on March 31, 2008 was Rs……. crores and the market capitalization as on September 03, 2008 was Rs……. crores.

The company is handling sizeable portion of equities and derivatives being traded on NSE and BSE. The major activities and offerings of the company today are Equity Broking and Depository Participant Services. The company is a member of the National Stock Exchange of India, Bombay Stock Exchange of India and is a Depository Participant with National Securities Depository Limited and Central Depository Services (I) Limited. The company is a listed company with BSE and NSE. The company has also issued shares under FDI scheme.

II. Identification of applicable laws

The role of information technology in identifying the applicable laws is really vital. The company can identify the applicable laws just by click of a button through software, which has to be updated from time to time. It may be possible that some of the legislations might be missed out while listing the applicable laws manually and thus Compliance management through system would help in

(i) Identifying risk attributes (i.e. identifying the applicable laws)

(ii) Application of control to mitigate the risk (control check list under various legislations (both time based and event based)

(iii) Generation of reports for identifying the non compliances

(iv) Reminder before the due date for compliance

(v) Having internal control on compliance.

In respect of the said XYZ limited, the following sample check list on applicable laws would give an idea on the same.

(It may be noted that the laws listed out here is general about drafting a compliance programme and may not be too comprehensive.)

(a) General applicability

(i) The Companies Act, 1956

(ii) Income Tax Act, 1961

(iii) Contract Act, 1872

(iv) Stamp Act

(v) Negotiable Instruments Act, 1881

(b) Company-specific applicability (i.e. a listed broking company)

(i) SEBI Act, 1992

(ii) Securities Contracts (Regulation) Act, 1956

(iii) Securities Contracts (Regulation) Rules, 1957

(iv) Depositories Act, 1996

(v) Prevention of Money Laundering Act, 2002

(vi) SEBI (Intermediaries) Regulations, 2008

(vii) SEBI (Stock Brokers and Sub-brokers) Regulations, 1992

(viii) SEBI (Depositories and Participants) Regulations, 1996

(ix) BSE/NSE bye laws, rules and regulations

(x) Listing agreement

(c) Labour laws

(i) The Employees Provident Funds and Miscellaneous Provisions Act, 1952

(ii) The Employees State Insurance Act, 1948

(iii) The Maternity Benefit Act, 1961

(iv) The Minimum Wages Act, 1948

(v) The Payment of Bonus Act, 1965

(vi) The Payment of Gratuity Act, 1972

(vii) The Child Labour (Prohibition and Regulation) Act, 1986

(viii) Payment of Wages Act, 1936

(ix) The Workmens Compensation Act, 1923

(d) Applicable State Laws

(e) Transaction based application

(i) FEMA 1999

(ii) FDI scheme

Individual checklists (time based and event based) may be prepared as a control system.

III. Individual responsibilities on compliances to be clearly defined

Responsibility with respect of compliances has to be clearly defined in the compliance management programme, which will enable the compliance officer to co-ordinate with the respective officials in respect of deviations if any. For example, person responsible for PF returns from HR department, person responsible for reports to be sent to NSE in respect of terminals etc. may be given clearly.

IV. Evaluation

Compliance management system should have a proper evaluation methodology through questionnaires to departmental heads etc. at regular intervals.

V. Bridging the gap between compliance in letter and compliance in letter and spirit

As we discussed compliance has to be carried out in letter and spirit. The compliance management system has to be made in such a manner that the compliance is made in letter and spirit.

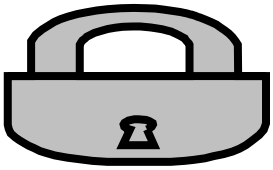
VI. Updation

Updation of compliance management programme is very essential as and when there is any change in any of the applicable law.

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



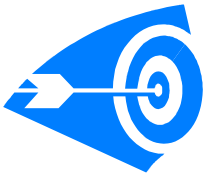
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Draft a Compliance Management programme for a Broking company.
2. Describe the scope of compliance management.
3. Explain compliance management process in general.
4. Explain the systems approach to compliance management.

STUDY XIII

SECRETARIAL AUDIT

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- Meaning, Need, Objectives, scope and process of secretarial audit
- Format of Secretarial Audit Report
- Checklists under Corporate, Industrial, SEBI, Foreign Exchange laws etc.

1. Introduction

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. Para V of the Guidelines states that :

"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."

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.

2. Need for Secretarial Audit

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

The multiplicity of laws, rules, regulations, etc. has necessitated introduction of a compliance management system to ensure compliances of laws applicable to a

company. This has a two-fold objective:

(a) Firstly, to protect the interests of all the stakeholders;

(b) Secondly, to avoid any legal action against the company and its management.

Under most laws, the persons responsible for compliance and liable for punishment are directors, Company Secretary and the officers who have been designated for specific compliances. From amongst the directors, the responsibility of managing and whole-time directors is greater. Under the Companies Act, a managing and/or whole-time director (besides Company Secretary) is an officer who is in default liable for penal consequences of defaults and thus responsible for compliances, while under most other laws they are the persons in charge of, and responsible to, the company for the conduct of the business of the company.

In India, a number of statutes contain under the heading "Offences by Companies" an identical provision regarding vicarious liability of directors and other company officers for company's offences. In Girdhari Lal Gupta v. D.N. Mehta AIR 1971 SC 2162, the Supreme Court has construed the expression 'a person in charge and responsible for the conduct of the business of the company' as to mean the person in overall control of the day-to-day business of the company. This ruling has been followed in a number of subsequent decisions.

Sub-clause I(C)(iii) of Clause 49 of the Listing Agreement provides "The Board should periodically review 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." Accordingly, all listed companies should introduce a system for reporting to the Board, on compliances with laws applicable to them. Hence, a Legal Compliance Reporting System is necessary to comply with sub-clause I(C)(iii) of Clause 49 of the Listing Agreement.

3. Secretarial Audit & Company Secretary in Practice (PCS)

A significant area of competence of PCS is "Corporate 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 programmes. 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 under section 2(2)(c)(v) of the Company Secretaries Act, 1980.

In order to guide its members with the process of Secretarial Audit, the Institute of Company Secretaries of India has issued this Referencer.

4. Secretarial Audit Process

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.

Benefits of Secretarial Audit are manifold. Ever-increasing complexities of laws and responsibilities of directors (especially non-executive directors) make it imperative that a PCS reports whether or not there exists proper compliance mechanism and systems in the corporate structure. PCS has also to verify whether diverse requirements under applicable laws have been duly complied with or not and if there is a need for any corrective measures or improvement in the system.

5. Beneficiaries of Secretarial Audit

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 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.

Corporate conduct manifesting good Governance is vital for the healthy, vibrant and ever growing corporate sector in global economy. In developing economies, inclusive growth is more than imperative. Adopting effective management tools like Secretarial Audit can go a long way in fulfilling these objectives.

6. Scope and Contents of Secretarial Audit

Scope:

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 thereunder;

(iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed there under;

(iv) Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;

(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, 1997;

(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 (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and

(h) 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, 2007;

(xi) Corporate Governance Guidelines for Insurance Companies, 2009 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 (not as part of Directors' 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 consisting of –
     - (i) Composition of the Board
     - (ii) Suitability of directors
     - (iii) Succession planning
   - (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) Decision making process.
     - (v) Adequacy of minutes
     - (vi) 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.

Secretarial Audit Report should be signed by the Practicing Company Secretary, who acts as the Secretarial Auditor by mentioning his CP Number issued by The Institute of Company Secretaries of India.

7. 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.

08. 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, he is unable to report compliance(s) by the Company".

09. 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.

10. Pre-requisites to Secretarial Audit

Appointment

(a) For effective functioning , Secretarial Auditor should be appointed by the members in the general meeting from amongst the Secretaries in Whole-time Practice and all the provisions relating to appointment, remuneration and removal of auditors contained in sections 224 to 226 of the Companies Act, 1956 should apply to appointment, remuneration and removal of Secretarial Auditor mutatis mutandis.

Communication to earlier incumbent

(b) Whenever a Secretarial Auditor is appointed in place of the existing Secretarial Auditor, he should communicate the appointment to the earlier incumbent in writing by registered/speed post or any other mode as may be allowed by The Institute of Company Secretaries of India from time to time.

Assignment

(c) After the appointment is carried out in the manner suggested, a letter of

engagement should be issued by the Company. Practising Company Secretary should formally accept the letter of engagement.

Access to information and Records

(d) The Company should provide the PCS access at all times to the books, papers, minute books, forms and returns filed and other records maintained by the company, for the purpose of Secretarial Audit.

(e) A PCS should be entitled to require from the company, such information and explanations as he may think necessary for the purpose of such Audit. However, depending on the facts and circumstances he may obtain a letter of representation from the company in respect of matters where personal verification may not be practicable.

For the guidance of the members, three specimen formats of the Secretarial Audit Report are provided, viz. Specimen 1 (Exhaustive Reporting), Specimen 2 (Exception Reporting), and Specimen 3 (Exception and Event Based Reporting). Depending on the size, activities and requirements of the organisation, PCS may adopt any or combinations of the three specimens.

Specimen 1

SECRETARIAL AUDIT REPORT

FOR THE FINANCIAL YEAR ENDED … … …

To
The Members ,
_____ Limited

I have conducted, the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by the company. Secretarial Audit was conducted in a manner that provided me a reasonable basis for evaluating the corporate conducts/statutory compliances and expressing my opinion thereon.

Based on my verification of the …….. (name of the company)'s books, papers, minute books, forms and returns filed and other records maintained by the company and also the information provided by the Company, its officers, agents and authorized representatives during the conduct of secretarial audit, I hereby report that in my opinion, the company has, during the audit period covering the financial year ended on _____, _____ complied with the statutory provisions listed hereunder and also that the Company has proper Board-processes and compliance-mechanism in place to the extent, in the manner and subject to the reporting made hereinafter:

I have examined the books, papers, minute books, forms and returns filed and other records 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 rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;

(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, 1997;

(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 (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and

(h) 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) 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, independence 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 Rs. ..... 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, 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, 1997 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) 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) 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, 2007.

(n) the Company has complied with Corporate Governance guidelines for Insurance Companies, 2009 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.

Specimen 2

SECRETARIAL AUDIT REPORT
FOR THE FINANCIAL YEAR ENDED … … …

To,
The Members,
…… Limited

I have conducted, the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by the company. Secretarial Audit was conducted in a manner that provided me a reasonable basis for evaluating the corporate conducts/statutory compliances and expressing my opinion thereon.

Based on my verification of the .....…….. (name of the company)'s books, papers, minute books, forms and returns filed and other records maintained by the company and also the information provided by the Company, its officers, agents and authorized representatives during the conduct of secretarial audit, I hereby report that in my opinion, the company has, during the audit period covering the financial year ended on _____, _____ complied with the statutory provisions listed hereunder and also that the Company has proper Board-processes and compliance-mechanism in place to the extent, in the manner and subject to the reporting made hereinafter:

I have examined the books, papers, minute books, forms and returns filed and other records 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 rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;

(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, 1997;

(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 (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and

(h) 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)

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;

(iv) The Listing Agreements entered into by the Company with ….. Stock Exchange(s);

During the period under review the Company has complied with the provisions of the Act, Rules, Regulations, Guidelines, Standards, etc. mentioned above subject to the following observations:

Note: Please report specific non compliances/observations/audit qualification, reservation or adverse remarks in respect of the above para wise.

I further report that

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.

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.

Note: Please report specific observations/qualification, reservation or adverse remarks in respect of the Board Structures/system and processes relating to the Audit period

Place:	Signature
Date:	Name of Company Secretary/Firm:
	ACS/FCS No.
	C P No.:

Note: Parawise details of the Audit finding, if necessary, may be placed as annexure to the report.

Specimen 3

SECRETARIAL AUDIT REPORT
FOR THE FINANCIAL YEAR ENDED … … …

To,
The Members,
…… Limited

I have conducted, the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by the company. Secretarial Audit was conducted in a manner that provided me a reasonable basis for evaluating the corporate conducts/statutory compliances and expressing my opinion thereon.

Based on my verification of ..... (name of the company)'s books, papers, minute books, forms and returns filed and other records maintained by the company and also the information provided by the Company, its officers, agents and authorized representatives during the conduct of secretarial audit, I hereby report that in my opinion, the company has, during the audit period covering the financial year ended on _____, _____ complied with the statutory provisions listed hereunder and also that the Company has proper Board-processes and compliance-mechanism in place to the extent, in the manner and subject to the reporting made hereinafter.

I have examined the books, papers, minute books, forms and returns filed and other records 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 rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;

(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, 1997;

(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 (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and

(h) 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)

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;

(iv) The Listing Agreements entered into by the Company with ….. Stock Exchange(s);

During the period under review the Company has complied with the provisions of

the Act, Rules, Regulations, Guidelines, Standards, etc. mentioned above subject to the following observations:

Note: Please report specific non compliances/observations/audit qualification, reservation or adverse remarks in respect of the above para wise.

I further report that

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.

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.

Note: Please report specific observations/qualification, reservation or adverse remarks in respect of the Board Structures/system and processes relating to the Audit period.

I further report that

during the audit period the company has .....

(Give details of specific events/actions having a major bearing on the company's affairs in pursuance of the above referred laws, rules, regulations, guidelines, standards, etc. referred to above.

For example

(i) Public/Right/Preferential issue of shares/debentures/sweat equity, etc.
(ii) Redemption/buy-back of securities
(iii) Major decisions taken by the members in pursuance to sec. 293 of the Companies Act, 1956
(iv) Merger/amalgamation/reconstruction, etc.
(v) Foreign technical collaborations

Place:	Signature
Date:	Name of Company Secretary/Firm:
	ACS/FCS No.
	C P No.:

Note: Parawise details of the Audit findings, if necessary, may be placed as annexure to the report.

MAJOR AREAS OF COMPLIANCES UNDER THE COMPANIES ACT, 1956

INTRODUCTION

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

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 and mention the name of each register, return, form or notice together with date of filing of the return, form or notice ?"

2. "Whether the company has followed all the requirements of the Act and the Articles of Association in respect of notices, proxies, quorum and minutes of all general meetings (including annual qeneral meeting and requisitioned extra-ordinary general meeting) and board and committee meetings and mention the date and type of each meeting?"

At present a company with a paid-up capital of Rs.10 Lakhs or more, but not more than Rs. 5 Crores is required to obtain a Secretarial Compliance Certificate, from the practising Company Secretary. This certificate covers 33 points and can be considered to be a reasonably comprehensive one. However, it does not apply to big companies, if paid-up capital were to be considered as the yardstick for measuring the size of a company. In order to make it comprehensive and useful to both the corporate sector and regulators, it is necessary to introduce the statutory need for a comprehensive audit encompassing not only the provisions of the Act but also other important legislations.

A perusal of the scheme of the Act makes it clear that compliances under this Act happen on two counts. Compliances of the first type are non-event based and they are the filing of the annual return, annual report including the secretarial compliance certificate wherever applicable. The compliances of the second category are those, which are necessary on the happening of certain events. These events require compliance-of-various provisions of the Act and in certain cases provisions of other legislations also.

To illustrate an issue of securities or buy back of securities would require not only the compliance of the Act but also the provisions of the applicable Guidelines/Regulations of Securities and Exchange Board of India (SEBI). For all these event based compliances, it is possible to, (in certain cases it is already there), make it necessary for a certification by a Company Secretary in practice or a Company Secretary in employment stating that the company has complied with all the provisions of the Act and other applicable legislations in so far as they apply to the event in question.

The existing certification requirements are not comprehensive. The Laws that apply in respect of the transaction in question are administered by different Departments and no comprehensive certification takes place covering all the regulations/laws. To illustrate, if one takes the issue of securities under the Employee Stock Option Scheme by a listed company, one would find that there are the provisions of the Companies Act, the Listing Agreement, the Foreign Exchange Management Act and the Regulations thereunder, SEBI Guidelines and Regulations, the Stamp Act and the Income Tax Act.

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.

Analysis of Part II of the Companies Act

Part II of the Act contains provisions relating to incorporation of a company, its memorandum and articles of association. Part II also deals with membership, contracts, deeds, investments, seal, service of documents and authentication of proceedings.

Alteration of Memorandum of Association

The three subjects viz., the name change, alteration of objects clause and shifting of registered office from one state to another are covered under it. 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.

Let us consider the position with regard to the alteration of the liability clause. Under Section 13 of the Act the liability clause is one of the conditions specified in 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 be 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 should be registered within 3 months 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.

Section 25 of the Act

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. Section 25 companies enjoy a lot of exemptions and they also enjoy concession in payment of filing fees and registration fees. Under the Income Tax Act, these companies are also eligible to enjoy exemption from Income Tax liability.

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

This being an important right, and Section 39 of the Act contains a specific provision clause in this regard. This section confers a statutory right and it should be attended to with utmost respect. In the era of Corporate Governance, the Company Secretary and the directors of a company are under an obligation to be answerable not only to the members but also to the stakeholders.

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.

CONSEQUENCES OF DEFAULT IN COMPLYING WITH CONDITIONS CONSTITUTING A PRIVATE COMPANY (Section 43)

Section 43 is also a very important section. A company in order to be a private company should necessarily include the provisions of clause (iii) of sub-section (1) of Section (3) of the Act in its articles of association. If a private company defaults in complying with any such provision, it shall cease to be entitled to the privileges and exemptions conferred on private companies and this Act shall apply as if it were not a private company.

CONVERSION INTO PUBLIC COMPANY (Section 44)

This is another case where there is a certification by the Registrar of Companies that follows such conversion. But the certification is not issued by the Registrar by virtue of any requirement under Section 44 of the Act. It is be noted that the Registrar issues the certificate, a fresh certificate of incorporation, consequent upon the deletion of the word “private” from the name of the company. Moreover the effect of a resolution under Section 44 of the Act deleting the specific conditions constituting a company, a private company, is immediate and the change in status happens no sooner than the resolution is passed. Hence the company forthwith on the passing of the resolution becomes a public company. Filing of the said resolution under Section 192 of the Act or the filing the statement of lieu of prospectus under Section 44 of the Act or the registration of the change of name arising out of the need for deleting the word “private” from the name of the company are all matters that may happen subsequent to the change in status. They have to be distinguished from the

certificate issued by the Registrar under section 18 of the Act whether for alteration of objects or for shifting of registered office. Further, the moment a private company becomes a public company under this section, it has to comply with various other requirements contained in the Act with regard to a public company.

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.

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.

ANALYSIS OF PART III OF THE COMPANIES ACT

Part III of the Act contains Sections 55 to 81 and this part deals extensively with issue and allotment of securities.

It is essential to distinguish between issue of securities by a listed company whether the proposed issue is to the public or not, from issue of securities by any other company. Where the securities are proposed to be issued to public, the unlisted company would be regarded as a company that purports to issue shares to the public. In both the cases, while there are very important provisions under the Companies Act, pursuant to the enactment to the SEBI Act and constitution of SEBI, and further pursuant to introduction of Section 55A in the Act by the Companies (Amendment) Act, 2000, all these matters have seen a necessary shift in focus from the provisions of Companies Act to the Guidelines of SEBI. This aspect must be borne in mind while considering the compliances with regard to issue of securities.

It should be borne in mind, for a listed company, every issue has to be in accordance with the SEBI Guidelines and the Listing Agreement also. Whereas these Guidelines will apply to an unlisted company only when there is an issue to public. Any issue of shares or debentures to 50 or more persons would be deemed to be an issue to public pursuant to Section 67 of the Act. In the case of listed companies compliance programme needs to cover anything falling under SEBI Guidelines or Listing Agreement.

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, 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 this regard, the Company Law Board in one of its decisions observed and held that unsecured loans that do not have the features of public deposits are not deposits at all.

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.

PRIVATE PLACEMENT (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. Virtually, neither there should be an offer nor any invitation to subscribe for shares/debentures to 50 persons or more otherwise than by way of a public issue.

This is interesting and it is possible in unlisted public companies. In listed companies a resolution under Section 81(1A) is usually passed and the Disclosure and Investor Protection Guidelines are followed as per Chapter XIII. Even in such

cases, it is quite possible that Section 67 of the Act is violated. A violation of Section 67 of the Act is a major violation and it creates a major offence. It cannot be said that Section 629A of the Act will apply and the offence is treated as though it is an offence for which specific penalty is provided elsewhere in the Act. A violation of Section 67 of the Act should be construed in the proper perspective and it should be said that all the provisions of Act and the SEBI Guidelines that apply to issue of shares or as the case may be, debentures to public have been violated.

The question involved is a question of fact and for the purpose of attracting Section 67 of the Act, it is not necessary that there should be an allotment of shares/ debentures though the filing of a Form No.2 evidencing allotment on a particular date to 50 persons or more will prove to be a clinching evidence of the contravention of Section 67 of the Act. Inspite of the amendment brought about by the Amendment Act 2000, questions like whether issue of shares to 50 persons or more in different tranches not happening in a single lot or originating at a particular point of time would attract Section 67 of the Act, often come up. The underlying principle that there should not be an offer or invitation to 50 persons or more 'is the guiding principle and whenever there is an offer or invitation to 50 persons or more otherwise than by way of a public issue, in accordance with the Act and the Guidelines, there will be a violation of Section 67 of the Act.

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 (Disclosure and Protection) Guidelines, 2000.All these are very important requirements and have been in place for protecting the investors. Only in respect of debt instruments privately placed by listed companies, there is a relaxation from this requirement. 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)

As per the listing agreement and Paragraph 2.1.4 of the SEB! (Disclosure and Investor Protection) Guidelines, 2000 and in view of the subsequent circular issued by SEBI, companies issuing securities to public have to necessarily get 'in principle' permission for listing the securities. However, the effect of Section 73 of the Act is very serious in that it makes the allotment totally void. Hence it is necessary to take care of that while complying Section 73.

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.

Section 211 of the Act would pose very complicated questions and finding an answer 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 ?

SECURITIES PREMIUM ACCOUNT (SECTION 78)

Under this section, there are certain restrictions with regard to using the moneys lying to the credit of the securities premium account of the company. Of late, this provision read with Section 100 of the Act has been frequently resorted to for various purposes. It is necessary to note that even though there will be adoption of the procedure prescribed under Section 100 of the Act relating to reduction of capital, companies resorting to this procedure normally obtain from the High Court concerned exemption from the need to mention the words “and reduced” alongwith its capital. Companies do not make a mention of this material matter having financial implication in the Directors’ Report as required under Section 217 of the Act. Many a times, companies might have utilized the securities premium account even without compliance of Section 78 or Section 78 read with Section 100 of the Act.

It should be ensured that the company has applied the moneys, if any, lying to its securities premium account in the manner and for the-purposes stipulated under Section 78 of the Act.”

REDEMPTION OF REDEEMABLE PREFERENCE SHARES (SECTION 80A)

Section 80A contains a major provision of law highlighting the significance attached to redemption of preference shares. The provisions of this section add the protection available to preference shareholders in addition to the voting rights conferred upon them in Section 87 of the Act. The penal provisions contained in this Section are very serious and the section creates a non-compoundable offence. CLB has no power to condone generally any delay in redemption of preference shares. The power vested in CLB applies only to preference shares which have become liable to be redeemed in pursuance of the requirement of the law imposed under this section and company cannot take for granted and delay the redemption. The only way in which company may post pone the redemption without being hit by the penal clauses of Section 80A appears to be a further issue of redeemable preference shares.

FURTHER ISSUE OF SHARES (SECTION 81)

Section 81 is 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:

Question: Whether a resolution of the general meeting of the company is required?

Answer: As per Section 81(1) of the Companies Act, 1956, (the Act), if a company contemplates further issue of shares after certain time (i.e, within 1 year after first allotment etc.,) such issue must first be offered to the existing members only. As per Section 81(1 A) of the Act if the shares were to be offered to persons other than (whether including existing members or not) in any manner without complying with the requirement of Section 81(1) of the Act, then only there is a requirement for obtaining a special resolution from the members of the company. Hence for a mere rights offer failing under Section 81(1) of the Act, no resolution of the company is required. However, it is needless to say that even in respect of listed companies, Clause 23 of the Listing Agreement provides the need for consent of the company in general meeting only if the issue were to be otherwise than on a rights basis.

Question: Whether, in a rights issue, the Board can permit the right to apply for additional shares even to the renouncees?

Answer: The Board has an unfettered right in the matter of disposal of shares that have not been subscribed. Therefore such shares can very well be offered to members to whom the offer of rights has been made or to any other person to whom such members choose to renounce the rights in accordance with Section 81(1)(c)of the Act.

Granting an option to subscribe for additional shares to the members or to their renouncees is very well within the statutory powers conferred upon the Board of Directors by Section 81(1)(d) of the Act. As long as such a right to apply for additional shares is restricted to shares remaining unsubscribed out of the total number of shares offered and as long as such right to apply for additional shares is part and parcel of the rights offer itself and the details of such a right have been spelt out clearly in the Letter of Offer itself, there is no problem.

Question: Will such offer of additional shares would be tantamount to a preferential issue within the meaning of Chapter XIII of the SEBI guidelines?

Answer: A resolution of the company in a general meeting is not required for the offer of rigrfts shares and there is no change in the position even if there be included the right to apply for additional shares.

As per Clause 13.0 under Chapter XIII relating to Guidelines for Preferential Issues, the Preferential Issue of Equity shares/Fully convertible Debentures (FCDs)/ Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed Companies whose equity share capital is listed on any stock exchange, to any select group of persons under Section 81(1 A) of the Act, on Private Placement basis, shall be governed by those Guidelines.

The term ‘Preferential Allotment’ means an issue of capital made by a body

corporate in pursuance of a resolution passed under sub section (1A) of Section 81 of the Companies Act, 1956.

As the Guidelines specifically refer to (a) issue of shares etc., to any select group of persons (b) an issue under Section 81(1A) of the Act and (c) to such issue on a Private Placement basis, any issue on a rights basis will not fall under the specific conditions laid down under Chapter XIII of the Guidelines relating to preferential issues.

As per definition given in sub-Clause (xxv) of Clause 1.2.1 in Chapter I of SEBI Guidelines, "Rights Issue means an issue of capital under sub-section (1) of the Section 81 of the Act, to be offered to the existing shareholders of the Company through a letter of offer. An issue of shares including granting an option to apply for additional shares to eligible members or their renouncees covered by sub-section (1) of Section 81 of the Act cannot attract the provisions of Chapter XIII of the Guidelines.

It is interesting to note certain provisions of the SEBI takeover code also. Under Takeover Regulation 3 (1) (b), any allotment pursuant to an application made by a shareholder for rights issue to the extent of his entitlement and up to the percentage specified in Regulation 11 of the said Regulations is outside the said code. As per Regulation 11 of the said Regulations, an acquirer acquiring 15% or more but less than 75% of shares or voting rights is required to make a public announcement as per the said code. However the limit mentioned in Regulation 11 of the Regulations will not apply to the acquisition by any person presently in control of the company and who has disclosed in the letter of offer that he intends to apply for additional shares beyond his entitlement if the issue goes undersubscribed. Provided further in the said Regulations that the above exemption from the code is not available to any acquisition that results in change in control of management of the Company.

Therefore offer of additional shares as part and parcel of the rights shares would not tantamount to a preferential issue within the meaning of Chapter XIII of the SEBI Guidelines.

It can be seen that further issue of shares would fall under the expression preferential allotment of shares.Preferential allotment of shares in the case of a listed company is governed by the SEBI (Disclosure and Investor Protection), Guidelines, 2000. Similarly, preferential allotment of shares of unlisted public companies is governed by Unlisted Public Companies (Preferential Allotment) Rules, 2003.

Compliance of guidelines of SEBI in the case of listed companies are regulated by SEBI. With regard to the Unlisted Public Companies (Preferential Allotment) Rules, 2003, it is necessary to note that the following are the basic requirements of the said Rules:

- It must be noted that there has to be an enabling clause in the Articles of Association of the Company that intends to make the preferential allotment of shares.
- There has to be a special resolution, which is duly passed in a general meeting and which is valid only for a period of 12 months from the date of passing. In other words, the preferential allotment should be completed within the said 12 months.

- The explanatory statement should contain certain specific disclosure requirement.
- It is necessary to obtain a certificate from a Company Secretary in practice and place before the general meeting in which the proposal with regard to preferential allotment would be considered and the certificate should state that the said allotment is being made in accordance with the said Rules.

In respect of conversion of loans into shares, there are certain important conditions subject to which these conversions will fall within the exceptions contained in this section. There is also need to comply with the Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to Convert such Debentures or Loans to Shares), Rules 1977.

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. It is duty of Company Secretry to confirm that.

TRANSFER OF SHARES (SECTION 108)

In the case of listed companies, transfers undergo a lot of process and in the demat era, there may not really be any need or control over transfers. In respect of private companies, it is necessary to remember the absolute need for compliance of provisions of the Articles of Association, because the Articles could contain certain restrictions. Most of the cases under Section 111 and some of the cases under Section 397 and 398 arise out of non-compliance of the provisions of the Articles of Association.

In respect of public companies, the shares are freely transferable and there cannot be restriction in the Articles of Association. A perusal of Section 111A of the Act would reveal that there are only a few options available to the Board of Directors for refusing to register the transfer of shares.

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 ?"

LIMITATION OF TIME FOR ISSUE OF CERTIFICATES (SECTION 113)

It is to be ensured that the company has delivered all the certificates within the time limit specified or within such extended time in respect of debentures after allotment/registration of transfer

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. However, it is necessary to note that the Act has not yet prescribed anything so far.
- 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.
- The Ministry of Company Affairs has clarified that 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 and DRR is must for debentures issued before the inserting of Section 117C. Section 117C came into force from 13/12/2000.
- 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. However this situation might arise rarely.

Section 122

This section makes a contract with a company to take up and pay for any debentures of the company could be enforced by a decree for specific performance.

ANALYSIS OF PART V OF THE COMPANIES ACT

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.

Considering, the number of petitions that are filed before Company Law Board, one would be able to appreciate the extent of understanding/compliance of these provisions. 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.

ANALYSIS OF PART VI OF THE COMPANIES ACT

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, (iij 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.

With regard to shifting of registered office of a company, the following requirements have to be noted:

- For shifting within the village or town limits, a board resolution will be sufficient.
- For shifting outside the city, village and town limits, a special resolution in general meeting is necessary.
- For shifting outside the city, village and town limits, though within the State, if the shifting removes the registered office from the jurisdiction of one Registrar of Companies to that of another Registrar, a special resolution in general meeting is necessary and the approval of the Regional Director is also required.
- For shifting the registered office from one State to another, a special resolution in general meeting and confirmation of the Company Law Board is necessary.

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 do not resort to book closure as it is not mandatory. But where they close their books, there is hardly any compliance of this section. There are many unlisted public companies with large shareholder base and therefore it cannot be said that this section has out lived its purpose.

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)

Read with 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 a 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.

PROVISIONS APPLICABLE TO GENERAL MEETINGS (SECTION 170 TO 186)

All procedural matters regarding general meetings are covered under these sections.

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 recent 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) Rules, 2003. [Rule 6]

GENERAL MEETING UNDER THE DIRECTION OF COMPANY LAW BOARD (SECTION 186)

Where a general meeting has been called, held and conducted pursuant to an order of the Company Law Board on the application of any director or member, it is necessary to bring it to the notice of the members in order to keep them informed of the impracticable situation that has led to the holding of such general meeting.

CIRCULATION OF MEMBERS' RESOLUTIONS (SECTION 188)

Under this section one can find another opportunity conferred upon members for making their representations and moving motions for being passed as resolutions. In order to ensure that there is no misuse, this section incorporates adequate checks and balances.

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 a 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. Interestingly, the concept of adequate profit is not defined in the Act.

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 205B of the Act has lost its relevance after the coming into force of Section 205C, though Section 205B is still in the statute book and it could be invoked in certain old cases.

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. The importance of this requirement would be understood by referring to the disclosure requirement incorporated in this respect in the Schedule VI (format of Balance Sheet) and in Schedule V (format of annual return).

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.

When the instrument which was originally tendered to the company was returned to the shareholder and a new transfer instrument was tendered instead of the returned one, the Company Law Board held that Section 206A will not apply to such cases because the registration of transfer was not kept pending at the time of issue of rights and bonus shares.

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 and if the Board wants to keep them elsewhere, the relevant Form No.23AA should be filed at the office of the Registrar of Companies. The question of filing the prescribed form would be covered by the general question relating to returns and registers. 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 notify the Ministry of Company 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 of 15 months.

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. The Company Law Board observed as follows:

> "It is clear that regulatory authorities which have authorised public issues did not monitor the utilization of the funds raised from the public. The CLB observed that the absence of such monitoring system was perhaps one of the reasons for this Company's position of being what it was. The CLB further held that in the larger interests of the public shareholders, and in the interest of the Company, certain suitable remedial steps had to be ordered, as it was clear that the management was guilty of commission and omission".

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 Requlations thereunder and the SEBI Guidelines and 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.

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).
- Disqualification of Directors (Section 274).
- Maximum number of Directorship (Section 275).
- Automatic vacation of office (Section 283).
- Removal of directors (Section 284).

Though a company is created as an artificial person with contribution to its capital coming from "several members", the directors are the persons who run the day-to-day affairs of the company and manage the business of the company. Section 290 of the Act contains a laudable provision. It provides that if subsequent to the appointment of a person as a director, any defect is discovered, such discovery will not affect the validity of acts of such a person in whose appointment a defect was discovered.

For illustration, in the case of banking companies, the Banking Regulation Act, 1949 provides that the director of a bank cannot continue in office for more than 8 years continuously [Section 10A(2-A)]. This implies that if a person is appointed as a director of a banking company on a particular day, he has to vacate the office on the expiry of 8 years from the date of his appointment. If he were to resign a few days before the expiry of the 8th year and if the banking company were to appoint another person in his place under Section 262 of the Act, can such person who filled the vacancy continue beyond the date on which the original director would have vacated his office by operation of law. Assuming a person who fills up the casual vacancy caused in such a manner, he cannot continue in office beyond the period upto which the original director would have continued in office. Disregarding the above position of law, if the person appointed under Section 262 continues in office, it could be said that there is a fundamental flaw in such continuance. However, the validity of all acts of such director is saved by Section 290 of the Act.

Therefore, the question whether the Board of Directors of the company is properly constituted or not, encompasses within its ambit a lot of questions of fact and law. Several such illustrations can be given in this regard. It goes without saying that answers to the above question would require a thorough examination of the provisions of not only Sections 252 to 266 of the Act, but also several other sections of the Act such as Sections 274, 269, 283, 284, 295, 397, 398 and many other laws going beyond the barriers of the Companies Act.

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. In the era of independent directors would such transactions require prior approval of Central Government is a different question altogether. 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. By a circular, the Ministry of Company Affairs has issued a checklist for being followed in respect of matters falling under Section 295.

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 and in the case of companies having a paid up share capital of not less than Rs.1 Crore, prior approval of the Central Government also. 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/relinguishment.

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.
- By a circular, the Department of Company Affairs has issued a checklist for being followed in respect of matters falling under Section 372A.

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)

Whether a company has appointed a whole time company secretary is a question, which is seldom asked. Many a times, statutory auditors used to have a doubt, whether to make a statement in their report about the vacancy. However, as per the present requirement, auditors are not under any duty to report whether the company has appointed a company secretary or not.

Given the fact that Section 383A is in statute book to ensure that the company carries out all its statutory obligations not only under the Companies Act but also under other legislations, it is necessary to ensure that "whether the company has appointed a whole time company secretary as per Section 383A of the Act?"

SCHEME OF COMPROMISE, ARRANGEMENT, ETC (SECTION 390 TO 394A)

Registration of every sanctioned scheme or arrangement is mandatory as per Section 394(3) of the Act. Though all other formalities concerning schemes or arrangements undergo a thorough scrutiny leading to sanction or otherwise, the registration part goes unchecked. It is necessary to check "Whether the company has registered the order of the court, if any, with RoC as required under Section 394(3) of the Act?"

ACQUISITION OF SHARES OF ANOTHER COMPANY (SECTION 395)

Under Section 395 of the Act, the following are the salient features:

- Facility for acquisition of minority stake.
- The trigger for the operation of the compulsory acquisition of the stake of the minority is the notice to be issued to them by the Transferee Company within 2 months of the expiry of the period of 4 months envisaged under Section 395 of the Act. But even without going through the grind, if an acquirer is confident of acquiring the entire control, there is no need to go through Section 395 of the Act. It is purely an option recognized by the statute.
- While acquisition through a route otherwise than the one stipulated under Section 395 of the Act is possible, there is no possibility of acquiring the minority stake as a matter of statutory requirement in a

case where the dissenting shareholders hold less than 10% in value of the share capital of the Company.

If a company acquires the shares of another company through Section 395, the circular should be registered in the prescribed form/manner and the company is liable to acquire the minority holdings within the prescribed time. If the company fails to register the circulars/if the company fails to buy the shares held by dissentient/minority shareholders, such defaults on the part of the acquiring company might go unnoticed.

OPPRESSION AND MISMANAGEMENT (SECTION 397 TO 407)

The provisions relating to oppression and mismanagement are considered to be very effective in resolving disputes between shareholders/directors representing different shareholder groups. So much so that these disputes are often referred to as battle for corporate management, control and ownership. At the same time, in such situations, the underlying truth is that there are under currents and it signals the need for abundant caution to be exercised by minority shareholders, creditors and other shareholders.

One has to check "Whether any petition/application has been filed against the companv or its directors under Section 397/398 of the Act and whether the company/directors have complied with the order of the Companv Law Board, if any, under Section 402/403 of the Act?"

EMPLOYEES SECURITY DEPOSITS AND PROVIDENT FUNDS (SECTIONS 417 TO 420)

It is necessary to note that the Act requires security deposits collected from employees to be preserved separately and the contributions to the provident fund constituted by the company to be made without any delay. In this context, it is necessary to underline the importance of these provisions from the point of view of the interests of the employees. Particularly, in times of financial crunch, the directors might utilise these monies for day-to-day purposes and therefore there must be an effective mechanism, which prevents the management from doing so.

APPOINTMENT OF RECEIVERS AND MANAGERS (SECTIONS 421 TO 424)

Under Section 421 of the Act, appointment of receivers, managers require the filing of abstract in the prescribed form with the Registrar of Companies under Section 422 of the Act, it must be noted that an invoices should bear the information that a receiver has been appointed.

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.

COMPLIANCES UNDER INBOUND/OUTBOUND INVESTMENT

Please refer to Chapter IX and X of this study material.

COMPLIANCES WITH RESPECT TO VARIOUS ISSUES (IPO/FPO)

Please refer to Chapter II and III of this study material.

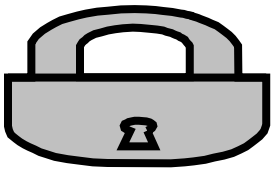
COMPLIANCES UNDER GDR AND IDR ISSUES

Please refer to Chapter VII and VIII of this study material.

LESSON ROUND-UP

- Secretarial Audit comprises 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 utility even to larger companies which otherwise have a whole-time Company Secretary in its employment.
- Secretarial Audit Report is a report which the Secretarial Auditor shall prepare in relation to a company whose secretarial compliances are seen by him with respect to the maintenance of statutory registers, minute books, meetings of the company, approvals required from various authorities under the Companies Act, Monopolies and Restrictive Trade Practices Act, etc.
- 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 MRTP, SEBI, regulations relating to capital issue, takeover code, insider trading, mutual funds, depositories and participants regulations, Foreign exchange/collaborations etc.

SELF-TEST QUESTIONS



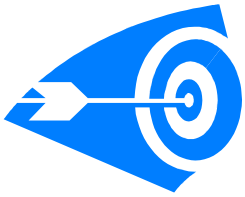
(These are meant for recapitulation only. Answers to these are not to be submitted for evaluation)

1. Discuss the need for and scope of Secretarial Audit.
2. State the guidelines evolved by the Institute for appointment of Secretarial Auditor.
3. What are the points to be kept in mind by the Secretarial Auditor while conducting Secretarial Audit of the company.
4. What all points are to be appraised while checking the compliance of a listed company?
5. Discuss the covenants imposed under the loan agreement entered into with the Financial Institutions.

STUDY XIV

SHARE TRANSFER AUDIT

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- Meaning, Need, scope of Share Transfer audit
- Appraisal of share transfer work
- Salient features of listing agreement pertaining to share transfers
- Audit for reconciliation of the total admitted capital with both the depositories and the total issued and listed capital etc.
- Safeguards on transfer of securities in dematerailised mode.

INTRODUCTION

Registration of transfer of shares, debentures and other securities is one of the area which has to be constantly monitored by the Company Secretary in a company . This is one area where the investors have interaction with the company and also judge its functioning. By not caring or not paying proper attention to the work connected with registration of transfers the company whether manual or electronic transfer, will have disgruntled shareholders. Naturally this will create a bad impression on them and consequently the image of the company would suffer.

Under Section 108 of the Companies Act, 1956 a company cannot register a transfer unless proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by and on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee is delivered to the Company with the certificate relating to the security involved in transfer or where no certificate is in existence, alongwith the letter of allotment of the security concerned.

Format of Transfer Deed

The transfer deed will have to be in Form 7B appended to the Companies (Central Government's) General Rules and Forms, 1956. If the transfer deed relates to transfer of shares it should be stamped with date by the Registrar of Companies or other officials authorised in this behalf by the Central Government before anything is written on it.

Validity of Transfer Deed

The transfer deed so stamped is valid for lodgement in the case of a listed company within 12 months of the date so stamped or first closure of the register of members after it is so dated-stamped, whichever is later.

In the case of an unlisted company it is valid for lodgement within two months of the date so stamped.

Where the validity period of an instrument of transfer has expired namely, the instrument is beyond 12 months from the date of presentation to the prescribed authority or from the date of book closure whichever is later in case of shares of a listed company, and in other case 2 months from the date of presentation, the holder may make an application in Form 7C to the Registrar of companies requesting for extension in validity, alongwith requisite fee based on the nominal value of shares.

The transfer deed so stamped is valid for lodgement in the case of a listed company within 12 months of the date so stamped or first closure of the register of members after it is so dated-stamped, whichever is later. In the case of an unlisted company it is valid for lodgement within two months of the date so stamped.

When date of stamping requirements on transfer deed is not applicable?

The date-stamping requirement is not applicable in relation to transfer deed executed for transfer of debentures or other securities in a company.

Registration of Transfer of Shares

Transfer Deed duly executed for the registration of a transfer of the shares or other interest of a member in a company may be submitted either by the transferor or by 'transferee', together with the relevant share certificates.

Under Section 113 of the Companies Act, a company is required to deliver the certificate within three months after the allotment of any of its securities and within two months after the application for registration of transfer of any such securities. However, this period for issue of certificates for debentures may be extended by the Company Law Board*, on an application being made to it in this behalf by the company to a further period of not exceeding nine months where it is satisfied that it is not possible for the company to deliver such certificates within the said periods. Generally, the practice is to send the certificate to the person who lodged the transfer in question with the company or as per the instructions at the time of lodgement of the transfer deed for registration. Also see *Jagatjit Industries Ltd. and others* v. *Mohan Meakin Ltd. and others* (1991) 6 CLA 22 (CLB). While the period of two months will generally be applicable to companies for return of certificates relating to a security after registration of transfer of the security, in the case of listed company this period has been curtailed to one month by virtue of a provision in the listing agreement whereunder companies have agreed to return the certificates within one month of the date of lodgement for transfer [vide Clause 3(c) of the listing agreement].

Where the securities are dealt within a depository, the company is required to intimate the details of allotment of securities to depository immediately on allotment of such securities and every depository shall on receipt of intimation from a participant, register the transfer of securities in the name of the transferee. In case

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* now tribunal.

the beneficial owner or a transferee of any securities seeks to have custody of such securities, the depository shall inform the issuer accordingly.

Along with the Depositories Act, 1996 a new Sub-section (14) was added to Section 111 of the Companies Act, 1956 by which Section 111 was made applicable only to a private company. At the same time Section 22A of Securities Contracts (Regulation) Act, 1956 was repealed. Instead a new Section 111A was inserted in the Companies Act, 1956, which provided that:

(1) The said section is applicable to a company other than a private company.

(2) If a transfer of shares has been made wrongly, the Company Law Board* may order rectification of the register of members and debentureholders.

(3) The shares and debentures of a public company are freely transferable. Where a company refuses to register a transfer within two months of deposit of the instrument of transfer, the transferee may appeal to the Company Law Board* for directing the Company to register the transfer [This was added to Section 111A(2) by Depositories Related Laws (Amendment) Act, 1997 (5 of 1997)].

AUDIT OF SHARE TRANSFERS

The auditor is required to check the following aspects while conducting share transfer audit.

— **Proper instrument should have been submitted to the company.** Execution and delivery of share transfer form is an essential pre-requisite without which a company cannot register a transfer. The prescribed Form 7B should be duly endorsed by the ROC.

— The share transfer form may be lodged either by transferor or by transferee.

Verify whether the transfer falls within the purview of the following cases:

(i) share transferred by a director or nominee on behalf of another body corporate under Section 49(2) and (3);

(ii) shares transferred by a director or nominee on behalf of a corporation owned or controlled by the Central or State Government;

(iii) shares transferred by way of deposit as a security for repayment of any loan or advance if they are made with any of these: (a) State Bank of India or (b) any scheduled bank or (c) any banking company or (d) financial institution or (e) Central Government or (f) State Government (g) any corporation owned or controlled by the Central or State Government; or

(iv) trustees who have filed the declarations;

(v) transfer of debentures.

In the aforesaid, the instrument of transfer may not be in the prescribed form.

— **Check whether transfer deed is duly stamped and executed both by transferor and transferee**.

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* now tribunal.

In the case of transfer of shares the stamp duty is uniform throughout the country. On every share transfer form, there shall be paid requisite Stamp Duty as per Indian Stamp Act, 1899 and the stamp duty payable on a share transfer is to be paid by affixing to transfer form special adhesive stamps bearing the words 'Share Transfer'.

In the case of transfer of shares the stamp duty is uniform throughout the country. In the case of transfer of debentures or other securities the stamp duty payable on transfer thereof vary from State to State.

In the absence of proof of payment of such consideration companies generally assume the market value of the shares on the date of execution of the transfer deed for the purpose of calculation of stamp duty. It should be noted that share transfer stamps of the value equivalent to the duty payable is to be affixed on the transfer deed and the stamps should be cancelled also before the transfer deed is lodged with the company. Strictly speaking, a company cannot accept a transfer deed for registration unless share transfer stamps are affixed and the same are cancelled.

In the case of transfer of debentures or other securities the stamp duty payable on transfer thereof vary from State to State. The duty has to be paid at the time of execution. The duty so paid at the time of execution should, however, be not less than the duty payable in the State in which the Registered Office of the company is situate if the deed had been executed there. Please refer to the relevant provisions of the various State Stamp Acts.

If shares are held jointly by two or more persons, the instrument of transfer must be executed by all joint holders. Splitting of joint holding into individual shareholding will also require execution of a share transfer deed. In such a case, all joint holders shall sign a transfer deed as transferors and the respective individuals holders in whose favour splitting is to be made, shall sign as transferees.

— **The signature of the transferor should tally with the specimen recorded with the company.**

Where although the signatures are attested by Notary Public, the same do not tally or the signatures have not been properly attested, the companies are advised to satisfy themselves where there is doubt/apprehension about the genuineness of signatures by making a reference to the transferor.

However, a company cannot escape liability where attestation is done negligently. The signatures of the transferor in the share/debenture transfer form must be witnessed by other person, giving his name, signature and address.

— **Where the instrument is executed by a person other than transferor or transferee named in instrument, on behalf of transferor or the transferee, the document authorising the executant to execute the instrument of transfer must be obtained by the company.** If the transferor is a body corporate, it should be ensured that a Board resolution of the transferor has been passed and proper authority has been given by the

Board of directors to the person signing as the transferor on behalf of the company.

— The share transfer form must be complete as regards other particulars i.e. name, address, occupation etc. of transferee.

— Share certificate or if no such certificate is in existence the letter of allotment of shares shall be delivered alongwith the instrument. Every instrument of transfer should be presented to the prescribed authority for dating before anything is filled in or signed by the transferor.

— **Share transfer form must be presented in time limit for delivery of instrument,** together with related certificates, in compliance with Section 108 of the Companies Act, 1956.

— If the transferee is a company then before registering the transfer it should be seen with reference to the Objects Clause of the Memorandum of Association of the company concerned whether it is one of the objects of the company to make investments in the securities of other companies and the investment is properly authorised by the Board of directors under Section 292 and, if applicable, under Section 372A of the Companies Act, 1956 and appropriate delegation has been given in favour of the person who has signed the transfer deed. In *Jagatjit Industries Ltd. and others* v. *Mohan Meakins Ltd. and others* (1991) 6 CLA 22 (CLB) companies need not indicate occupation in the relevant column of the transfer deed.

— Where the application is made by the transferor and relates to partly paid up shares, check whether the company has given due notice of application to the transferee and whether the transferee has raised objection, if any, within two weeks from the date of receipt of the said notice.

— If the signed transfer deed has been lost, the same stamp is affixed on the written application, in which case, the Board may, if it thinks fit, register the transfer on suitable terms of indemnity.

— **Check whether any restriction, is/was at any time imposed on the transfer of shares, whether by the Articles or under any other law**.

— Check whether the transferor and transferee are both entered as beneficial owners in the records of a depository in which case provisions of Section 108 do not apply.

— Check whether the transfer is in violation of provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

— If the company is a listed company and Shares Transfer Agents are processing the company's share transfer work, check whether they have followed the guidelines issued by various market intermediaries including general norms for processing of documents, norms for processing of transfers and norms for objection.

— Check whether all the work related to share registry in terms of both physical and electronic form is maintained by the company at a single point i.e. either in house by the company or by a SEBI registered Registrar and Transfer Agent.

— Check whether uniform guidelines prescribed by SEBI are followed by Registrars to an Issue (RTI)/Share Transfer Agents (STA) and companies for handling and processing of transfer documents

SEBI vide its circular No. 1 (2000-2001) dated May 09, 2001 has issued uniform guidelines to be followed by RTI/STA and companies. These guidelines have been divided into three parts:

(i) General norms for processing of documents.

(ii) Norms for processing of transfers.

(iii) Norms for objection.

Draft of the formats to be used have also been suggested in these guidelines.

All registered RTIs and STAs and companies listed on stock exchanges should mandatorily follow these guidelines and formats. These directions are issued pursuant to powers conferred on SEBI under Section 11B of SEBI Act, 1992.

In addition to the above aspects, the following aspects are to be kept in mind while effecting transfers.

(a) Appraisal of register of members/debenture holders

Check whether a company has properly maintained its register of members and register of debentureholders with respect to the following aspects:

— Whether the registers are maintained in the form prescribed under the Companies (Issue of Share Certificates) Rules, 1960 or as near thereto as circumstances admit.

— Whether the details of the transfers have been posted in the proper folios in the register of members. In case of transferee being a new member whether new folio has been allotted to him. In case after recording the transfer the holding of a member becomes nil whether the folio has been properly closed.

— Whether entries in the register are authenticated by the Secretary or any other person authorised by the Board.

— Whether in case of a company having more than 50 members an index of members is maintained.

— Whether every change in the register of members has been recorded in the index within 14 days.

— Whether the declarations received under Section 187C have been properly entered in the proper folio of the register of members.

(b) Processing of Dividends/Interest Warrants, considering share transfer

The paramount requirement in the processing of dividend/interest warrants is to determine the persons entitled to the dividend/interest as the case may be. For this purpose, under Section 154 of the Companies Act, 1956, companies are empowered to close the register of members/register of debenture holders by giving 7 days' clear notice by advertisement in some newspaper circulating in the district in which the registered office of the company is situate. In case of listed companies under the listing agreement companies are required to close the transfer books only once in a year with reference to the annual general meeting. For all other purposes the stock

exchanges require fixation of record date. Before closing the transfer books or fixing the record date the concerned stock exchange should be given a notice at least 42 days in advance. In view of the above, in the case of listed companies while transfer books can be closed for the payment of dividend/final dividend, for all other purposes they can only fix a record date. Even though Section 154 of the Companies Act, 1956 is silent with regard to giving notice to members in regard to fixation of record date, it is necessary to publish notice in the same manner as is done for closure of register of members so as to enable the members/debentureholders to lodge the transfer deed in time for getting their entitlement.

All valid transfer deeds lodged with the company before the date of commencement of the closure of register of members/register of debentureholders or the record date should be given effect to and list of persons who are entitled for the dividend/interest as the case may be should be prepared.

Separate banking account should be opened for payment of dividend/interest, as the case may be. The dividend warrants/interest warrants should be got printed, prepared and duly signed. It should be kept ready for delivery. As soon as the dividend is declared at the general meeting the dividend warrant should be posted. In the case of interest the same should be posted immediately after it becomes due for payment or even earlier but dating the interest warrant with the date on which the interest becomes due. In any case the dividend warrants should be sent to the persons entitled thereto within 30 days of the declaration of the dividend (Section 207).

Under the listing agreement listed companies are required to intimate the stock exchange at least 21 days in advance of the date on and from which date the dividend will be payable. Listed companies are also required to issue dividend warrants payable at par at such centres as may be agreed to between the stock exchange and the company. Even though listing agreement is silent about the interest warrant, the procedure set out above should equally apply for payment of interest on debentures which are listed on stock exchanges.

A Company Secretary in Practice should while appraising the processing of dividend and interest warrants keep the foregoing aspects in mind and ensure that they are scrupulously followed by companies.

(c) Signature Verification on Transfer Deed

Where it is found that the transferor's signature on the transfer deed varies, a company is not bound to accept the deed even if it has been attested and the Ministry of Finance, Stock Exchange Division has advised companies that where there is a variation in the signature of the transferor, the company should send a notice to the transferor by registered post informing him of the receipt of the deed purportedly signed by him and that the company shall take action to register the transfer if the company does not receive any objection from the transferor within 21 days of the date of the said notice. This will help companies not to delay action in bona fide cases.

(d) Audit for reconciliation of the total admitted capital with both the depositories and the total issued and listed capital.

While conducting share transfer audit of a company which has both physical and

demat shares, the auditor check the following aspects

(i) Whether the work related to share registry in terms of both physical and electronic is maintained at a single point i.e. either in-house by the company or by a SEBI registered R & T Agent.

(ii) Whether the company or the registrars and share transfer agents (RSTA) as the case may be are maintaining records of all the shares dematerialised, rematerialised and details of all securities declared to be eligible for dematerialisation in the depositories and

(iii) Whether dematerialisation of shares are confirmed / created only after an in-principle approval of the stock exchange / s where the shares are listed and the admission of the said share with the depositories have been granted.

(iv) Whether they shall have proper systems and procedures in place to verify that the securities tendered for dematerialisation have not been dematerialised earlier.

(v) whether they ascertain, reconcile daily and confirm to the depositories that the total number of shares held in NSDL, CDSL and in the physical form tallies with the admitted, issued and listed capital of the issuer company; and

(vi) Whether they confirm that the dematerialisation requests have been processed within 21 days and shall also state the reasons for shares pending confirmation for more than 21 days from the date of request.

(vii) Whether Audit as specified by SEBI was undertaken by a qualified Chartered Accountant or a Company Secretary, for the purposes of reconciliation of the total admitted capital with both the depositories and the total issued and listed capital, ensuring the following aspects.

The total of the shares held in NSDL, CDSL and in the physical form tally with the issued / paid-up capital.

The Register of Members (RoM) is updated.

The dematerialisation requests have been confirmed within 21 days and state the shares pending confirmation for more than 21 days from the date of requests and reasons for delay.

The details of changes in share capital (due to rights, bonus, preferential issue, IPO, buyback, capital reduction, amalgamation, de-merger etc) during the quarter and certify in case of listed companies.

(viii) Whether in-principle approval for listing from all stock exchanges was obtained in respect of all further issues.

(ix) Whether the company has submitted the audit report on a quarterly basis to the stock exchange/s where they are listed.

(x) Whether there is any difference observed in the admitted, issued and listed capital.

(e) Safeguards to address the concerns of the Investors on Transfer of Securities in Dematerialized Mode

The concerns arising out of transfer of securities from the Beneficial Owner (BO) Accounts without proper authorization by the concerned investor have been brought to the notice of SEBI by some Investors' Associations. Accordingly SEBI has decided to put in place the following safeguards to address the concerns of the investors on electronic transfer:

(a) The depositories shall give more emphasis on investor education particularly with regard to careful preservation of Delivery Instruction Slip (DIS) by the BOs. The Depositories may advise the BOs not to leave "blank or signed" DIS with the Depository Participants (DPs) or any other person/entity.

(b) The DPs shall not accept pre-signed DIS with blank columns from the BO(s).

(c) The DPs shall issue only one DIS booklet containing not more than 20 slips for individual account holders and not more than 100 slips for non-individual account holders, at a time.

(d) If the DIS booklet is lost/stolen/not traceable by the BO, the same must be intimated to the DP immediately by the BO in writing. On receipt of such intimation, the DP shall cancel the unused DIS of the said booklet.

(e) The DPs can issue subsequent DIS booklet to a BO only after the BO has used not less than 75 per cent of the slips contained in the previous DIS booklet. The DP shall also ensure that a new DIS booklet is issued only on the strength of the DIS instruction request slip (contained in the previous booklet) duly complete in all respects, unless the request for fresh booklet is due to loss, etc., as referred to in clause (d) above.

(f) The DPs shall not issue more than 10 loose DIS to one account-holder in a financial year (April to March). The loose DIS can be issued only if the BO(s) come in person and sign the loose DIS in the presence of an authorised DP official.

(g) The DPs shall put in place appropriate checks and balances with regard to verification of signatures of the BOs while processing the DIS.

(h) The DPs shall cross check with the BOs under exceptional circumstances before acting upon the DIS.

(i) The DPs shall mandatorily verify with a BO before acting upon the DIS, in case of an account which remained inactive i.e., where no debit transaction had taken place for a continuous period of 6 months, whenever all the ISIN balances in that account (irrespective of the number of ISINs) are transferred at a time. However, in case of active accounts, such verification may be made mandatory only if the BO account has 5 or more ISINs and all such ISIN balances are transferred at a time. The authorized official of the DP verifying such transactions with the BO, shall record the details of the process, date, time, etc., of the verification on the instruction slip under his signature.

(f) Annual Return and Share Transfers

Companies are not required to get share transfer audit done but companies whether listed or not are required to file within two months of the holding of the

Annual General Meeting a list of members, debentureholders etc. once in six years with the Registrar of Companies alongwith the Annual Return. In the case of listed companies the Annual Return is required to be signed by a secretary in whole-time practice. Therefore, before signing the Annual Return as above Company Secretary in practice is required to examine the transfer records to satisfy himself that the transfers have been properly registered and in case any request for registration of transfer has been refused, the company concerned has complied with the requirements of section 108 and section 111A of the Companies Act. Of course, it will not be practicable to verify each and every transfer lodged with the company in case of medium sized and big companies. Therefore, the Company Secretary in practice can make a test check or a random check of the transfers. He should further invariably go through the agenda papers and minutes of the meeting of the Board of directors or Committee of directors in which matters relating to the registration of transfers or refusal to registration of transfers have been complied with. It may be added that the legal position has been broadly outlined above, but the Company Secretary in Practice is required to keep himself up-to-date on the law relating to share transfer and confirm compliance of the same while examining the transfers.

(g) Company Secretary as compliance officer in monitoring share transfers

In pursuance of Clause 47(a) of the Listing Agreement, a listed company has to appoint a Company Secretary as a compliance officer who will be responsible for monitoring the share transfer process and report to the company's board in each meeting. As a compliance officer, the company secretary is required to directly liase with the authorities such as SEBI, Stock Exchanges, ROC etc. and investors with respect to implementation of various clauses, rules, regulations and other directives of such authorities and investor service and complaints related maters.

Therefore, it is imperative for company secretaries to be conversant with the legal and procedural aspects of transfer of shares/debentures.

(h) Salient Provisions in the listing agreement with respect to transfer of shares

Clauses 3(c) and 6 of the Listing Agreement mainly deal with the subject matter of the certification.

Under sub-clause (c) of clause 3, a listed company is required to issue certificates within one month of the date of lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies. Thus, with regard to securities transferred generally, a listed company is required to transfer and issue the relative certificate for securities within a period of one month from the date of lodgement of transfer.

Also clause 6 of listing agreement provides that the issuer will, if so required by the exchange, certify transfers against letters of allotment, certificates and balance receipts and in that event the company will promptly make on transfers an endorsement to the following effects:

"Name of the Issuer_____

Certificate/Allotment Letter No._____ for the within mentioned_____ securities is deposited in the Issuer's office against his transfer No._____.

Signature(s) of official(s)_____

Date_____."

Apart from this various other clauses like Clause 7, 8, 10, 11, 12, 12A, 13, 14, 15, 16, 17, 21, 23, 34, 47 in the Listing Agreement cover the gamut of Share Transfer.

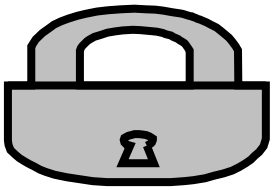
Keeping the aforesaid provisions in the listing agreement in view before certifying that a listed company has complied with these requirements, a Company Secretary should normally be required to verify in respect of each transfer lodged with the company, whether the relative certificate has been despatched after making endorsement of transfers within the stipulated time. While this is the general rule, it may not be always physically possible for a Company Secretary to verify each and every transfer deed, particularly, in the case of a company whose shares are frequently traded and the volume of transfers is large. In such cases, he can, on going through the systems and procedures in place with regard to transfers of securities, consolidation, renewal or exchange of securities and for endorsement of calls assess the extent to which he has to verify the facts for the purpose of this certification, e.g. if a Practising Company Secretary is convinced of the adequacy of the systems and procedures, he may decide to have a random or test check and decide to issue a certificate based on such a check. However, it should be borne in mind at the time of a random or test check if the Practising Company Secretary comes across considerable deficiencies in this regard, he should undertake complete check of all transfers. In any case no hard and fast rule can be laid down as regards the extent to which this check should be conducted. This will depend largely upon the position existing in the company and the judgement of the Practising Company Secretary concerned, even though he is required to certify about the completeness of transfer and despatch of certificates within the stipulated time.

The examination should not be confined only to duly completed transfer deeds lodged with the company but it should also include transfer lodged with the company which are deficient and are retained by the company after making a reference or returned to the lodger for making good the deficiency. Keeping in view the purpose for which the certification has been stipulated, it is but proper that the verification should cover all transfers lodged with the company whether they are fit for transfer or not. Transfer in respect of deficient transfer, return or reference to the lodger should also be done within a period of one month from the date of lodgement of transfer deeds. There should not be any delay in this regard.

LESSON ROUND UP

- Registration of transfer of shares, debentures and other securities is one of the main and important works of a Company Secretary in a company.
- All companies listed on stock exchanges are required to do the processing of share transfers and effect transfers in accordance with the provisions of the Companies Act, 1956, listing agreement and the guidelines issued by SEBI.
- Work related to share registry in terms of both physical and electronic should be maintained at a single point i.e. either in-house by the company or by a SEBI registered R & T Agent.
- As per the listing agreement, a listed company should insist on the RTA to produce to it a certificate from a Practicing Company Secretary that all transfers have been completed within the stipulated time.
- While effecting electronic transfers, DPs are advised to take safeguards on aspects such as delivery instruction slip etc.

SELF TEST QUESTIONS



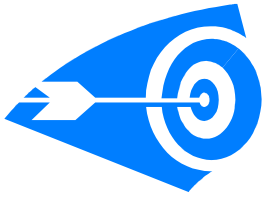
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. State the areas which need to be verified for appraisal of share transfer work.
2. Is it necessary for a company to get a share transfer audit done? State how the company secretary in practice should go about it?
3. Write a brief note on Audit for reconciliation of total admitted capital with both the depositories and the total issued and listed capital.
4. What are the safe guards to be taken in case of electronic transfer?

STUDY XV

COMPLIANCE CERTIFICATE

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- When Compliance Certificate is required?
- Various provisions of Companies (Compliance Certificate) Rules, 2001
- Various provisions of Companies (Appointment & Qualifications of Secretary) Rules, 1988.
- Check list for compliance certificate

Introduction

The Companies (Amendment) Act, 2000 had inserted a proviso to Sub-section (1) of Section 383A of the Companies Act which provides that *e*very company having such paid-up share capital as may be prescribed* shall have a whole-time secretary and where the Board of Directors of such company comprises only two directors, neither of them shall be the secretary of the company.

Every company not required to employ a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar a certificate from a secretary in whole-time 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 the provisions of this Act, and a copy of such certificate shall be attached with Board's report, referred to in Section 217.

When the appointment of whole time Company Secretary is mandatory?

Under Section 383 A(1) of the Companies Act, 1956, every Company having a paid-up share capital of not less than five crore rupees shall have a whole-time Company Secretary.

When Compliance Certificate from Practising Company Secretary is required?

Every Company not required to employ a whole-time secretary under Section 383 A(1) of the Companies Act, 1956 and having a paid up capital of ten lakhs rupees or more shall obtain a certificate from a secretary in whole-time practice.

* at present, Five Crores.

Why Compliance Certificate for Smaller Companies?

It is a well established fact that smaller companies fall prey to violations of the provisions of the Companies Act in the absence of professional support as compared to companies which have employed a qualified Company Secretary. The Ministry of Corporate Affairs institutes every year, a large number of prosecutions against the companies and their officers in default for contravention of various provisions of the Companies Act. Most of the companies against whom prosecutions are instituted are private limited companies or small public limited companies which do not have the benefit of expert professional advice of qualified Company Secretaries.

Accordingly, every company having a paid-up share capital of rupees ten lakh or more but less than rupees two crores is required to file with the Registrar of Companies (ROC), a Compliance Certificate obtained from a secretary in whole-time practice and also attach a copy of this certificate with a report of the Board of Directors of the Company.

Compliance Certificate not only acts as an effective mechanism to ensure that the legal and procedural requirements under the Companies Act are duly complied with but also instills professional discipline in the working of the company besides building up the necessary confidence in the state of affairs of the company. It relieves the company and its directors including the nominee directors from the consequences of unintended non-compliance of the provisions of the Companies Act. It curbs the tendency on the part of the smaller companies to short circuit the procedural requirements which primarily occur due to ignorance or lack of professional support and acts as a pre-emptive check to monitor compliance with the requirements of the Companies Act and the Rules made thereunder.

The Company Secretary, while undertaking the work of issuing Compliance Certificate should act as a friend and guide to the management of companies, instilling professionalism in their management, so that these companies appreciate their contribution. Only a positive and helpful approach can build the necessary confidence. If there have been technical non-compliances, the approach should be to guide and advise the company to make good the deficiencies by maintaining proper records, filing the requisite returns or seeking compounding of offences.

THE COMPANIES (COMPLIANCE CERTIFICATE) RULES, 2001

In terms of the newly inserted proviso to Sub-section (1) of Section 383A, the Central Government has prescribed the Companies (Compliance Certificate) Rules, 2001 (hereinafter called the rules) for issue of Compliance Certificate by a Practising Company Secretary.

The Rules have come into force w.e.f. February 1, 2001 i.e. the date of their publication in the Official Gazette.

According to Sub-rule (1) of Rule 3, every company not required to employ a whole-time secretary under Sub-section (1) of Section 383A of the Act and having a paid-up share capital of ten lakh rupees or more shall obtain a certificate from a Practising Company Secretary.

SCOPE OF COMPLIANCE CERTIFICATE

The scope of Compliance Certificate would comprise of certification of the

compliance of various requirements under the Companies Act and the Rules thereunder. The Practising Company Secretary should certify compliance only in respect of matters specified in the Form prescribed under the Rules and where any matter is not applicable, he should specify accordingly.

Sub-rule (2) of Rule 3 specifies that the Compliance Certificate shall be in Form appended to the Rules or as near thereto as circumstances admit. Certain amount of flexibility in the Form has, therefore, been provided which means that if any information required to be given in the certificate does not fit into the format, necessary modifications may be made in the format by the Practising Company Secretary.

At the time of issue of the first Compliance Certificate, the Practising Company Secretary should verify the registers and records maintained by the company from the first day of the financial year except where there are reasons for Practising Company Secretary to verify the records for the earlier years. Such occasions may arise in respect of maintenance of registers, retirement of directors by rotation, issue of share certificate when the allotments were made in the earlier years, payment of managerial remuneration, etc.

Period of Certification

Sub-rule (2) of Rule 3 provides that the Compliance Certificate shall relate to the period pertaining to the financial year of the company. The Companies (Amendment) Act, 2000 has come into force w.e.f. 13th December, 2000 and the Companies (Compliance Certificate) Rules, 2001 have come into force w.e.f. 1st February, 2001. Accordingly every company to which these Rules are applicable is required to obtain a Compliance Certificate from a Practising Company Secretary for the financial year in respect of which Board's report is signed on or after 1st February, 2001.

Filing of Compliance Certificate

Every company to which these Rules apply is required to file with the ROC the Compliance Certificate within thirty days from the date on which its annual general meeting is held.

Where the annual general meeting of such company for any year has not been held, such certificate is required to be filed with the ROC within thirty days from the latest day on or before which that meeting should have been held in accordance with the provisions of the Companies Act.

In case the annual general meeting is held and adjourned, the Compliance Certificate should be filed with the ROC within thirty days from the date on which such adjourned meeting was held provided such adjourned meeting is held within the statutory limit.

Right of Practising Company secretary to Access Records

Sub-rule (3) of Rule 3 provides that the Practising Company Secretary for the purpose of issue of Compliance Certificate shall have right to access at all times to the registers, books, papers, documents and records of the company whether kept in pursuance of the Act or any other Act or otherwise and whether kept at the registered

office of the company or elsewhere and shall be entitled to require from the officers or agents of the company, such information and explanations as the Practising Company Secretary may think necessary for the purpose of such certificate.

Compliance Certificate to be attached with Board's Report

Proviso to Sub-section (1) of Section 383A of the Act requires that the Compliance Certificate shall be attached with the Board's report referred to in Section 217. It is, therefore, necessary for the company to attach a copy of the Compliance Certificate with the Board's report while forwarding the same to members and others under Section 219 of the Act.

Further it would also be desirable for the Board to give full information and explanation in its report to the members under Section 217 of the Act on every reservation, qualification or adverse remarks contained in the Compliance Certificate.

Laying of the Compliance Certificate at the Annual General Meeting

Sub-rule (4) of Rule 3 requires the Compliance Certificate to be laid by the company in its annual general meeting. As a good secretarial practice, the certificate should be read at the meeting and also made available to the members for inspection.

Disqualifications of secretary in whole-time practice-Recommended by the Guidance note on Compliance Certificate published by ICSI

With a view to ensure that Practising Company Secretary shows utmost integrity and independence of judgement in the performance of his duties, it is desirable that, a person referred to in Sub-section (3) or Sub-section (4) of Section 226 of the Act, not to be eligible for appointment or reappointment for giving Compliance Certificate to a company.

Accordingly, the following persons are not to be qualified for appointment as Practising Company Secretary of a company

(a) a body corporate;
(b) an officer or employee of the company;
(c) a person who is a partner, or who is in the employment, an officer or employee of the company;
(d) a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;
(e) a person holding any security of that company which carries voting rights.

Penalty for non-compliance

Where a company fails to comply with the requirement of filing the Compliance Certificate with the Registrar of Companies or attaching the copy of such certificate with Board's report, in terms of Sub-section (1A) of Section 383A the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues.

Methodology for carrying out verification for certification

It would be advisable that the Practising Company Secretary requests the

company for access to various documents and books including the Memorandum and Articles of Association of the company, Annual Reports of the last two to three years, various statutory and other registers including the Minutes Books, copies of forms and returns filed with the ROC etc. which he considers essential for the purposes of laying down the certification programme.

Practising Company Secretary should verify all the available records. However, depending on the facts and circumstances he may obtain a letter of representation from the company in respect of matters where verification by Practising Company Secretary 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.

Certification with qualification

As specified in the Form, the qualification, reservation or adverse remarks, if any, may be stated by the Practising Company Secretary at the relevant places.

If the scope of work required to be performed, is restricted on account of limitations imposed by the client or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the certificate may be qualified as such.

Practising Company Secretary shall have due regard to the circulars and/or clarifications issued by the Ministry of Corporate Affairs from time to time. It is recommended that a specific reference of such circulars at the relevant places in the certificate may be made, wherever necessary.

Penalty for false Compliance Certificate

Section 628 deals with penalty for false statements. According to said Section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a statement

(a) which is false in any material particular, knowing it to be false, or
(b) which omits any material fact, knowing it to be material;

he shall, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

In view of this, a Practising Company Secretary will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate. However, a person will be penalised under Section 628 in case he makes a statement, which is false in any material particular, knowing it to be false, or which omits any material fact knowing it to be material.

Professional Responsibility

While the newly inserted provision has opened up the much awaited significant area of practice for company secretaries, it equally casts onerous responsibility on them and poses a greater challenge whereby they have to justify fully the faith and confidence reposed by the Government and trade and industry and measure up to

their expectations. Company Secretaries must take adequate care while issuing Compliance Certificate. It is based on this certificate that confidence of the company, Government and trade and industry will build-up vis-a-vis our profession. Any failure or lapse on the part of a Practising Company Secretary in issuing a Compliance Certificate may not only attract penalty for false statement under Section 628 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 negligence in issuing the Compliance Certificate. Therefore, it becomes imperative for the Practising Company Secretary that he exercises great care and caution while issuing the Compliance Certificate and also adheres to the highest standards of professional ethics and excellence in providing his services.

CEILING ON NUMBER OF COMPANIES TO WHICH A PCS CAN ISSUE COMPLIANCE CERTIFICATE

In exercise of the powers conferred by Clause (1) of Part II of the Second Schedule to the Company Secretaries Act, 1980 (56 of 1980), as amended by the Company Secretaries (Amendment) Act, 2006, the Council of the Institute of Company Secretaries of India has specified that:

A member of the Institute in practice who is entitled—

(i) to issue compliance certificate to the proviso to Sub-section (1) of Section 383A of the Companies Act, 1956 (1 of 1956); and/or

(ii) to sign an Annual Return pursuant to the proviso to Sub-section (1) of Section 161 of the Companies Act, 1956 (1 of 1956), shall be deemed to be guilty of professional misconduct if he—

— issues compliance certificates; and/or

— signs Annual Return

for more than eighty companies in aggregate, in a calendar year.

Provided, however, that in the case of a firm of Company Secretaries, the ceiling of eighty companies aforesaid would apply to each partner therein who is entitled to (i) sign the compliance certificate in terms of the proviso to Sub-section (1) of Section 383A of the Companies Act, 1956; (ii) sign Annual Return in terms of the proviso to Sub-section (1) of Section 161 of the Companies Act, 1956.

FORMAT OF COMPLIANCE CERTIFICATE

[vide Notification G.S.R. 52(E) dated 31.1.3001]

FORM

[See Rule 3]

Compliance Certificate

To,

The Members
_____(Name of the company)

I/We have examined the registers, records, books and papers of_____ Limited (the Company) as required to be maintained under

the Companies Act, 1956, (the Act) and the rules made thereunder and also the provisions contained in the Memorandum and Articles of Association of the Company for the financial year ended on 31st March, 20__. In my/our opinion and to the best of my/our information and according to the examinations carried out by me/us and explanations furnished to me/us by the company, its officers and agents, I/we certify that in respect of the aforesaid financial year:

1. the company has kept and maintained all registers as stated in Annexure ‘A’ to this certificate, as per the provisions and the rules made thereunder and all entries therein have been duly recorded.
2. the company has duly filed the forms and returns as stated in Annexure 'B’ to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the rules made thereunder.
3. the company being private limited company has the minimum prescribed paid-up capital and its maximum number of members during the said financial year was _____ excluding its present and past employees and the company during the year under scrutiny:
   (i) has not invited public to subscribe for its shares or debentures; and
   (ii) has not invited or accepted any deposits from persons other than its members, directors or their relatives.
4. the Board of Directors duly met _____times on _____(dates) in respect of which meetings proper notices were given and the proceedings were properly recorded and signed including the circular resolutions passed in the Minutes Book maintained for the purpose.
5. the company closed its Register of Members, and/or Debentureholders from _____ to _____ and necessary compliance of Section 154 of the Act has been made.
6. the annual general meeting for the financial year ended on _____ was held on _____ after giving due notice to the members of the company and the resolutions passed thereat were duly recorded in Minutes Book maintained for the purpose.
7. _____ extraordinary meeting(s) was/were held during the financial year after giving due notice to the members of the company and the resolutions passed thereat were duly recorded in the Minutes Book maintained for the purpose.
8. the company has advanced loan amounting to Rs._____ to its directors and/or persons or firms or companies referred in the Section 295 of the Act after complying with the provisions of the Act.
9. the company has duly complied with the provisions of Section 297 of the Act in respect of contracts specified in that section.
10. the company has made necessary entries in the register maintained under Section 301 of the Act.
11. the company has obtained necessary approvals from the Board of Directors, members and previous approval of the Central Government pursuant to Section 314 of the Act wherever applicable.

12. the Board of Directors or duly constituted Committee of Directors has approved the issue of duplicate share certificates.
13. the Company has:
    (i) delivered all the certificates on allotment of securities and on lodgment thereof for transfer/transmission or any other purpose in accordance with the provisions of the Act;
    (ii) deposited the amount of dividend declared including interim dividend in a separate bank account on _____ which is within five days from the date of declaration of such dividend;
    (iii) paid/posted warrants for dividends to all the members within a period of 30 (Thirty) days from the date of declaration and that all unclaimed/unpaid dividend has been transferred to Unpaid Dividend Account of the Company with _____Bank on_____;
    (iv) transferred the amounts in unpaid dividend account, application money due for refund, matured deposits, matured debentures and the interest accrued thereon which have remained unclaimed or unpaid for a period of seven years to Investor Education and Protection Fund;
    (v) duly complied with the requirements of Section 217 of the Act.
14. the Board of Directors of the company is duly constituted and the appointment of directors, additional directors, alternate directors and directors to fill casual vacancies have been duly made.
15. the appointment of Managing Director/Whole-time Director/Manager has been made in compliance with the provisions of Section 269 read with Schedule XIII to the Act and approval of the Central Government has been obtained in respect of appointment of_____ not being in terms of Schedule XIII.
16. the appointment of sole-selling agents was made in compliance of the provisions of the Act.
17. the company has obtained all necessary approvals of the Central Government, Company Law Board, Regional Director, Registrar or such other authorities as may be prescribed under the various provisions of the Act.
18. the directors have disclosed their interest in other firms/companies to the Board of Directors pursuant to the provisions of the Act and the rules made thereunder.
19. the company has issued_____shares/debentures/other securities during the financial year and complied with the provisions of the Act.
20. the company has bought back_____shares during the financial year ending _____ after complying with the provisions of the Act.
21. the company has redeemed _____preference shares/debentures during the year after complying with the provisions of the Act.
22. the company wherever necessary has kept in abeyance rights to dividend,

rights shares and bonus shares pending registration of transfer of shares in compliance with the provisions of the Act.

23. the company has complied with the provisions of Sections 58A and 58AA read with Companies (Acceptance of Deposit) Rules, 1975/the applicable directions issued by the Reserve Bank of India/any other authority in respect of deposits accepted including unsecured loans taken, amounting to Rs._____ raised by the company during the year and the company has filed the copy of Advertisement/Statement in lieu of Advertisement/necessary particulars as required with the Registrar of Companies _____ on _____. The company has also filed return of deposit with the Registrar of Companies/Reserve Bank of India/other authorities.
24. the amount borrowed by the Company from directors, members, public, financial institutions, banks and others during the financial year ending____ is/are within the borrowing limits of the company and that necessary resolutions as per Section 293(1)(d) of the Act have been passed in duly convened annual/extraordinary general meeting.
25. the company has made loans and investments, or given guarantees or provided securities to other bodies corporate in compliance with the provisions of the Act and has made necessary entries in the register kept for the purpose.
26. the company has altered the provisions of the memorandum with respect to situation of the company's registered office from one State to another during the year under scrutiny after complying with the provisions of the Act.
27. the company has altered the provisions of the memorandum with respect to the objects of the company during the year under scrutiny and complied with provisions of the Act.
28. the company has altered the provisions of the memorandum with respect to name of the company during the year under scrutiny and complied with the provisions of the Act.
29. the company has altered the provisions of the memorandum with respect to share capital of the company during the year under scrutiny and complied with the provisions of the Act.
30. the company has altered its articles of association after obtaining approval of members in the general meeting held on _____ and the amendments to the articles of association have been duly registered with the Registrar of Companies.
31. a list of prosecution initiated against or show cause notices received by the company for alleged offences under the Act and also the fines and penalties or any other punishment imposed on the company in such cases is attached.
32. the company has received Rs. _____ as security from its employees during the year under certification and the same has been deposited as per provisions of Section 417(1) of the Act.
33. the company has deposited both employee’s and employer’s contribution to Provident Fund with prescribed authorities pursuant to Section 418 of the Act.

Note: The qualification, reservation or adverse remarks, if any, may be stated at the relevant place(s).

Place: Signature:
Date: Name of Company Secretary:
C.P. No.:

Annexure A

Registers as maintained by the Company

1. _____ u/s _____
2. _____ u/s _____
3. _____ u/s _____

Annexure B

Forms and Returns as filed by the Company with the Registrar of Companies, Regional Director, Central Government or other authorities during the financial year ending on 31st March, 20___.

1. Form No. _____ Filed u/s _____ for _____
2. Form No. _____ Filed u/s _____ for _____
3. Form No. _____ Filed u/s _____ for _____

CHECKLIST FOR COMPLIANCE CERTIFICATE

Under the 'MCA-21' project, the Ministry of Company Affairs has put all the Business Processes and services of the office of Registrar of Companies (ROC) on the e-Governance Mode. As such, relevant filings would need to be done mandatorily in every ROC office in the format prescribed under the new e-forms. Therefore, in view of the above, the Compliance Certificate, as provided in amended Companies (Central Government) General Rules and Forms, 1956 has to be filed along with Form No. 66 of the aforesaid rules as attachment.

1A Statutory Registers

(a) Register of Investments [Section 49(7)]

The auditor should check the following:

(a) whether all investments made by the company on its own behalf are held in its own name?

(b) whether Certificate or letter of allotment of concerned shares or securities, is in it's custody or with the banker etc. and make a physical certification of it.

(c) if the company is not holding investments made by it in its name as allowed by Sub-sections (2), (3), (4) or (5) of Section 49 verify whether:

  (i) the company's principal business consists of buying and selling shares or securities or else;

  (ii) the company has entered such particulars in the register maintained thereof clearly and conspicuously as may be necessary to identify fully the shares or securities in question and the bank or person in whose name or custody they are held.

(d) register is kept open for inspection of any member or debenture holder of the company, without charge, during business hours, subject to such reasonable restrictions as the company may by its articles or in general meeting impose, so that not less than two hours in each day are allowed for inspection.

(e) (i) if shares are held by directors in other body corporate check that appointment was properly made and shares in such body corporate are to an amount not exceeding qualification shares.

(ii) shares are held in its subsidiary in the nominees' name to ensure that the number of members does not fall below the statutory minimum.

(b) Register of Deposits [Rule 7 of Companies (Acceptance of Deposits) Rules, 1975]

Check:

(i) whether the company has maintained the Register of Deposits?

(ii) whether complete entries in respect of all depositors have been made?

(iii) whether the company has small depositors as per latest amendments?

(iv) Whether there has been any default in repayment of deposits or amount of interest thereon and the same is indicated clearly?

(v) compare the Register alongwith Return of Deposits filed with Registrar of Companies.

(vi) whether the company, if an NBFC, is registered with RBI and has complied with RBI directions.

(vii) whether the register has been preserved in good order for a period of eight calender years from the financial year in which the latest entry was made.

(c) *Register of Securities Bought Back (Section 77A)*

Check whether register of securities bought back has been maintained for entering the following particulars, namely, (i) the consideration paid for securities bought back; (ii) the date of cancellation of securities; (iii) the date of extinguishing and physically destroying of securities and such other particulars as prescribed in Form 4B (to be cross verified with the attachment of e-form 4C) of the Companies (Central Government's) General Rules and Forms, 1956 and Annexure B to the Private Limited Company and Unlisted Public Limited Company (Buy- back of Securities) Rules, 1999.

(d) *Register of Charges (Section 143) and Copies of Instruments Creating Charge (Section 136)*

Check whether:

(i) all charges, fixed and floating on the undertaking or on any property of the company have been entered in the Register alongwith the details required under Section 143(1) i.e. (a) that description of the property charged, (b) amount of charge, and (c) except in case of securities of bearer the names of persons entitled in charge. Check whether date of filing of e-Form No. 8 is given in the Register.

(iii) in case of fully satisfied/repaid charges, e-Form No. 17 has been filed and entries thereof have been made in the Register.

(iv) Check if any delay is condoned by any competent authority, the date and facts of such condonation are given.

(v) the certificate of registration of charges in connection with issue of debentures is endorsed on every debenture or certificate of debenture stock issued.

(vii) whether copies of instruments creating charges in pursuance of Section 136 and register of charges pursuant to Section 143 are kept open for inspection according to Section 144.

(e) *Register of Members (Section 150) and Index of Members (Section 151):*

Check whether:

(i) separate registers for each class of shares are maintained in the format as prescribed under Rule 7 of the Companies (Issue of Share Certificate) Rules, 1960;

(ii) (a) the particulars relating to the name, address and the occupation, if any, of each member;

(b) in the case of a company, having a share capital, the shares held by each member, distinguishing each share by its number except where such shares are held with a depository and the amount paid or agreed to be considered as paid on those shares;

(c) the date on which each person was entered in the register as a member;

(d) the date on which any person ceased to be a member; and

(e) Stock held, if any, by the members have been properly entered.

(iii) entries in the Register are authenticated by the Secretary or any other person authorised by the Board for the purposes of sealing and signing share certificates;

(iv) declaration made to a company under Sub-section (1), (2) or (3) of Section 187C has been noted in its Register of members within 30 days from receipt of declaration;

(v) an index of members is maintained unless the Register of members is in such a form as in itself constitutes an index, where the company has more than 50 members. The index can be in the form of a card index;

(vi) every change made in the Register of members has also been recorded in the index within 14 days; and

(vii) The index has been maintained at the same place as the register of members.

(viii) list of beneficial owners, (in case of shares held in depository) is also kept by the company.

(f) Register and Index of Debentureholders (Section 152):

Check whether:

(i) the company has maintained separate registers for each type of debentures and entered therein the particulars prescribed in Sub-section (1) of Section 152 i.e. (a) the name and address, and the occupation, if any, of each debenture holder; (b) the debentures held by each holder, distinguishing each debenture by its number except where such debentures are held with a depository, and the amount paid or agreed to be considered as paid on those debentures; (c) the date on which each person was entered in the register as a debenture holder and (d) the date at which any person ceased to be a debenture holder;

(ii) an index of debenture holders is maintained unless the Register of debenture holders is in such a form as in itself constitutes an index, where the number of debenture holders is more than 50. The index can be in the form of a card index;

(iii) every alteration made in the Register of debenture holders has been recorded in the index within 14 days;

(iv) list of beneficial owners (in case of debentures held in depository) is also kept by the company.

(g) Foreign Registers of Members or Debenture holders (Section 157):

Check whether the Articles of Association authorise for keeping a foreign register of members or debenture holders. If yes, check whether:

(i) notice of the situation of the office where registers are kept has been filed with the Registrar within 30 days from the date of the opening of any foreign register;

(ii) notice of the change, if any, in the situation of such office or of its discontinuance was filed with the Registrar within 30 days from the date of such change or discontinuance;

(iii) a duplicate of every foreign register has been kept at the registered office and changes in the register duly entered from time to time;

(iv) the above registers are kept open for inspection and extracts/copies thereof are supplied on receipt of requisition with the prescribed fees.

(h) Registers and Returns under Section 163

Check whether:

(i) the Register of members, the index of members, the Register and index of debenture holders, contracts entered into by a company for the appointment of a manager, managing director and copies of annual returns filed under Sections 159 and 160 in e-form 20B together with the copies of certificates and documents required to be annexed under Sections 160 and 161 are kept at the registered office of the company;

(ii) if the above registers and returns instead of being kept at the registered

office of the company, are being kept at any other place within the city, town or village in which the registered office is situate; whether the other place has been approved by a special resolution and the Registrar was given an advance copy of the proposed special resolution;

(iii) the above registers and returns are kept open for inspection by any member or debenture holder without fee, and by any other person on payment of Rs.10/- or such other fee as may be prescribed, during business hours subject to such reasonable restrictions as the company may impose;

(iv) copy of such register etc. or extract thereof is supplied within a period of ten days against any request received on payment of Re.1 for every 100 words or fractional part thereof or such other fee as may be prescribed;

(v) the stock exchange is notified in case the shares are listed.

(i) Minutes Book of Meetings

(a) Minutes Book of Meetings of Directors

Check whether:

(i) minutes books for Board and Committee meetings are maintained in accordance with the provisions of Section 193;

(ii) the proceedings of each meeting are entered within 30 days of the meeting;

(iii) each page of the minutes book is consecutively numbered;

(iv) each page of individual minutes is duly initialled or signed and the last page of each such minutes is dated and signed by the Chairman of the same meeting or of the next succeeding meeting;

(v) names of directors present at the meeting are recorded in the minutes;

(vi) leave of absence granted is recorded;

(vii) nature of interest of a director in any transaction and also his abstaining from discussion/voting on resolution are recorded;

(viii) names of directors dissenting from or not concurring with the resolution are recorded;

(ix) minutes have not been attached or pasted to the minutes book;

(x) minutes are maintained in loose leaf form; if so whether safeguards against manipulation have been taken and the leaves are bound at reasonable intervals, say six months/one year; and

(xi) the fact that documents or drafts placed before the meeting is recorded in the minutes.

(b) Minutes Books of Proceedings of General Meetings

Check whether:

(i) minutes books are properly maintained, viz.

— the proceedings of each general meeting have been entered within 30 days of the meeting;

— the pages of the minutes book are consecutively numbered. Each page is duly initialled or signed and the last page of the record of proceedings of each meeting is dated and signed by the Chairman of the meeting within 30 days of the meeting;

— in the event of death/inability of the Chairman to sign minutes of the general meeting, the Board resolution has been passed authorising any director to sign within that period;

— the minutes are not attached or pasted. All erasures or alterations are duly authenticated;

— the minutes are maintained in loose leaf form; if so whether safeguards against manipulation have been taken and the pages are bound at reasonable intervals, say six months/one year; and

— the fact that documents or drafts placed before the meeting is recorded in the minutes.

(ii) minutes books have been kept at the registered office of the company and kept open during business hours for inspection of members and also, inspection is allowed to any member without charge during business hours subject to such reasonable restrictions as the company may, by Articles or in general meeting impose;

(iii) check if copies of minutes of general meetings were furnished within 7 days of the receipt of request on payment Re.1 for every 100 words or fractional part thereof or such other fee as may be prescribed.

(j) Minutes Book of Class Meeting/Creditors Meeting

Check whether company has held class meetings, debenture holders meetings or creditors meeting. If yes, whether minutes book in respect of these meetings has been properly maintained.

(k) Books of Accounts and Cost Records (Section 209)

Check whether:

(i) books of accounts are kept at the registered office. If the same are kept at some other place in India, a Board resolution was passed and e-Form No.23AA filed with the Registrar within 7 days of the decision;

(ii) the company is required to maintain cost records. If so, whether cost records are being maintained;

(iii) the books are maintained in good order together with vouchers, invoices and connected records for a minimum period of 8 years; and

(iv) books of accounts and papers were easily accessible to directors for inspection.

(v) the books of account have been maintained properly and on the accrual basis of accounting.

(vi) proper books of account relating to the transactions of a company's branch

office have been kept and proper summarized returns made upto-date are sent to the place, where books of account of the company are kept at intervals not more than three months.

(l) Register of Particulars of Contracts, companies and firms in which Directors are Interested (Section 301)

Check whether:

(i) the register is being properly maintained by entering separately particulars as prescribed under Sub-section (1) of Section 301 of all contracts or arrangements to which Section 297 or Section 299 applies, ; i.e. the date of contract or management, date of placing them before the Board, the names of parties thereto, the principal terms and conditions thereof.

Where the value of goods and materials or cost of services forming part of contract or arrangement exceed one thousand rupees.

(ii) and the names of the directors voting for or against the contract or arrangement and the names of those remaining neutral are recorded

(iii) entries have been made within 7 days (including public holidays) from the date on which the Board approved the contract and in case of other contract or arrangement within seven days of the receipt at the registered office of its particulars, or within 30 days of the date of contract/arrangement whichever is later. 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;

(iv) 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) [Form 24AA];

(v) the register has been signed by the directors present at the Board meeting following the meeting in which the contracts were considered and approved;

(vi) where the above contracts and/or arrangements have been approved by members in their general meeting, the register is maintained and signed in accordance with the terms of the resolution thereat; and

(vii) 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.

(m) Register of Directors, Managing Director, Manager and Secretary under Section 303

Check whether:

(i) the necessary particulars prescribed in Sub-section (1) of Section 303 and changes therein have been entered in respect of every director, managing director, manager or secretary;

(ii) the names and particulars of companies and/or firms nominating directors have also been entered in the register; and

(iii) the register is kept at the registered office and is kept open for inspection by

members free of charge and by outsiders on payment of fee of Re.1/- during business hours subject to such reasonable restrictions as the company may by its Articles or in general meeting impose.

(iv) the disclosure is made by the concerned person within 21 days as per Section 305.

(v) requisite returns in duplicate were sent to the Registrar in Form No. 32 within 30 days of the appointment or change.

(vi) Register may be checked with Form No. 32, Annual Returns filed with Registrar and cheque signing authority to corporate bank accounts.

(vii) Where a person is a deemed director of the company, whether particulars relating to him are entered in the above Register.

(n) Register of Directors' Shareholdings under Section 307

Check whether:

(i) the register was duly kept at the registered office and contains particulars prescribed in Sub-sections (1), (2) and (3) of Section 307 and was kept open for inspection of any member or debenture holder during business hours subject to reasonable restrictions as the company may, by its Articles or in general meeting, impose during the period beginning 14 days before the date of the company's annual general meeting and ending three days after the date of its conclusion, and it was kept open for inspection by any person acting on behalf of the Central Government or of the Registrar during the said period or any other period;

(ii) the register was produced at the commencement of the annual general meeting and was kept open and accessible during the continuation of the meeting to any person having the right to attend the meeting; and

(iii) every director and every person deemed to be a director under Section 307(10) has given notice in writing to the company in conformity with Section 308(1) and (2) to enable it to comply with the provisions of Section 307.

(o) Register of Investments or Loans made, Guarantee Given or Security provided under Section 372A (w.e.f. 31.10.1998)

Check whether:

(i) the register has been maintained for entering the following particulars; (a) the name of the body corporate; (b) the amount, terms and purpose of the investment or loan or security or guarantee; (c) the date on which the investment or loan has been made; and (d) the date on which the guarantee has been given or security has been provided in connection with a loan;

(ii) the particulars of every investment or loan made or guarantee given or security provided has been entered chronologically in the register within seven days of the making of such investment or loan, or the giving of such guarantee or provision of such security;

(iii) the register is kept at the registered office of the company; and the register is kept open for inspection and extracts thereof have been supplied to

members, if required, on payment of the requisite fee.

Note: If the provisions of Section 372A are not applicable to a company, no entries need to be made in the Register of investments or loans made, guarantee given or security provided under Section 372A.

(p) Register of Renewed and Duplicate Certificates under Rule 7 of the Companies (Issue of Share Certificates) Rules, 1960

Check whether:

(i) the register has been maintained containing prescribed particulars, viz.; the name of the person to whom the certificate has been issued, the number and date of issue of share certificate etc.; and

(ii) all entries in the register have been authenticated by the secretary or any other person authorised by the Board of directors.

(iii) necessary entries have been made in the register of members for issuance of duplicate certificate and the original certificate, if available is cancelled.

(iv) duplicate certificates have been issued with the authority of the Board or committee and properly signed with the common seal of the company.

(v) Necessary changes have been indicated in the Register of Members by making suitable cross-references.

(q) Register of Destruction of Records/Documents

Check whether:

(i) the records and documents are being kept in the company at least for the periods stated in the Companies (Preservation and Disposals of Records) Rules, 1966;

(ii) the company has maintained a register in the prescribed form and has entered particulars of documents destroyed as per Rule 4 of the aforesaid Rules.

(r) Register of Employee Stock Options

(i) Check that if the company had issued employee stock options, it maintained a register of employee stock options and entered therein particulars of options granted.

(ii) Check whether the following details were *inter alia* and as far as applicable entered in the register viz. date of special resolution approving the scheme, category of employees entitled to participate in the scheme, total number of options granted, market price per share on the date of grant, name of the grantee, number of options granted, vesting period, options vested, exercise period, options exercised, exercise price and market price per share, number of shares arising as a result of exercise of option, options lapsed, if any variation the date of such variation, lock-in-period, date of expiry, money realised by exercise of options etc.

(iii) Check whether the register is property maintained, preserved for a reasonable time and is open for inspection, subject to reasonable restrictions.

(s) Register of Postal Ballot

If the company was required to or proposed to get any resolution passed through postal ballot, check whether—

(a) a separate register was maintained for each postal ballot to record the assent or dissent received through postal ballot;

(b) particulars relating to serial number given by scrutinizer, date of receipt of postal ballot form, name, folio number/client ID number of the member, number of shares held nominal value of shares, whether the shares have voting, differential voting or non-voting rights, number of votes in favour, number of votes against, number of invalid votes and reasons therefor have been properly entered.

(c) Register alongwith postal ballot forms have been kept in the safe custody of the scrutinizer till the chairman signs the minutes book in which result of the voting by postal ballot is recorded.

(t) Register of Sweat Equity Shares

(i) Check whether a company issuing sweat equity shares has maintained a register for this purpose as required under Rule 5 of Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003 and by listed companies, in a form as near thereto.

(ii) Check whether the register contained the particulars relating to folio number/ certificate number, date of passing of resolution, date of issue of sweat equity shares, name of allottee, status of the allottee, referencer to entry in register of members, number of sweat equity shares issued, face value of the share, price at which shares issued, total co9nsideration paid by employee/director and lock-in-period.

(iii) Check whether the register is property maintained, preserved for a reasonable period of time, and is open for inspection, subject to reasonable restrictions, if any.

(B) Other Registers

Following registers are optional registers and should be maintained as good secretarial practice. However, if the following registers are not maintained, the Practising Company Secretary should not qualify his certificate/Audit Report:

(1) Register of Inspection

Check whether the company has maintained the register of inspection containing the following particulars viz:

(i) Serial Number

(ii) Date and time of inspection

(iii) Name and address of person who has inspected the document

(iv) Particulars of documents inspected

(v) Copies, if any taken

(vi) Fees, if any received

(vii) Signature of the person who inspected the documents

(viii) Signature of a director.

Note: Maintenance of the said register would help in verifying the compliance of various provisions of the Companies Act, 1956 where records/documents are available for inspection. The register need not be kept for inspection.

(2) Register of Directors' Attendance

As per Regulation 71 contained under Schedule-1 (Table A) to the Companies Act, 1956, every director present at any meeting of the Board or of a Committee thereof shall sign his name in a book to be kept for that purpose. In view of this, companies should maintain a register for recording the attendance of directors present in a meeting of the Board/Committee thereof.

(3) Register of Shareholders' Attendance

Check whether the company has maintained a register of shareholders' attendance at the general meetings or has kept the attendance slips collected from the members at the meeting.

(4) Register of Proxies

Check whether the register of proxies containing details of proxies lodged in respect of every general meeting is maintained. It may be verified whether the particulars relating to name of member appointing proxy, folio numbers of members, number of shares held by members, name of proxy, date and time of receipt of proxy form, number of valid and invalid proxies and other relevant entries have been made chronologically.

(5) Register of Transfers/Transmission of shares

Check whether:

(i) the company has maintained separate register of transfers for different classes of shares/debentures, and entered therein the particulars relating to the registration of transfer of shares/debentures along with the date of Board/Committee resolution approving transfer/transmission;

(ii) transfer number as per the register of transfer and date of approval has been entered in the Share Transfer Deed in Form 7B;

(iii) the Company has maintained a separate file and register of documents like Powers of Attorney, Probate, Letters of Administration and/or Succession Certificate, Resolution of companies or other bodies corporate authorising any particular person(s) to sign on its behalf that are registered with the company; and

(iv) details of nomination forms have been noted.

(6) Register of Fixed Assets

Check whether the register of fixed assets has been properly maintained containing prescribed particulars of quantitative details and situation of fixed assets of the company and its updated written down values alongwith the basis of revaluation.

(7) Register of Documents Sealed

Check whether:

(i) the company has maintained a register of documents sealed;

(ii) the register contains the following information:

(a) number and date of the resolution(s) authorising the use of the seal;

(b) date of affixing seal;

(c) persons in whose presence the seal was affixed;

(d) document sealed;

(e) location of document.

Apart from the aforesaid, registers may have been maintained in respect of Insider Trading, Substantial Acquisition of shares and Takeovers, Preferential allotment, and the same may be verified with the corresponding Rules/Regulations/ Provisions in this behalf.

2. Filing of Forms, Returns and Documents with the Registrar

(A) Periodical Returns

(a) Annual Return

Check whether:

(i) e-Form-20B together with Annual return specified in Schedule V of the Act has been duly filed with the ROC within 60 days of the holding of the annual general meeting;

(ii) where annual general meeting has not been held, the return was filed within 60 days from the date on which the annual general meeting ought to have been held;

In case of an adjourned annual general meeting, check whether the annual return incorporates the date of the original meeting.

(iii) the return has been digitally signed by the MD or Director or Manager or Secretary of the company;

(iv) in case of a company whose shares are listed on a recognised stock exchange, the annual return in Schedule V is also signed by a secretary in whole-time practice.

(v) the details in removable storage media (Floppy/compact disc) have been filed with the Registrar in case of bigger size of attachment.

(b) Balance Sheet, etc., under Section 220

Check whether:

(i) the balance sheet, etc., were adopted by the annual general meeting within the prescribed time stipulated in Section 210 read with Section 266;

(ii) copy of balance sheet along with profit and loss account and other documents so required (auditors' report, directors' report, corporate governance report, compliance certificate etc.) and e-form 23AC were filed with the ROC within 30 days of the date of the annual general meeting. In case of a private company, the profit and loss account may have been

separately attached to e-Form 23AC;

(iii) where an annual general meeting has not been held, copies of balance sheet etc. were filed within 30 days from the latest day on or before which the meeting should have been held and whether a statement of the fact and of the reasons therefor was filed along with the balance sheet etc.;

(iv) where balance-sheet etc., were laid before but not adopted by the annual general meeting or the annual general meeting was adjourned without adopting the balance sheet, whether a statement of the fact and reasons therefor was filed along with the balance sheet, etc.

(v) whether balance sheet etc. is duly authenticated in terms of Section 215 of the Act.

(c) Compliance Certificate under Section 383A

Check whether:

(i) the company to which proviso to Sub-section (1) of Section 383A is applicable has filed with the ROC a certificate from a Practising Company Secretary in Form appended to the Companies (Compliance Certificate) Rules, 2001 along with e-Form 66 within 30 days from the date of annual general meeting.

(ii) in case the annual general meeting of the company is not held for the year, the aforesaid Compliance Certificate has been filed with the ROC within 30 days from the latest day on or before which that meeting should have been held.

(B) Other Important Returns

(a) Return of Allotment

Check whether:

(i) the company has made any allotment of its shares. If so, the return of allotment in e-Form No.2 was filed with the Registrar within 30 days stating the number and nominal amount of the shares comprised in the allotment, the names, addresses, and occupations of the allottees, and the amount, if any, paid or due and payable on each share. If the company has passed special resolution under Section 81(1A), it it should also have filed e-form 23 before filing form 2 and mentioned its SRN (Service Request Number) in e-Form 2;

(ii) shares were allotted at a discount. If so, copy of the resolution authorising the issue of shares at a discount along with a copy of the order of the Company Law Board was filed with the return;

(iii) shares were issued for consideration other than cash. If so, the original contract, along with a copy thereof, entered into with the persons to whom the shares were allotted for consideration other than cash was filed with the return;

(iv) the copy of the contract was verified by an affidavit by a director or the Secretary of the company;

(v) the contract for issue of shares for consideration other than cash was not

reduced in writing. If so, whether particulars of the contract were filed in e-Form No.3 and the Form was duly stamped with stamp duty which would have been paid, had the contract been reduced to writing;

(vi) bonus shares were issued. If so, a return stating the number and nominal amount of the shares comprised in the allotment, the names, address and occupation of the allottees and a copy of the resolution authorising the issue of such shares was filed;

(vii) allotment has been made in pursuance of the order of the Court under Sections 391/394. If so, verify whether shares were allotted in the proportion stated in the order.

(viii) the list of alottees is mandatorily attached to the form. Also check whether the copy of board or members' resolution approving the shares, has been attached.

(ix) the regulator had extended the time for filing the return under Section 75(3) and the return was duly filed in the extended time period;

Notes: 1. The return of allotment is not required to be filed in case the allotment was of forfeited shares or the allotment was made to the subscriber to the Memorandum and Articles of Association.

2. The return of allotment is not required to be filed where debentures are allotted.

(b) Return on Buy-Back of Securities

(i) Check whether the company has filed with the Registrar, e-Form No. 4C under the Companies (Central Government's) General Rules and Forms, 1956 (as amended) and a return in the form specified at Annexure A to the Private Limited Company and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999 after the completion of buy-back.

(ii) Check whether the return (e-form 4C) is filed with the Registrar within 30 days from the completion of the buy-back.

(iii) Check that where the company was required to file e-form 23 in relation to the resolution passed for buy-back, filing of e-form 23 preceded the filing of this return and SRN of Form 23 has been entered in e-form 4C.

(iv) Check whether any Merchant Banker was appointed, and if so, whether his name has been entered in the form.

(v) Check that the following documents were attached to the e-form 4C viz. description of securities bought back by the company (in the prescribed format); particulars relating to the holder of securities before buy-back (in the prescribed format); copy of special resolution, if any; copy of Board resolution in case buy-back was approved by the Board etc.

(vi) Check whether e-form 62 is submitted together with the filing fees.

(c) Notice of redemption of preference shares, consolidation, division, increase in share capital, cancellation of shares and increase in number of members

Check whether:

(i) the requisite notice in e-Form No.5 was filed within 30 days from the day on which any of the aforesaid events occurred or resolution passed as the case may be; and

(ii) e-Form 23 had been filed where special resolution was passed for such alterations and SRN of e-Form 23 is mentioned in the form;

(iii) in case there is consolidation/sub-division/cancellation for both equity and preference shares, then a separate e-form is filed for each category of shares;

(iv) in case, the authorized share capital is increased both independently and by Central Government Order then the details of the total additional authorized capital for equity and preference shares had been duly entered in the e-form 5.

(v) the attachments viz. altered memorandum of association, articles of association, proof of Central Government order for increase in authorised share capital, had been duly sent along with the form;

(vi) the e-form had been duly certified by a chartered accountant, or cost accountant or company secretary (in whole-time practice) by digitally signing the e-form;

(vii) requisite registration fees have been paid on the difference between the increased capital and the existing authorised capital at the existing rate.

(d) Notice of Situation/Change in Situation of Registered Office

Check whether:

(i) the notice of situation or the notice of change in the situation of registered office in e-Form-18 has been filed within 30 days of the date of incorporation or change;

(ii) Form 18 is pre-certified by a company secretary or chartered accountant or cost accountant in whole-time practice;

(iii) A copy of the Board resolution had been attached in case the company's registered office was shifted within the local limits of the city or town or village in which it was earlier situated;

(iv) A copy of special resolution was attached, in case the company's registered office was shifted outside the local limits of the city or town or village in which it was earlier situated and form 23 was duly filed.

(v) in addition to the above, check also the following (if applicable):

(a) in the case of change in the situation of the registered office outside the local limits of any city, town or village though within the same State but from the jurisdiction of one ROC to the jurisdiction of another ROC, check whether:

(i) application in e-Form 1AD for obtaining confirmation of Regional Director;

(ii) confirmation from Regional Director has been received;

(iii) certified copy of the confirmation has been filed with the ROC within two months from the date of confirmation;

(iv) Form No. 23 has been filed within 30 days along with the copy of special resolution passed by the company (to be passed by postal ballot in case of listed companies);

(v) Form No. 18 has been filed with both the ROCs within 30 days of changing the office with both the Rregistrars;

(vi) the ROC has certified the registration.

(vii) Form No. 21 has been filed along with the certified copy of the order of the Company Law Board with both the ROCs within three months.

(c) in the case of change in situation of the registered office from one State to another, check whether:

(i) e-Form 23 has been filed with ROCs within 30 days of passing of resolution;

(ii) petition has been made to Company Law Board for approval;

(iii) As stated aforesaid Form No. 18 has been filed with both the ROCs within 30 days from the date when the change becomes effective and Form 21 has been filed with both the ROCs within three months.

(e) Court/CLB Orders

Check whether e-Form No.21 has been filed with the ROC along with certified copies of the following orders:

Section	
17(2)	Order of the Company Law Board approving the shifting of the registered office from one State to other.
79	Order of the Company Law Board approving Issue of shares at discount.
81(4)	Order of the Central Government for conversion of debentures or loans or part thereof into shares of the company, subject to specified conditions, if found necessary in the public interest.
81(3)	Order of the Central Government approving the terms of issue of debentures relating to conversion of debenture or loan into shares.
94A(2)	Order of the Central Government permitting public financial institution to convert debentures or loan into shares.
102(1)	Order of the Court confirming the reduction of capital.
107(3)	Order of the Court disallowing or confirming variation of the shareholders rights.
111(5) or 111A	Order of the Company Law Board dismissing the appeal or rejecting the application in respect of refusal of registration of transfer and directing that the transfer or transmission shall be registered by the company/ directing the rectification of the register of members.

113	Order of the Company Law Board granting extension of time for issue of debenture certificate.
141	Order of the Company Law Board extending time for filing particulars of registration, modification or satisfaction of charges or rectifying the register of charges.
186	Order of the Company Law Board for a meeting of the company to be called, held and conducted in terms of the Order.
391(2)	Order of the Court sanctioning any compromise or arrangement.
394(2)	Order of the Court making provisions for several matters specified in Section 394(1) for implementing the compromise or arrangement.
397	Order of CLB for relief in cases of oppression
398	Order of CLB for relief in cases of mismanagement
404(3)	Order of the Company Law Board providing for change in Memorandum or Articles.
445	Order of CLB for winding up passed under section 443 to be filed with Registrar.
481	Order of CLB for the dissolution of the company.

It should be ensured that the original certified copies of the Court or CLB Orders were also submitted simultaneously at the concerned ROC office.

(f) Registration of Resolutions and Agreements

Check whether copies of resolutions and agreements required to be filed along with e-Form No. 23 with the ROC under Section 192 have been filed within 30 days after the passing of the resolution or the making of the agreement.

(g) Return of Appointment of Managing Director/Whole-time Director/Manager

Check whether:

(i) a return in e-Form No. 25C is filed within 90 days from the date of appointment of Managing Director or Whole-time Director/Manager;

(ii) the certification with respect to compliance of all the requirements of Schedule XIII has been given by the auditor or secretary of the company. Also, it has been pre-certified by a Chartered Accountant or Cost accountant or a Secretary in whole-time practice.

(iii) the Director Identification Number (DIN) has been duly entered in case of a director and the PAN had been entered in the case of a manager in the Form.

(iv) Copy of the board resolution and copy of the shareholder(s) resolution, if any had been duly attached to the form.

(v) The particulars in e-form 23, in respect of appointment of managing director or reappointment or variation of the terms have been filed with the Registrar within 30 days of the appointment. (This provision is not applicable to appointment of whole-time director and manager.

(vi) Whether Form 32 was also filed with the Registrar in case an existing

director was appointed managing director or manager or where the appointment was so made for the first time.

(h) Consent to Act as Director of the Company (in the Case of Public Company)

Check whether the director other than those specified in Sub-section (2) of Section 264 has filed with the Registrar his consent to act as director on a plain paper attached to e-Form No. 32 within 30 days of his appointment.

Note: If an undertaking for acquiring qualification shares is made, the undertaking should be given on a stamp paper of requisite value and the same should be attached to e-Form 32.

(i) Particulars of Appointment of Directors, Managing Director, Manager, or Secretary and Changes thereof [Section 303(2)]

Check whether:

(i) the requisite returns had been filed with the ROC in e-Form No. 32 within 30 days of appointment/change in director, managing director, manager or secretary along with documents evidencing the same;

(ii) upon the change in particulars of director to a managing/whole-time director or an additional director being appointed as a director at annual general meeting, the fact has been notified in e-Form No. 32 also.

(iii) The Director Identification Number (DIN) had been duly entered in case of director and the Permanent Account Number (PAN) in case of manager or secretary, had been mentioned.

(iv) The particulars of changes for more than three persons had been notified to the Registrar by using the Addendum to e-form 32.

(v) The photograph of the persons appointed was duly attached to e-form 32 and in case of consent required, the consent letter of the appointee was attached.

(vi) If an undertaking to take qualification shares was given, the evidence of payment of stamp duty was also attached to the form. Also, the original attachment relating to qualification shares was duly filled in and signed on stamp paper and was sent to the concerned ROC office simultaneously.

(j) Return of Deposits under Section 58A

Check whether:

(i) the company has on or before 30th day of June, filed with the Registrar a return in the form annexed to Companies (Acceptance of Deposits) Rules, 1975 duly certified by the auditor of the company along with e-Form 62;

(ii) a copy of the return has simultaneously been furnished to Reserve Bank of India.

(k) Particulars of Beneficial Interest in Shares

Check whether-

(i) E-form 22B has been filed with ROC within 30 days of receipt of declaration under section 187C.

(ii) The declarations under section 187(4), (2) and/or (3) had been attached to the form.*

(l) Registration of Creation/Modification/Satisfaction of Charge

Check whether:

(i) the charge falls within any one of the categories of registrable charges as provided in Sub-section (4) of Section 125;

(ii) the prescribed particulars of the charge requiring registration were filed with the ROC in e-Form No. 8 digitally 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;

(iii) The e-Form 8 was pre-certified by a Practising Company Secretary or Chartered accountant or Cost accountant;

(iv) in case of issue of debentures of a series, if there has been any charge to the benefit of debenture holders of that series, the required particulars have been filed with the Registrar in Form No. 10 (Form 10 should also have been pre-certified as above) within 30 days from the date of execution of the debentures of the series;

(v) in case commission, allowance, discount is paid or made in consideration for subscribing, etc., to debentures, whether the forms included particulars of such commission, etc.;

(vi) the documents were duly registered by the ROC or a Charge Identification Number was allotted;

(vii) 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;

(viii) 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;

(ix) 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;

(x) where payment or satisfaction of charge registered has been effected in full, intimation thereof has been sent to the ROC in e-Form No.17 by the company as well as the charge- holder within 30 days from the date of such payment or satisfaction (Section 138);

(xi) the satisfaction of charge has been registered by the ROC.

(xii) 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 a petition has been made to the Company

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* Form 22B is a new form which seeks to replace. Form III under Companies (Declaration of Beneficial Interest in Shares) Rules, 1975.

Law Board in accordance with the Company Law Board Regulations, 1991 and CLB order obtained and certified copy of such order has been furnished to the ROC along with e-Form No. 21.

(C) Forms, Returns and Documents to be Filed with other Authorities

Check whether forms, returns and documents have been filed with the other authorities wherever applicable, as mentioned below:

(1) intimation has been given to the Company Law Board in respect of any default made by the company in repayment of any deposits from small depositors within 60 days from the date of default. Intimation shall be given on monthly basis;

(2) copy of Return of Deposits of a non-banking non financial company has been filed with the Reserve Bank of India pursuant to Rule 10 of the Companies (Acceptance of Deposits) Rules, 1975;

(3) text of advertisement inviting deposits by a non-banking financial company has been filed with the Reserve Bank of India pursuant to Rule 5 of the Non-Banking Financial Companies And Misc. Non-Banking Companies (Advertisement) Rules, 1977;

(4) returns have been filed with the Securities and Exchange Board of India in case of buy-back of securities;

(5) intimations required to be given to the Official Liquidator/Courts when the company is in the process of winding up/amalgamation/merger/ reconstruction have been given;

(6) report by public companies in relation to Disqualification of Directors pursuant to Section 274 1(g) and Rules thereunder have been given;

(7) statement of amount(s) credited to Investor Education and Protection Fund have been duly furnished;

3. Status of the Company

(a) In case of Private Company

Check whether:

(i) the company has a minimum paid up capital of Rs.1 lakh or such higher paid-up capital as may be prescribed from time to time. In case of an existing private company this requirement was to be complied within a period of two years from the commencement of the Companies (Amendment) Act, 2000 i.e. from 13.12.2000;

(ii) company's articles contain provisions

(a) restricting the right to transfer its shares;

(b) limiting the number of members to fifty;

(c) prohibiting any invitation to public to subscribe to its shares/debentures; and

(d) prohibiting any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

(iii) Whether the existing number of members with reference to the Register of Members is fifty. If it exceeds fifty, ascertain the number of present employees who are members of the company and number of persons, who

were previously employees as well as members and who have continued to be members, after their employment ceased, and find, whether after deducting the number of present and past employees, the total number of members exceeds fifty.

(b) In case of Private Company which is a Subsidiary of a Public Company

Check whether the company has a minimum paid-up capital of 5 lakh rupees or such higher paid up capital, as may be prescribed from time to time. In case of existing public limited company, check that it has enhanced its paid up capital to five lakh rupees within two years from the commencement of the Companies (Amendment) Act, 2000 i.e. 13.12.2000.

Note: A company registered under Section 25 before or after the commencement of the Companies (Amendment) Act, 2000 shall not be required to have minimum paid up capital specified above. However, a guarantee company having share capital should have minimum paid-up capital specified above.

4. Meetings of Directors and Minutes

Check whether:

(i) the requisite number of Board meetings as required under Section 285 of the Companies Act and in case of listed companies, also as required under Clause 49 of Listing Agreement were held during the year;

(ii) notice of each Board meeting in writing was issued to every director for the time being in India and at his usual address in India to every other director;

(iii) attendance-records are maintained and the requirements of Board meetings regarding quorum, chairman, minutes etc., have been complied with;

(iv) whether a meeting had been adjourned for want of quorum and at the adjourned meeting quorum was present.

(v) the items required to be transacted only at the meeting of the Board were actually transacted at the meeting and not by way of resolution by circulation or otherwise;*

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* In the following cases, the resolution can not be passed by the Board by circulation:

(a) Filing up of casual vacancy in the office of a director appointed in a General Meeting [Section 262(1)].
(b) To make calls on members [Section 292(1)(a)].
(c) To authorize, the buy-back referred to in the first proviso to clause (b) of sub-section (2) of section 77A [section 292(1)(aa)].
(d) To issue debentures [Section 292(1)(b)].
(e) To borrow money otherwise than above [Section 292(1)(c)].
(f) To invest funds [Section 292(1)(d)].
(g) To make loans [section 292(1)(e)].
(h) To delegate powers [Section 292(1)(c)(d) and (e)].
(i) To approve contracts in which directors are interested [Section 297].
(j) To note the general disclosure of directors' interests or the general notice or renewal thereof [Section 299].
(k) To note disclosure of shareholdings of directors and manager [Section 307].
(l) In case of a public company,
  (i) to appoint a person as manager or managing director in more than one company [Section 316 and 386].
  (ii) Make inter corporate loans and investment [Section 372A].

(vi) every director has disclosed his interest at the Board meeting where transaction is considered in which he is directly or indirectly interested and the interested director has abstained from participating or voting at such meeting and the notices of disclosure of general interest under Section 299 have been received from all the directors before the close of the financial year and placed before and read at the next Board meeting and entries thereof have been made in the Register under Section 301 and noted by the Board and renewed every year;

Note: Interested directors of a private company need not abstain from participating or voting.

(vii) Whether any item of business which has been not included in the agenda taken up at the meeting, with the permission of the Board.

(viii) the Board had constituted any committees; if so whether requirements regarding quorum, chairman, minutes, etc., of committee meetings were duly complied with;

(ix) the minutes of committee meetings were regularly placed before the Board for taking note of;

(x) the draft of the resolutions proposed to be passed by circulation together with necessary papers were circulated to all the directors then in India and their number was not less than the quorum fixed for the Board meeting and to all the other directors at their usual addresses in India;

(xi) the resolution by circulation was approved by requisite number of directors as required under Section 289;

(xii) the resolutions passed by circulation were put up at the next Board meeting for taking note of.

(xiii) the company being a Producer company, then provisions of section 58V of the Act have been complied with.

5. Closure of Register of Members or Debentureholders

Check whether:

(i) the Register of members or debentureholders was closed during the year;

(ii) the period for which it was closed did not exceed, in the aggregate, forty five days in a year and not for more than thirty days at any one time.

(iii) not less than seven days' previous notice was given by advertisement in some newspaper circulating in the district in which the registered office of the company is situated, to close the register;

(iv) the company has kept foreign register of members or debentureholders; if so, whether an advertisement has been given in some newspaper circulating in the district wherein the foreign register is kept where the company closes its register of members/debentureholders.

Note: Normally this register is closed only before the annual general meeting and for other purposes record dates may be fixed only by listed companies. This requirement will not normally apply to a private company.

6.(a) Annual General Meeting and Minutes

Check whether:

(i) the first annual general meeting was held within 18 months from the date of incorporation of the company.

(ii) subsequent annual general meetings have been held in each year (calendar year) and the gap between two successive annual general meetings has not been more than 15 months or the period extended by the ROC as the case may be;

(iii) the Board of Directors had approved the notice of annual general meeting including the business to be transacted thereat, the time, date and place of the meeting;

(iv) a private company has by its articles and a resolution agreed to by all the members, fixed the time as well as place of annual general meeting;

(v) the provisions of Section 210 read with Section 166 have been complied with and if not whether an application for extension was made to ROC concerned;

(vi) meetings have been called during business hours on a day not being a public holiday and held at the registered office of the company or at any place in the same city, town or village;

(vii) provisions of Sections 171 to 193 and other requirements e.g., notice, quorum, chairman, proxy, attendance, placing and reading of Auditors' report, placing instruments of proxy, proxy register and register of directors' shareholdings, conduct of meeting and preparation and signing of minutes etc., were complied with (if the meetings were called at a shorter notice, the same should have been consented to by all members in writing in Form 22A).

Note: Provisions of Sections 171 to 186 do not apply to private companies if the Articles of Association so provide.

(b) Sending of Notices, etc. to the Members

Check whether:

(i) a copy of the balance sheet, auditors' report, Boards' report along with a copy of the compliance certificate and other specified documents including notice of the meeting were sent to members, trustees of debentureholders, auditors, etc. free of cost at least 21 clear days before the meeting. If sent less than 21 clear days before the meeting whether such shorter period was agreed to by all the members. If any directions were received from the Central Government for circulation of the cost audit report to the members along with the notice of the annual general meeting, whether the same has been complied with;

(ii) in case the shares of the company are listed on a stock exchange ensure that the company has supplied a copy of the complete and full balance sheet and profit and loss account and the directors report to shareholders as provided under Clause 32 of the listing agreement though abridged accounts

could be sent pursuant to Section 219(1)(b)(iv) in Form 23AB;

(iii) a copy of the unabridged annual report was sent to members, debenture-holders and depositors on demand, without charge, within 7 days of the requisition.

Minutes Books of Proceeding of General Meetings

Check

(i) Whether Minutes books are properly maintained;

— the proceedings of each meeting have been entered within 30 days of the meeting:

— the pages of the minutes book are consecutively numbered. Each page is duly initialed or signed and the last page of the record of proceedings of each meeting is dated and signed by the Chairman of the meeting within 30 days of the meeting;

— in the event of death/inability of the Chairman to sign minutes of the general meeting, the Board resolution has been passed authorizing any director to sign within that period;

— the minutes are not attached or pasted. All erasures or alterations are duly authenticated;

— the minutes are maintained in loose leaf form; if so whether safeguards against manipulation have been taken and the pages are bound at reasonable intervals, say six months/one year; and

— the fact that documents or drafts placed before the meeting is recorded in the minutes.

(ii) minutes books have been kept at the registered office of the company and kept open during business hours for inspection of members and also, inspection is allowed to any member without charge during business hours subject to such reasonable restrictions as the company may, by Articles or in general meeting impose.

(iii) check if copies of minutes of general meetings were furnished within 7 days of the receipt of request on payment Re.1 for every 100 words or fractional part thereof or such other fee as may be prescribed.

7. Extraordinary General Meeting

Check whether:

(i) requirements relating to notice, attendance, Chairman, quorum, proxy, proxy register/instruments of proxy and proper conduct of meeting as well as maintenance of minutes of a general meeting have been complied with (whether 95% of the members had agreed in writing, before the meeting was convened on a shorter notice);

(ii) In case of meetings on requisition,

(a) the requisition has set out the matters for consideration and has been signed by members holding not less than 1/10th of the paid-up capital with voting rights or 1/10th of the total voting power, as the case may be;

(b) the requisition had been deposited at the registered office of the

company;

(c) the Board, within 21 days of deposit of a valid requisition has proceeded to call a meeting on a day within 45 days from the date of deposit of such requisition;

(d) in case the meeting has been called by requisitionists, reasonable expenses incurred by them have been reimbursed by the company and this sum has been recovered from the defaulting directors.

(e) whether the proceedings of the meeting have been duly minuted.

8. Loans to Directors

Check whether provisions of Section 295(2) are applicable. If applicable check whether:

(a) check whether provisions of Section 292(1)(c) and 372A are applicable and if so, have been complied with. If applicable, check whether, any loan has been made to:

(i) any director of the lending company

(ii) any director of the holding company

(iii) any partner of any such director

(iv) any relative of any such director

(v) any firm in which any such director is a partner

(vi) any firm in which a relative of such a director is a partner

(vii) any private company of which any such director is a director.

(viii) any private company of which any such director is a member

(ix) any body corporate of which not less than 25% of the total voting power may be exercised or controlled at a general meeting by any director or by two or more directors together; and

(x) any body corporate, the Board of directors, managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or any director or directors, of the lending company.

(b) the previous approval of the Central Government as per Section 295 (except housing loan to a managing director as per the guidelines issued by the Central Government) has been obtained. (i.e. in form 24AB)

(c) The application has to be submitted with following enclosures in the PDF files:

(1) Copy of the Board resolution indicating the proposal of the company, terms and conditions, interest of directors or relatives, if any, specifying rate of interest chargeable, the schedule and terms of repayment, the loan is not being made out of borrowed funds of the company.

(2) Any other major or important condition having bearing on the loan or financial position of the company.

(3) A declaration that company has not defaulted in making repayments to the investors as and when they become due to them.

(4) Copy of draft loan agreement.

(5) Declaration to the effect that funds proposed to be loaned are not required for its working capital requirements at least for a year.

(6) A declaration from the statutory auditor or a company secretary in whole-time practice that:-

(i) The company has not defaulted in:

— The repayment of any fixed deposits or part thereof or interest thereon;

— Payment of dividend;

— Redemption or repayment of debenture and timely payment of interest thereon;

— Redemption of preference shares; and

(ii) The company is regular in filing all e-forms or returns as required to be filed under the Companies Act, 1956;

(iii) The proposal is in conformity with the provisions of section 372A of the Companies Act, 1956;

(iv) The company is not in any default on account of undisputed dues of the Central Government e.g., income tax, central excise etc. For this purpose, the status of disputed and undisputed dues shall be made available so as to enable the Ministry to form a view in the matter vis-avis the coverage thereof available and assessed against the Net Worth/Profits of the applicant company.

(7) Copy of member resolution containing specific approval of required members along with explanatory statement.

(8) List of directors of board of both the companies and disclosing inter-se interest if any.

(9) Copy of loan scheme for the employees of the company, if any.

(10) No objection certificate (NOC) or prior approval of public financial institutions or banks in case any term loan is subsisting.

(11) Copy of letter from bank or financial institutions wherein the company has been asked to furnish corporate guarantee or security for the loan sanctioned to the borrower company.

(12) Shareholding pattern of applicant and borrowing company.

(13) Certified copy of the Memorandum and Articles.

(14) Certified copy of the balance sheet and profit and loss account of the company for last three years.

(d) check whether Form 24AB was pre-certified by a chartered accountant, cost accountant or company secretary in whole-time practice.

(e) Any quantity of such loan, guarantee or security is outstanding at the end of financial year.

(f) whether necessary entries have been made in register of loans.

(g) Also, whether the case was exempted by virtue of the following clarifications

issued by Central Government in respect of Section 297:

Section 297 (1) does not apply to

(a) the employment as managing director/whole-time director

(b) appointment of additional directors

(c) transactions in respect of immovable property

(d) services of a legal practitioner

(e) contract of personal services

(f) contracts on principal to principal basis

(g) sale or purchase for cash

Note: Relevant ledger accounts should also be verified.

9. Board's Sanction for Certain Contracts

Check if exemptions provided in Sub-section (2) of Section 297 were applicable. If not, check whether:

(i) Board of directors' consent was obtained by a resolution passed at a meeting for entering into contracts in which directors were interested;

(ii) Board approved the contract by passing a resolution at a Board meeting, before the contract is entered into or within three months of the date on which it was entered into;

(iii) Where the Contracts were entered in cases of emergency, whether these complied with the provisions regarding resolution to be passed in the context;

(iv) Proper quorum was present and an interested director did not participate or vote at that meeting;

(v) Regional Director's prior approval was obtained if the paid-up share capital of the company was not less than rupees one crore by filing e-form 24A;

(vi) whether e-form 24A was accompanied by the attachments relating to copy of agreement containing particulars of contract, copy of board resolution and proceedings of meeting, a detailed application pertaining to the Act that whether the terms of the contract conform to the prevailing market rates and whether the company has entered into any contract with any other person in respect of sale, purchase or supply etc. and whether the terms of such contract are similar to the terms of the proposed contract(s).

(vii) the particulars of contract were entered in the register of contracts in accordance with Section 301.

Note: Relevant ledger accounts should also be verified.

Entries in Register of Contracts

Check whether:

(i) the register is being properly maintained by separately entering particulars as

prescribed under sub-section (1) of section 301, of all contracts or arrangements to which section 297 or section 299 applies;

(ii) the names of the directors voting for or against the contract or arrangement and the names of those remaining neutral are recorded;

(iii) entries have been made within 7 days from the date on which contract or arrangement was made. 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;

(iv) 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);

(v) the register has been signed by the directors present at the Board meeting following the meeting in which the contracts were considered;

(vi) where the above contracts and/or arrangements have been approved by members in their general meeting, the register is maintained and signed in accordance with the terms of the resolution thereat; and

(vii) 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.

10. Holding Office or Place of Profit

Check whether:

(i) a director of the company and others referred to in Clause (b) of Sub-section (1) of Section 314 hold any office or place of profit;

(ii) necessary declaration was obtained from persons referred to in Sub-section (2A) of Section 314;

(iii) a prior special resolution was duly passed at the general meeting and e-Form No. 23 was duly filed with the Registrar;

(iv) whether the total monthly remuneration was Rs. 10,000 or more;

(v) approval of the Central Government was obtained where monthly remuneration paid was not less than Rs. 50,000/-, or as may be prescribed from time to time in e-form 24B;

(vi) Form 24B was accompanied by:

(a) copy of the resolution passed by the board of directors, relating to the proposed appointment.

(b) copy of rules of company relating to terms and conditions in regard to perquisites as applicable to its employees

(c) shareholding pattern of the company etc.

(vii) the person concerned was rendering professional advice (in which case section 314(1) is not applicable).

(viii) the concerned person vacated his office immediately and refunded the remuneration received from the company if the Central Government's permission was either not obtained or denied.

Note: Relevant ledger accounts should also be verified.

11. Issue of Duplicate Share Certificates

Check whether:

(i) duplicate certificates have been issued with the prior consent of the Board or Committee thereof as also in accordance with the provisions of Section 84 of the Act;

(ii) both strength and quorum of the Committee of directors constituted under Rule 3(b) of the Companies (Issue of Share Certificates) Rules, 1960, are not less than 3 directors where the total number of directors of the company exceeds 6 and not less than 2 directors where the total number does not exceed 6 and to the extent the composition of the Board of directors permits, half of the number of members of the Committee are directors other than a managing director or whole-time director;

(iii) the Board resolution for issue of duplicate share certificates has been passed;

(iv) the form of certificate including split/consolidated/replaced/duplicate issued conforms to Rule 5 of the said Rules;

(v) certificates issued by the company comply with Rule 6 of the said Rules as to affixing seal and signing of certificates;

(vi) (a) particulars of every share certificate issued in the Register of members have been recorded;

(b) particulars of every share certificate issued for split/consolidation or duplicate certificate issued are recorded in the register of renewed/ consolidated and duplicate certificate issued;

(c) all entries made in the Register of members or register of renewed or duplicate certificates have been authenticated by the Secretary or such other persons as may be appointed by the Board.

(vii) the company has a good internal control system for blank form of share certificate and all certificates issued and blank stationery have been periodically accounted to the Board;

(viii) all books and documents relating to the issue of share certificates have been preserved in good order permanently;

(ix) appropriate indemnity bond and affidavit have been obtained.

(x) an advertisement was released in case articles so require.

12. Issue of Certificates, Transfer/Transmission of Shares, Dividend, Board's Report

(a) Issue of Certificates for Shares and other Securities

Check whether:

(i) the company has allotted shares/debentures and entered the names of

allottees in its register of members/debentureholders;

(ii) the company has issued and delivered share-certificates as per Sections 83 and 113 of the Act and the provisions of the Companies (Issue of Share Certificates) Rules, 1960;

(iii) the company has executed Debenture Trust Deed in case of secured debentures;

(iv) the company has delivered debenture-certificates within the prescribed period and in case of delay, CLB Order for extension of time has been obtained;

(v) the company has registered transfer and transmission of shares as per Sections 108 to 113;

(vi) the company has kept in abeyance the registration of transfers in cases of Court-injunction.

(b) Transfer and Transmission of Shares

I. Transfer of Shares

Check whether:

(i) the requirements contained in the Articles of Association have been complied with;

(ii) the transfer of shares/debentures and the issue of certificates thereof have been made within the stipulated time under Sections 108 and 113 in accordance with the procedures prescribed;

(iii) in respect of transfer deeds reported lost, the company has registered transfer of shares based on an application in writing on stamp paper of the required value with indemnity duly executed by the transferee to the satisfaction of the Board in accordance with the first proviso to Section 108(1);

(iv) transfer applications duly executed by the transferor and transferee completed in all respects are delivered to the company within the validity period mentioned in Section 108(1A);

(v) share transfer application is in Form 7B/7BB, as the case may be;

(vi) a notice had been sent to the transferee in case of application for transfer of partly paid shares pursuant to section 110(2) and (3);

(vii) requisite permission under Section 108A, 108B and 108C has been obtained from the Central Government in applicable cases;

(viii) any directions issued by the Central Government under Section 108D has been complied with;

(ix) Central Government or CLB/Tribunal has not imposed any restriction on transfer [Section 247, 248, 250 etc.]

(x) nomination of shares/debentures received under Section 109A has been duly noted on relevant registers by the company;

(xi) the shares/debentures have not been registered in the name of a firm, HUF, trust (unless registered under Societies Registration Act, 1860), in view of the provisions under Section 153;

(xii) certification of transfer was done in accordance with the provisions under Section 112. If yes, check whether the certification on the instrument of transfer to the effect "certificate lodged" was done by a duly authorised person; and

(xiii) all transfers have been properly included in the Annual Return.

Note: Practising Company Secretary should also verify entries in the register of transfers.

The provisions of section 108 will not apply to transfer of security by the transferor and transferee, both of whom are entered as beneficial owners in the records of a depository.

II. Transmission of shares

Check whether:

(a) a person had been nominated to whom the shares/debentures were to vest in the event of death in Form 2B;

(b) the shares have been transmitted to the legal representative of the deceased shareholder in the case of death of a sole shareholder and in the case of joint holdings only to the survivor(s);

(c) transmission of shares is effected upon the production of succession certificate or probate or letter of administration or indemnity duly signed by the legal heirs of the deceased or as per procedure stipulated by the Board of directors and/or Articles of Association.

(c) Declaration, Payment and Transfer of Dividend

Check whether:

(i) dividends were declared out of profits after providing for depreciation according to the provisions of Section 205(2) (unless an exemption in this regard was obtained);

(ii) specified minimum amount has been transferred to reserves according to the Companies (Transfer of Profits to Reserves) Rules, 1975;

(iii) Board resolution recommending dividend has been passed;

(iv) the Board has authorised the opening of a separate Bank Account for payment of dividend;

(v) 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;

(vi) register of members was closed as per the provisions of Section 154;

(vii) interim dividend, if any, declared by the Board of directors has been confirmed/noted at the annual general meeting;

(viii) dividend recommended by the Board was declared at the annual general meeting;

(ix) dividend warrants were printed, signed and despatched to the registered shareholders within 30 days of declaration;

(x) permission of Reserve Bank of India, if required was obtained before dividend was remitted to foreigners/non resident Indians;

(xi) stock exchanges were duly intimated, in case of listed company;

(xii) voluntary transfer to reserves, if any, was made according to the Companies (Transfer of Profits to Reserves) Rules, 1975;

(xiii) in case of inadequacy of profits, 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 by (e-filing) of form pursuant to such rules, duly precertified;

(xiv) dividends were paid in accordance with Section 206 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;

(xv) 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 (Section 205A);

(xvi) 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 and while transferring the amount, the company furnished a statement in the prescribed form under Section 205A(6).

(xvii) where duplicate dividend warrants were issued, whether indemnity in lieu of dividend warrants lost/defaced were obtained.

(d) Board's Report

Check whether:

(i) a Board resolution was passed authorising chairman or other directors to sign the report on behalf of the Board;

(ii) the report and any addendum thereto was duly signed by persons authorised to sign;

(iii) the Board's report was attached to the balance sheet;

(iv) the report contained specified particulars viz. state of affairs of the company, proposed transfer to reserves, proposed dividend, material changes affecting the financial position, conservation of energy, technology absorption, etc. Also whether the requirements specified in Companies (Disclosure of Particulars in the Report of Board of Directors Rules), 1988 have been complied with;

(v) the Board's report includes a statement showing employees particulars in accordance with the Companies (Particulars of Employees) Rules, 1975;

(vi) the Board's report includes a Directors Responsibility Statement, about:

— following applicable accounting standards

— consistent application of accounting policies

— maintenance of adequate accounting records

— preparation of annual accounts on going concern basis;

(vii) in the case of a Non-Banking Financial Company, a Residuary Non-banking company, the Board's report includes details required to be furnished under Non-Banking Financial Companies (Reserve Bank) Directions, 1988/ Residuary Non-Banking Companies (Reserve Bank) Directions, 1987, as the case may be;

(viii) in case the company has passed a special resolution to purchase its own securities (Buy-back) pursuant to Section 77A and the Buy-back has not been completed within the time specified (12 months from the date of the resolution), the reasons for failure have been specified;

(ix) a copy of the Compliance Certificate issued by a Practising Company Secretary was attached to the Board's report;

(x) the Board's report gives the fullest information and explanations on every reservation, qualifications or adverse remarks, if any contained in the auditors report;

(xi) changes in the directors of the company have been reported.

(e) Transfer of Unpaid Amounts to the Investor Education and Protection Fund

(i) Check whether the company has duly transferred the following amounts to the Investor Education and Protection Fund:

(a) amounts in the unpaid dividend accounts of the company;

(b) the application money received by the company for allotment of any securities and due for refund;

(c) matured deposits with the company;

(d) matured debentures with the company;

(e) interest accrued on the amounts referred to in clauses (a) to (d) above;

if such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment and filed a copy of challan evidencing such deposit with the Registrar.

(ii) whether company has filed Form I of Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 duly certified.

(iii) whether the other provisions of Investor Education and Protection Fund Rules, 2001, as far as applicable were complied with.

13. Number and Appointment of Directors

Check whether:

(a) the appointment conforms to the provisions contained in the Articles;

(b) 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;

(c) if the number had fallen below the minimum, whether action was taken to bring the number atleast to the minimum;

(d) if it is a new company, check if the first directors were appointed in accordance with the Articles;

(e) in the case of a public company whether the provisions of Sections 255 and 256 have been duly complied with;

(f) persons other than retiring directors who were candidates for directorship at the general meeting had given not less than fourteen days notice and made a deposit of Rs. 500/- per candidate and had also complied with the provisions of Section 257;

(g) in the case of a public company if the number of directors has been increased beyond 12, approval of the Central Government under Section 259 has been obtained;

(h) if the Board has filled up casual vacancy among directors appointed in general meeting, the appointment was in accordance with the Articles and was made at a meeting of the Board;

(i) if the Board has appointed any alternate/additional director during the year under Sections 313 and 260 respectively, the appointment was in accordance with the Articles;

(j) if any nominee director has been appointed during the year, the appointment is in consonance with the provisions of the Articles of the company;

(k) the company has complied with the provisions of Section 265 where it has adopted principle of proportional representation for appointment of directors;

(l) in the case of a public company, check whether it has secured Central Government approval as required under Section 268 for amendment of any provision relating to the appointment or re-appointment of managing or wholetime director or of a director not liable to retire by rotation;

(m) directors other than those referred to in Sub-section (2) of Section 264 had given consent to act as director within 30 days of his appointment and the consent was filed with the ROC as an attachment in Form No. 32;

(n) none of the directors suffers from any of the disqualifications with reference to Section 274 and Companies (Disqualification of Directors under section 274(l)(g) of the Companies Act, 1956 Rules, 2003 and a form DD-A had been filed by the director(s) before appointment/reappointment. [If the director is disqualified, the auditor should have reported the same to the members and the company should have filed e-form DD-B with the Registrar of Companies]. Also, whether any application has been filed in e-form DD-C for removal of disqualification of directors;

(o) none of the directors is holding directorships in more than 15 companies subject to provisions of Section 278 of the Act;

(p) the office of any director stands vacated on account of any of the disqualifications specified in Section 283 or contravention of the provisions of Section 314(1);

(q) the Board has taken note of the resignation tendered by any director or has accepted the same in terms of articles;

(r) the company has filed form No. 32 for any change among directors/ managing director;

(s) in the case of a private company, the office of any director stands vacated on account of any of the additional grounds specified in the Articles of Association;

(t) If any director was removed before the expiry of his term of office, in accordance with the provisions of Section 284 such director was not appointed afresh by the Board of directors as per proviso to Section 284(6); and

(u) whether Register of Directors (Section 301) and Register of Directors Shareholdings (Section 307) have been maintained.

14. Appointment of Managing Director, Whole-time Director or Manager

Check whether:

(i) the appointment conforms to provisions contained in the Articles of Association;

(ii) the appointment was made in accordance with the provisions Section 269;

(iii) appointment had been made pursuant to Schedule-XIII (a) the appointee has furnished a declaration or otherwise stated that he satisfies the conditions specified in Part I of Schedule XIII; (b) the appointment was in accordance with the conditions specified in Schedule XIII; (c) return in e-Form No.25C was filed with the Registrar within 90 days of the date of appointment; (d) the appointment had been approved by the members in general meeting; (e) in case of appointment of managing director, e-Form No. 23 was filed with the ROC within 30 days; (f) e-Form No. 32 has been filed; and (g) in case the appointee had not completed the age of 25 years, but had attained the age of majority or had attained the age of 70 years, his appointment had been approved by a special resolution and e-Form No. 23 was filed with the ROC; (h) the appointment has been in accordance with the Part II of Schedule XIII i.e. approval of remuneration committee etc. as the case may be.

(iv) an abstract of appointment and remuneration was sent to members of the company within 21 days of appointment under Section 302 of the Act.

(v) the appointment required the approval of the Central Government; if so 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;

(vi) the managing director or whole-time director does not suffer from any of the disqualifications specified in Sections 274 and 267. In the case of manager, check with reference to Section 385;

(vii) remuneration paid to Managing/Whole-time Director/Manager is in

accordance with the provisions of the Act and terms and conditions of approval;

(viii) the provisions of Section 316/386 where applicable, have been complied with.

(ix) The company had no/inadequate profits, it has paid remuneration etc. according to amended Part II of Section II of Schedule XIII and Remuneration Committee have been formed accordingly.

(x) The company is notified by Department of Commerce as one in special Economic Zones, remuneration not exceeding Rs. 2,40,00,000 per annum or Rs. 2,00,000 per month is paid. Also, provided such companies have not raised any money by public issue of shares/debentures in India and have not defaulted in India in repayment of any debts including public deposits or debentures or interest thereon for a continuous period of thirty days in a financial year.

15. Appointment of Sole Selling Agents

Check whether:

(i) the company has complied with provisions of Section 294 for appointment of sole selling agents and verify that such appointment is not prohibited under Section 294AA;

(ii) e-Form No. 23 has been duly filed;

(iii) the agreement/resolution states specifically that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which appointment is made;

(iv) Central Government required the company to furnish to it information regarding terms and conditions of the appointment of sole selling agent and if so verify whether necessary information was furnished;

(v) the Central Government varied the terms and conditions of sole selling agent and if so whether the same were complied with;

(vi) e-form I has been filed for obtaining approval of Central Government for appointment of sole selling agents;

(vii) such previous approval of the Central Government has been obtained where the individual firm or body corporate appointed as sole selling agent had substantial interest in the company;

(viii) approval by special resolution and of the Central Government was obtained for appointment of sole selling agent where the paid-up share capital of the company was Rs. 50 lakhs or more.

16. Disclosure of interest by the Directors to the Board of Directors

Check whether:

(i) every director has disclosed his interest at the Board meeting where transaction is considered in which he is directly or indirectly interested;

(ii) the notices of disclosure of general interest under Section 299 if received from any director in Form No. 24AA in the last month of the financial year has been placed before and read at the next Board meeting;

(iii) entries thereof have been made in the register under Section 301, (Register of Contracts) noted by the Board;

(iv) such notice under Section 299 if not given at the meeting of the Board, whether it was brought up and read at the meeting of the Board next after it was given;

(v) any director who has been appointed as director of another company during the year has made disclosure thereof in terms of Section 305 of the Act.

17. Issue of Capital and Securities

(a) In Case of Private Companies

Check whether:

(i) the relevant provisions in Articles of Association have been complied with and the increase is within the authorised capital of the company;

(ii) the company has issued equity share capital with differential rights as to dividend, voting or otherwise, if any, in accordance with the Rules prescribed by the Central Government;

(iii) return of allotment was filed with the ROC in e-Form No. 2 in accordance with the provisions of Section 75;

(iv) the register of shareholders/members has been properly maintained and the number of shareholders are not more than 50;

(v) share certificates, have been issued to the allottees in accordance with the Companies (Issue of Share Certificates) Rules, 1960 within the prescribed period; and

(vi) where the company has issued preference shares, provisions of Sections 80(5A) and 80A have been complied with;

(vii) the company has privately placed debentures and if so it has complied with provisions of Section 117C and a copy of the Trust Deed has been forwarded on payment of requisite fee to any member or debentureholder;

(viii) the company, which has completed a buy-back of its shares or other specified securities has not made further issue of the same kind of securities in the last 6 months beginning therefrom, as stipulated in Section 77A(8).

(b) In Case of Public Listed Companies

SEBI(ICDR) Regulations 2009 are applicable to issue of shares/debentures by listed Companies. The detailed compliance check list is given in Chapter II in respect of various types of issues.

(c) Issue of Sweat Equity Shares

Check whether:

(i) at least one year has elapsed since the date on which the company was entitled to commence business;

(ii) that the sweat equity shares issued are shares only of a class already issued;

(iii) that a special resolution was passed at a general meeting authorising the issue;

(iv) also that the special resolution specified the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such shares are to be issued;

(v) whether the company has filed e-Form No. 23 with the ROC along with a copy of the resolution within 30 days from the date the resolution was passed;

(vi) if the company is an unlisted company, that the issue of sweat equity shares was in accordance with the rules as prescribed by the Central Government, Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2000.

If the Company is a Listed Company

Check *inter alia* :

(vii) the company had forwarded 3 copies of the notice and one copy of the proceedings of the general meeting to the stock exchange;

(viii) that the issue was in accordance with the regulations made by SEBI in this regard;

(ix) if the shares were issued for consideration other than cash, the Articles of the company permit the same.

(d) Issue of Shares with Differential Voting Rights

Check that:

(i) the Articles of Association authorizes the issue of shares with differential voting rights;

(ii) the company has not been convicted of any offence arising under the SEBI Act, 1992; Securities Contracts (Regulation) Act, 1956 or the Foreign Exchange Management Act, 1999;

(iii) the company had distributable profits in terms of section 205 of the Act during the three financial years preceding the year in which aforesaid shares were issued;

(iv) the company has not defaulted in filing annual accounts and annual returns during the immediately preceding three financial years preceding the financial year in which the aforesaid shares were issued;

(v) the company has not failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend after it was declared;

(vi) the provisions in the Memorandum allow issue of the said shares. If not, whether the proposal for issue of the said shares. If not, whether the proposal for issue of the said shares has been approved by the shareholders under section 94 of the Act;

(vii) the company has not defaulted in meeting investors' grievances;

(viii) the proposal for issue of the said shares has been approved by the shareholders by special resolution by Postal ballot in the case of a listed company and by the shareholders of any other company by special resolution under section 81 of the Act;

(ix) the sum total of the shares issued with differential voting rights is not more than 25% of the total capital of the company;

(x) the explanatory statement relating to the said resolution sets out the—

(a) the rate of voting right which the equity share capital with differential voting right shall carry;

(b) the scale or in proportion to which the voting rights of such class or type of shares will carry;

(c) the company shall not convert its equity capital with voting rights into equity share capital with differential voting rights and the shares with differential voting rights into equity share capital with voting rights;

(d) the shares with differential voting rights shall not exceed 25% of the total share capital issued;

(e) statement that a member of a company holding any equity share with differential voting rights shall be entitled to bonus shares, right shares of the same class;

(f) the holders of the equity shares with differential voting rights shall enjoy all other rights to which the holder is entitled to except right to vote as indicated in (a) above.

(xi) a register of members of shares with differential voting rights is being maintained.

(e) Capitalisation of Profit/Issue of Bonus Shares

Check whether:

(i) Articles of Association of the company provide for capitalisation of profits;

(ii) requisite resolution was passed by the shareholders in their meeting for capitalisation of profits and issuing bonus shares;

(iii) bonus issue is made out of free reserves built out of genuine profits or share premium collected in cash only and reserves created by revaluation of fixed assets are not capitalised;

(iv) return of allotment in e-Form No. 2 was filed within 30 days of passing resolution.

In the Case of Listed Company, also check whether:

(v) guidelines issued by SEBI relating to Bonus shares for disclosure and investor protection have been duly complied with;

(vi) issue of bonus shares is not made prior to 12 months after a public/right issue;

(vii) the bonus proposal has been implemented within six months from the date of Board's approval.

18. Buy-Back of Shares/Securities

If the company has bought back any shares/securities, check whether:

(i) the Articles authorise buy back of securities;

(ii) a special resolution was passed at a general meeting approving the buy-back of securities and the same was filed along with e-Form No. 23 with the ROC within 30 days from the date of passing the resolution;

(iii) the buy-back was made only out of the company's free reserves, securities premium account, the proceeds of any shares or other specified securities;

(iv) the buy-back was not made out of the proceeds of an earlier issue of the same kind of shares/securities;

(v) (a) the aggregate value of buy-back was not exceeding 25% of the total paid-up capital and free reserves of the company.

(b) if the buy-back was of equity shares in the financial year, it did not exceed 25% of the total paid-up equity capital in that financial year.

(c) all the shares/securities so bought back were fully paid-up.

(d) the ratio of debt including all amounts secured and unsecured owed by the company was not more than twice the capital and its free reserves after such buy-back, except where a higher ratio has been prescribed by the Central Government for a class or classes of companies.

(vi) Notwithstanding the provisions of Section 77A(2) in case buy-back was upto 10% of total paid-up equity capital and free reserves of the company, the same has been authorised by the Board by means of a resolution passed at its meeting [Proviso to Section 77A(2)].

Provided no offer of buy-back was made within a period of 365 days reckoned from the date of the preceding offer of buy-back, if any.

(vii) the buy-back process was completed within 12 months from the date of passing of the special resolution; if it was not completed within the stipulated time also check whether the reasons thereof were stated in the Board's report;

(viii) If the Company is an Unlisted Public Limited Company or a Private Limited Company, Check whether:

(a) the buy-back was made in accordance with the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999 issued by the Department of Company Affairs;

(b) the company had passed a special resolution and an explanatory statement was annexed to the notice containing disclosures as specified in Schedule I to the Rules;

(c) a draft letter of offer containing particulars specified in Schedule II to the Rules was filed with ROC;

(d) a declaration of solvency in e-form 62 (form No. 4A) was filed with the ROC along with the letter of offer;

(e) the letter of offer was despatched immediately after filing with ROC but not later than 21 days from its filing with ROC;

(f) the offer for buy-back remained open to the members for a period not less than 15 days and not exceeding 30 days from the date of despatch

of letter of offer;

(g) the acceptance per shareholder was on proportionate basis where shares offered by shareholders are more than the total number of shares to be bought back;

(h) the company had immediately after the date of closure of the offer opened a special bank account and deposited therein such sum, as would make up the entire sum due and payable as consideration for the buy-back in terms of the Rules;

(i) the share certificates so bought back were extinguished and physically destroyed in the presence of a Practising Company Secretary within 7 days of the last date of completion of buy-back;

(j) the company had furnished with the ROC a certificate duly verified by two directors including the Managing Director and a Practising Company Secretary certifying compliance with above mentioned Rules and also specifically Rule 10(1) of the said Rules regarding extinguishing of share certificates within 7 days of the extinguishing and destruction of the certificates;

(k) the company has filed with the ROC a return on buy-back of securities as prescribed in Annexure 'A' of the said Rules within 30 days of completion of the buy-back;

(l) the register of buy-back of securities has been maintained by the company as prescribed in Annexure 'B' of the said Rules.

(ix) If the Company is a Listed Company in addition to the requirements stated at (i) to (vii) above check whether:

(a) the buy-back was made as per the SEBI (Buy-back of Securities) Regulations, 1998;

(b) the company has filed with SEBI and the ROC a return on buy-back of securities within 30 days of completion of the buy-back in the prescribed format;

(c) the register of buy-back of securities has been maintained by the company in the prescribed format.

(x) the company which has completed buy-back has not made further issue (including rights issue) of the same kind of shares or other specified securities within 6 months except by way of bonus issues or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares;

(xi) prohibition for buy-back is not attracted in certain circumstances as set out under Section 77B.

19. Redemption of Preference Shares/Debentures

(a) Redemption of Preference Shares

Check whether any preference shares have been redeemed; if so check:

(i) the provisions contained in Articles of Association have been complied with;

(ii) the conditions set out in Section 80 of the Act have been met; and

(iii) e-Form No. 5 has been filed with the ROC within 30 days from the date of redemption.

(b) Redemption of Debentures

Check whether:

(i) company has followed the provisions in the Articles of Association;

(ii) 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;

(iii) the company has not utilised the debenture reserve except for the redemption of debentures;

(iv) the company has paid interest and redeemed the debentures in accordance with the terms and conditions of their issue;

(v) the company has complied with the order, if any, of the Company Law Board with regard to redemption of debentures.

20. Rights to dividend, rights shares and bonus shares held in abeyance

Check whether:

(i) rights to dividend, rights shares and bonus shares have been held in abeyance in cases where the instrument of transfer has been delivered to the company and the transfer of such shares has not been registered by the company;

(ii) in case instrument of transfer of shares is pending registration with the company, check whether the dividend relating to such shares has been transferred to a special bank account opened by the company under Section 205A unless the company is authorised by the registered shareholder, in writing, to pay such dividend to the transferee specified in the instrument of transfer.

Non Banking Financial Companies

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/ securities issued by Government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property. A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme or arrangement or any other manner, or lending in any manner is also a non-banking financial company (Residuary non-banking company

Following are the major compliances by NBFCs

- In terms of Section 45-IA of the RBI Act, 1934, it is mandatory that every NBFC should be registered with RBI to commence or carry on any business of non-banking financial institution as defined in clause (a) of Section 45 I of

the RBI Act, 1934. However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under Section 620A of the Companies Act, 1956, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.

- A company incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934 should have a minimum net owned fund of Rs 25 lakh (raised to Rs 200 lakh w.e.f April 21, 1999).
- An NBFC maintaining required Net Owned Funds(NOF)/Capital to Risk Assets Ratio (CRAR) and complying with the prudential norms can accept public deposits as follows:

Category of NBFC having minimum NOF of Rs 200 lakhs	**Ceiling on public deposit**
AFC* maintaining CRAR of 15% without credit rating	1.5 times of NOF or Rs 10 crore whichever is less
AFC with CRAR of 12% and having minimum investment grade credit rating	4 times of NOF
LC/IC** with CRAR of 15% and having minimum investment grade credit rating	1.5 times of NOF

*AFC = Asset Finance Company ** LC/IC = Loan company/Investment Company

As has been notified on June 17, 2008 the ceiling on level of public deposits for NBFCs accepting deposits but not having minimum Net Owned Fund of Rs 200 lakh is revised as under:

Category of NBFC having NOF more than Rs 25 lakh but less than Rs 200 lakh	**Revised Ceiling on public deposits**
AFCs maintaining CRAR of 15% without credit rating and	Equal to NOF
AFCs with CRAR of 12% and having minimum investment grade credit rating	1.5 times of NOF
LCs/ICs with CRAR of 15% and having minimum investment grade credit rating	Equal to NOF

- Presently, the maximum rate of interest an NBFC can offer is 12.5%. The interest may be paid or compounded at not shorter than monthly rests.

- The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.
- NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 12.5 per cent per annum. The interest may be paid or compounded at rests not shorter than monthly rests.
- NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.
- NBFCs (except certain AFCs) should have minimum investment grade credit rating.
- NBFCs cannot accept deposits from NRIs except deposits by debit to NRO account of NRI provided such amount does not represent inward remittance or transfer from NRE/FCNR (B) account.
- The NBFCs accepting public deposits should furnish to RBI

1. Audited balance sheet of each financial year and an audited profit and loss account in respect of that year as passed in the annual general meeting together with a copy of the report of the Board of Directors and a copy of the report and the notes on accounts furnished by its Auditors;
2. Statutory Annual Return on deposits - NBS 1;
3. Certificate from the Auditors that the company is in a position to repay the deposits as and when the claims arise;
4. Quarterly Return on liquid assets;
5. Half-yearly Return on prudential norms;
6. Half-yearly ALM Returns by companies having public deposits of Rs. 20 crore and above or with assets of Rs. 100 crore and above irrespective of the size of deposits ;
7. Monthly return on exposure to capital market by companies having public deposits of Rs. 50 crore and above; and
8. A copy of the Credit Rating obtained once a year along with one of the Half-yearly Returns on prudential norms.

21. Borrowing Powers

(a) 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.

(b) In Case of Public Company

Check whether:

(i) the Memorandum and Articles contains provisions with respect to the powers

of the company to borrow money and to charge the assets of the company;

(ii) the power to issue debentures has been exercised at the meeting of the Board;

(iii) the power to borrow money, otherwise than on debentures, has been exercised at the meeting of the Board;

(iv) 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 delegate;

(v) 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;

(vi) Form No. 23 has been filed with the ROC under Section 192(4)(ee)(i).

22. Loans, Investments, Guarantees and Securities (Section 372A)

(a) Check whether provisions of Section 372A 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 prescribed under Section 372A.

(b) Check that:

(i) the company has not defaulted in complying with the provisions of Section 58A;

(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); and

(iv) the company has obtained prior approval of the public financial institutions, 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.

(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 financial

institutions where any term loan is subsisting 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) In case of listed companies, the resolution was passed through postal ballot process;

(v) no omnibus special resolution(s) have been passed;

(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 extra-ordinary) 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) the details regarding the transaction(s) 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).

23. Memorandum of Association

Alteration in the memorandum of association with respect to change in registered office from one state to another and object clause

(i) Check whether:

(a) the Board of directors had passed a resolution for change in registered office of the company/alteration of object clause;

(b) the Board has called a general meeting and necessary special resolution has been passed at the said meeting;

(c) a certified true copy of the special resolution along with the certified true copy of the explanatory statement was filed with the Registrar in Form No.23, within thirty days from the date of passing of the resolution;

(d) a petition has been filed before the Company Law Board, for confirmation of the alteration of Memorandum relating to change of place of the company's registered office from one State to another.

(e) a certified true copy of the order of the CLB 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) the Registrar of each State registered the same and issued the Certificate of registration under his hand; and

(g) every copy of the memorandum issued after the date of alteration is in accordance with the 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

(ii) Check whether:

(a) 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) it has made application in form 1AD to the Regional Director for confirmation of special resolution;

(c) the RD had passed the confirmation order of the resolution within four weeks from the date of receipt of the company's application;

(d) 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; and

(e) 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.

(iii) Check whether the provisions of the Memorandum with respect to the objects of the company was altered during the year. If so, check whether:

(a) the company has filed with the ROC in Form No. 23 the special resolution passed by the company within one month from the date of such resolution;

(b) the ROC issued certificate registering alterations; and

(c) the alterations had been incorporated in all the copies of the Memorandum.

(d) the resolution was passed through postal ballot process and the alteration was notified to the Stock Exchange if the shares were listed.

Name and Capital

(iv) Check whether the company changed its name during the year. If so, check whether:

(a) the company had obtained the availability of new name from Registrar or Companies;

(b) the Board of Directors had called and held the general meeting within six

months of date of intimation from Registrar;

(c) the company has passed a special resolution and filed eForm No. 23 with the ROC within 30 days and obtained Central Governments approval where applicable;

(d) fresh certificate of incorporation was obtained from the ROC;

(e) the name has been painted/affixed/printed on the name board, business letters, bill heads, Memorandum and Articles;

(f) new common seal has been adopted by the Board; and

(g) the change was notified to Stock Exchanges if the shares are listed.

(v) Check whether the company altered the conditions of its Memorandum as regards share capital in any of the ways mentioned in Section 94(1). If so, check whether:

(a) alteration was authorised by the Articles and the general meeting;

(b) alteration had been effected in all copies of Memorandum and Articles etc.; and

(c) e-Form No. 5 and 23 were filed with the ROC within 30 days.

(d) the alteration was notified to the stock exchange if the shares were listed.

(e) every copy of the memorandum and articles issued after the date of alteration is accordance with alteration.

24. Articles of Association

(a) Check the extent of applicability of Table A of Schedule I of the Act.

(b) Check whether the articles were altered during the year under Section 31. If so, check whether:

(i) copy of the special resolution was filed with the Registrar in Form No. 23;

(ii) the change had been incorporated in all copies of the articles;

(iii) if the alteration had the effect of converting a public company into a private company, whether:

— approval of the Registrar of Companies was obtained; and

— a printed copy of the articles as altered was filed with the Registrar within one month of the date of the receipt of the order of approval; and

— In case shares of the company were listed on a recognised Stock Exchange, the resolution was passed through postal ballot process;

(iv) the alteration has been notified to the stock exchange in case the shares are listed.

25. Prosecution or Show Cause Notices

Check whether:

(i) ROC has issued any show-cause notice for non-compliance of any provision

of the Act. Verify the explanations given in the light of alleged default.

(ii) The Board considered the show cause notice at a meeting or otherwise.

(iii) Any inspection or investigation into the affairs of the company has been ordered and whether it is outstanding at the time of issue of the certificate.

(iv) Any penalty, fine or punishment has been imposed on the company and whether it has been complied with.

26. Deposit of Employees Security Deposits

Check whether:

(i) any money or security deposited with the company by any employee in pursuance of his contract of service with the company has been kept or deposited by the company within 15 days from the date of deposit in an account as specified in Clauses (a) to (c) of Sub-section (1) of Section 417;

(ii) the company has not utilised any portion of such money or securities except for the purposes agreed to in the contract of service.

27. Deposit of Contribution to Provident Fund

Check whether:

(i) the company has constituted a Provident Fund for its employees or any class of employees. 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 has 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 Sub-section (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.

(ii) where the company has created a trust for the employees provident fund, the company shall collect the contribution and pay to the trustees of the said fund, the employees' and employer's contributions within 15 days from the date of collection. Also, the Board for this purpose shall approve the execution of trust deed, appointing trustees, getting approval of commissioner of Income-tax etc.

(iii) if the employees' contribution is deducted from their salary, verify the amount deducted from salary register.

(iv) the employees' contribution is equal to the employer's contribution and aggregate tallies with the quantum mentioned in the statement sent to Provident Fund Commissioner.

CHECK LIST FOR OTHER COMPLIANCES

There may be certain matters which have bearing on the compliances under the Companies Act although not directly referred to in the 33 paragraphs of the Form appended to the Companies (Compliance Certificate) Rules, 2001. An illustrative but not exhaustive list of some such matters is given below. It is likely that PCS during the course of scrutiny comes across non-compliance with regard to such matters. While PCS need not qualify non-compliance of such matters he/she may suitably advise the management on the same.

1. DIRECTORS/OFFICERS

(a) Appointment of Officers

Check whether:

(i) the company has appointed qualified secretary in conformity with section 2(45) and 383A read with the Companies (Appointment and Qualifications of Secretary) Rules, 1988 and filed Form No. 32 with Registrar of Companies within 30 days from the date of appointment;

(ii) the company has charged any person with the responsibility of complying with specified provisions as per section 5 and if so whether Form Nos. 1AA, 1AB and 1AC as the case may be under the Companies (Central Government's) General Rules and Forms, 1956 have been filed with ROC within 30 days;

(iii) if receiver or manager of property of the company under section 137 has been appointed, notice thereof has been given to the ROC within 30 days in Form No. 15 of the Companies (Central Government's) General Rules and Forms, 1956;

(iv) in case company has appointed a Manager, it has complied with the provisions of section 269 of the Act read with Schedule XIII.

(b) Vacation of Office of Directors

Check whether:

(i) the director has vacated his office on happening of any of the events specified under section 283(1) of the Act;

(ii) the director has vacated his office on account of any contraventions of sections 314(1) and 314(1B);

(iii) in case of a private company, the director has vacated his office on any other ground as specified in the Articles in addition to those specified in sub-section (1) of section 283.

(c) Retirement of Directors

Check whether:

(i) one third of such directors for the time being as are liable to retire by rotation, or if their number is not three or a multiple of three, then, lthe number of nearest to one third, retire from office at first annual general meeting and at every subsequent annual general meeting;

(ii) the directors retiring by rotation are those who have been longest in office since their last appointment;

(iii) between directors appointed on the same day, the retirement was, in default of and subject to any agreement among themselves, determined by draw of lots;

(iv) the company has filled up such vacancy by appointing the retiring director or some other person;

(v) the director has stated his willingness for his reappointment;

(vi) the vacancy was filled up at the adjourned meeting, or the retiring director was deemed to be reappointed under provisions of section 256(4).

Note: Unless otherwise specified in the Articles of Association, the aforesaid requirements shall not apply to a private company.

(d) Removal of Directors

Check whether:

(i) a special notice as required under sub-section (2) of section 284 was given to the company to remove a director;

(ii) the company has sent forthwith a copy thereof to the director concerned and the director was provided opportunity to be heard on the resolution at the meeting;

(iii) the representation, if any, made by concerned director has been notified to the members on the request of the director along with the notice of the resolution and if a copy of the representations was not sent because they were received too late or because of company's default, it was read out at the meeting on the request of the director;

(iv) the director who was removed from office was not reappointed as a director by the Board of directors;

(v) the company has filed form No.32 with the Registrar of Companies within 30 days from the date of removal;

(vi) any order was passed by Company Law Board for removal of director.

(e) Disclosures

Check whether the company has made the following disclosures:

(i) the address of its registered office as per Section 147;

(ii) the authorised share capital in its official publications and if yes, subscribed/ paid-up share capital as per Section 148;

(iii) directors' interest in contract(s) appointing manager or managing director as per Section 302.

Check whether the company has complied with the requirements in pursuance of disclosures by directors regarding:

(i) particulars of directors under Section 303;

(ii) particulars of other directorships under Section 305;

(iii) particulars of directorship, membership and partnership under Section 299;

(iv) particulars of directors shareholdings under Section 308;

(v) particulars of interest or concern in any contract under Section 297.

(f) Appointment/Change and Remuneration of Auditors

Check whether:

(i) the appointment and remuneration of auditors are in order with reference to Sections 224, 224A, 225, 226 and 228;

(ii) the company has obtained requisite intimation under Section 224(1B) before appointment/reappointment of auditors;

(iii) the company has intimated appointment/reappointment of auditors under Section 224(1).

(g) Redemption of Irredeemable Preference Shares under Section 80-A

Check whether the company had issued before the commencement of the Companies (Amendment) Act, 1988 preference shares which were irredeemable or not redeemable before the expiry of ten years, if so:

(i) whether steps had been taken to comply with the requirements of Section 80A(1)(a) or 80A(1)(b) as the case may be;

(ii) if the company was not in a position to redeem any such share within the period specified in Clause (a) or (b) of Sub-section (1) of Section 80A, check whether consent of the Company Law Board had been obtained for issue of further redeemable shares equal to the amounts due (including the dividend thereon) in respect of unredeemed preference shares.

(h) Commencement of New Business stated in 'Other Objects' in the Memorandum in the Case of Public Companies

Check whether:

(i) a special resolution was passed under Section 149(2A) before commencement of such new business and e-Form No. 23 was filed with the ROC;

(ii) the shareholders approved the resolution by a simple majority, and if so check whether approval was obtained from the Central Government;

(iii) a duly verified declaration by one of the directors or the secretary or, where the company has not appointed a secretary, by a Practising Company Secretary in e-Form No. 20A was filed with the ROC.

(i) Membership of Holding Company

Check whether:

(i) the company is a member of a company which is its holding company;

(ii) the company which is a member of its holding company has been allotted any shares or acquired further shares after it became a subsidiary as such allotment or transfer is void.

(j) Loans by Company for Purchase of its Own or Holding Company's Shares

Check whether:

(i) the company gave any financial assistance for the purpose of or in connection with purchase of shares in the company or in its holding company;

(ii) the company had given any such financial assistance, it should be ensured that it fell within the exemption under Section 77.

(k) Remuneration of Directors

Check whether:

(i) the payment of remuneration to directors was within the limits provided under

Sections 198 and 309 of the Act;

(ii) 'net profit' has been computed in accordance with the provisions of Sections 349 and 350;

(iii) the remuneration paid to managing director/whole-time director was in accordance with the provisions of the Articles, Schedule XIII to the Companies Act, 1956, resolution passed by the shareholders in general meeting and/or approval of the Central Government;

(iv) remuneration paid if any has been recovered in case approval by the Central Government was either not obtained or denied;

(v) special resolution was passed for payment of remuneration by way of commission to directors who are not whole-time/managing directors;

(vi) increase in the remuneration was effected with Central Governments approval in accordance with Section 310;

(vii) no other remuneration was paid to a director in any other capacity except as permitted;

(viii) no tax free payment was made;

(ix) compensation for loss of office, if any, has been paid within the limits specified in Sub-section (4) of Section 319;

(x) the amount of remuneration by way of fee for each meeting of the Board of directors or a committee thereof has not exceeded Rs. 5,000/- or such other amount as may be prescribed from time to time.

Note: The aforesaid requirements do not apply to private companies.

(l) Balance Sheet and Profit and Loss Account

Check whether:

(i) balance sheet and profit & loss account has been prepared in the form set out in Part I and Part II of the Schedule VI;

(ii) Central Government's permission has been received under Section 211(4) for any modifications in relation to any of the requirements as to the matters to be stated in the company's balance sheet or profit and loss account.

(m) Cost Audit and Appointment of Cost Auditor

Check whether:

(i) there was an order of the Central Government ordering audit of cost accounts of the company;

(ii) Board resolution was passed for appointing a person as cost auditor and whether he was qualified to act as such;

(iii) approval of the Central Government was obtained for the appointment of the cost auditor and the cost auditor was issued appointment order;

(iv) a copy of the cost audit report was received from the cost auditor;

(v) full information and explanations were furnished to the Central Government for any reservations or qualifications contained in the cost audit report;

(vi) any directions were received from the Central Government for circulation of the cost audit report to the members along with the notice of the annual general meeting and, if so, whether the same has been complied with.

(n) General

Check whether:

(i) a company has served documents on a member in conformity with the provisions of Section 53;

(ii) a public company has paid underwriting commission; if so, check whether it has complied with the provisions contained in Section 76 and its Articles of Association;

(iii) the company has complied with the provisions of Section 188 in respect of circulation of members resolutions;

(iv) the company has paid interest out of capital and if so check the payment has been authorised by its Articles or by a special resolution in as much as with the previous sanction of the Central Government.

(o) Conversion of a Public Company into a Private Company

Check whether:

(i) the company has received the approval of ROC;

(ii) the company has passed a special resolution authorising the conversion and altering the Articles so as to contain the matter specified in Section 3(1)(iii) and filed the same with the ROC;

(iii) the company has passed a special resolution as required under Section 21 read with Section 13(1)(a) and filed the same with the ROC;

(iv) in case shares of the company were listed on a recognised Stock Exchange, the resolution was passed through postal ballot process;

(v) the company has obtained consent of every creditor to whom the company owes substantial amounts or has issued a public notice in newspapers for conversion of a public company into a private company;

(vi) the company has obtained fresh certificate of incorporation from ROC;

(vii) the alteration of name has also been effected in the Memorandum and Articles of Association, common seal, name board and other documents.

(p) Conversion of a Private Company (which is a Subsidiary of a Public Company) into a Public Company

A private company which is a subsidiary of a public company is a public company as per provisions of Sub-clause (c) of Clause (iv) of Sub-section (1) of Section 3. Therefore, check whether:

(i) it has altered its Articles by deleting provisions relating to matters specified in Clause (iii) of Sub-section (1) of Section 3;

(ii) it has altered its Articles for increasing the number of its members to minimum seven;

(iii) it has altered its Article for increasing the number of its directors to at least

three directors;

(iv) it has altered other regulations in the Articles which are not applicable to a public company;

(v) it has a minimum paid-up capital of five lakhs rupees or more on or before 12th December 2002 or such higher paid-up capital as may be prescribed;

(vi) it has filed e-Form No. 23 with the ROC and obtained a fresh certificate of incorporation;

(vii) it has filed prospectus/statement in lieu of prospectus with ROC.

(q) Conversion of a Private Company into a Public Company under Section 44

Check whether:

(i) the company has increased the number of its directors to minimum three;

(ii) the company has increased the number of its members to minimum seven;

(iii) the company has secured shareholders' approval by special resolution for deletion of the Article containing restrictive provisions applicable to a private company [vide Section 3(1)(iii)];

(iv) the resolution has been passed through postal ballot process if the shares of the company are listed;

(v) the company has altered other regulations in the Articles which are not applicable to a public company;

(vi) the company has filed e-Form No. 23 with the ROC alongwith the special resolution and explanatory statement;

(vii) the company has filed prospectus/statement in lieu of prospectus with the ROC;

(viii) the company has received a new certificate of incorporation after deleting the word private in its name.

(r) Statutory Meeting/Class Meetings/General Meeting

(i) Statutory Meeting (in case of a Public Company)

Check whether:

(i) the meeting has been held within the period prescribed under Section 165(1);

(ii) notice of meeting and statutory report in e-Form No. 22 duly certified were sent to the members and ROC; and

(iii) other requirements of a general meeting e.g., quorum, notice, preparation and signing of minutes, etc., were complied with.

(ii) Meeting of Class of Shareholders

Check whether:

(i) the meeting has been convened after duly complying with the provisions under relevant Section and Rule 7 of the Companies (Central Government's) General Rules and Forms, 1956 e.g., for reduction of capital, for variation of rights of shareholders as directed by Court;

(ii) the applicable provisions (e.g. those under Section 102/106) have been duly complied with;

(iii) subject to directions of the Court, requirements relating to notice, attendance, Chairman, quorum, proxy, proxy register/instruments of proxy and conduct of meeting as well as maintenance of minutes of a general meeting have been complied with.

(iii) Meeting of Creditors and Others

Check whether:

(i) the meeting has been convened after duly complying with rule 7 of the Companies (Central Government's) General Rules and Forms, 1956, the terms of agreement or the directions of Court/CLB e.g., meetings convened in sections 391/394 or sections 397/398;

(ii) as directed by the Court, requirements relating to notice, attendance, Chairman, quorum, proxy, proxy register/instruments of proxy a nd conduct of meeting as well as maintenance of minutes of a general meeting have been complied with.

(iv) Passing of Resolutions by Postal Ballot under Section 192A by a Listed Company

Check whether:

(i) the company has passed any resolution by resorting to postal ballot;

(ii) the company has passed the resolution only by postal ballot in respect of following business s declared by the Central Government to be conducted by means of a postal ballot:

— alteration in the object clause of memorandum;

— alteration of articles of association in relation to insertion of provisions defining private company;

— buy-back of own shares by the company under sub-section (1) of section 77A;

— issue of shares with differential voting rights as to voting or dividend or otherwise under sub-clause (ii) of clause (a) of section 86;

— change in place of registered office outside local limits of any city, town or village as specified in sub-section (a) of section (1) of section 293;

— giving loans or extending guarantee or providing security in excess of the limit prescribed under sub-section (1) of section 372A;

— election of a director under proviso to sub-section (1) of section 252 of the Act;

— variation in the rights attached to a class of shares or debentures or other securities as specified under section 106.

(iii) the company had sent a notice to all the shareholders:

(a) by registered post acknowledgement due or under certificate of posting

and has published an advertisement in a leading English Newspaper and in one vernacular Newspaper circulating in the State in which the registered office of the company is situated, about having dispatched the ballot papers;

(b) along with a draft resolution explaining the reasons therefor and requesting them to send their assent or dissent in writing on a postal ballot within a period of thirty days from the date of posting of the letter;

(c) along with a postage pre-paid envelope for facilitating the communication of assent or dissent of the shareholder to the resolution within the said period.

(iv) the appointment of Scrutinizer is in order i.e., w.r.t. board resolution;

(v) postal Ballot papers from the shareholders were received within thirty days from the date of issue of Notice;

(vi) the Board resolution making the Company Secretary and one of the functional director responsible for the entire Postal Ballot process was delivered to ROC within one week of passing such resolution;

(vii) the company has sent then notice of resolution to be passed by Postal Ballot by Registered post Acknowledgement due or under Certificate of Posting;

(viii) the resolution was passed without modification;

(ix) the resolution passed was assented to by the requisite majority; and

(x) the Register of Postal ballot, Postal Ballot forms and other documents were maintained and preserved till the resolution was given effect to.

3. Observance of Secretarial Standards

Check whether the company has followed the applicable secretarial standards prescribed by the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980).

4. Sundry Items (General)

(a) Holding Company and Subsidiary Company

Check whether:

(i) if during the year the company has become a 'holding company' or 'subsidiary company' under section 4 and where the financial year of the subsidiary does not coincide with that of the holding company there should not have been a gap in excess of six months between the financial year of the holding and subsidiary company;

(ii) in such cases the balance sheet of holding company include certain particulars as to its subsidiaries as required under section 212;

(iii) where the holding company was unable to obtain the required information check whether a report in writing to that effect was attached to the balance sheet of the holding company.

(iv) any exemption was obtained from Central Government and if so whether directions given by Central Government were complied with.

(b) Calls on Shares/Debentures

Check whether:

(i) call on shares/debentures was made by the Board of directors by means of resolutions passed at the Board meeting as required under Section 292(1)(a);

(ii) call on shares/debentures complied with the stipulations contained in the Articles of Association;

(iii) the Board of directors approved the rate of interest payable on delayed payment of calls in conformity with the provisions contained in the Articles of Association.

(c) Forfeiture and Re-issue of Shares

(a) Forfeiture

Check whether:

(i) the company has forfeited shares during the year in accordance with provisions contained in the Articles;

(ii) necessary noting/recording has been done in the Register of members and other registers.

(b) Re-issue of Forfeited Shares

Check whether:

(i) the company has reissued the forfeited shares and if so, the re- issue has been done in accordance with the provisions contained in the Articles;

(ii) the aggregate of the amount received on forfeited shares and amount received on the reissue of those forfeited shares was not below the issue price of the original shares which were duly forfeited;

(iii) share certificates have been issued to the allottee(s) and necessary entries made in the Register of members.

Note: There is no need to file return of allotment with ROC for re-issue of forfeited shares.

(d) Further Issue of Capital

Check whether:

(i) the increase is within the authorised capital of the company otherwise authorised capital should be increased accordingly.

(ii) at the first instance shares are offered to the existing shareholders in proportion to the capital paid-up on shares held.

(iii) in case offered to any persons whether or not those persons include existing shareholders in any manner whatsoever:

(a) special resolution was passed; or

(b) else the votes cast in favour of the resolution exceeded the votes cast against the proposal, the approval of the Central Government was obtained;

(c) in case of special resolution, e-Form 23 was filed with the Registrar.

(iv) the Board has approved the draft Letter of Offer of rights before issue;

(v) the company has complied with the SEBI (Disclosure and Investor Protection) Guidelines for issue of Rights Shares;

(vi) the appointments of all the agencies dealing with the issue were duly approved by the Board;

(vii) initial listing application(s) has/have been filed with the Stock Exchanges before mailing letter of offer;

(viii) the basis of allotment has been approved by the Regional Stock Exchange;

(ix) refund orders were sent in time;

(x) permission for listing has been obtained;

(xi) permission of the RBI has been obtained for export of the certificate.

Note: These provisions are not applicable to a director appointed by Central Government and a director holding office for life on 1.4.1952

(e) Approvals from the Shareholders

(a) If not less than 25 per cent of the subscribed capital of the company is held whether singly or in any combination by public finance institutions, etc. as mentioned in Section 224A, check whether the appointment of the auditor was approved by the members by passing a special resolution.

(b) Check whether the consent of the company in general meeting was obtained in respect of the matters specified under Section 293.

(c) If the company's paid-up share capital is Rs. 50 lakhs or more, check whether the appointment of sole selling agent was made with the consent of the company accorded by special resolution and the approval of the Central Government (Section 294).

(d) Check whether appointment of sole-selling agent for any area was approved by the company in the first general meeting held after such appointment under Section 294.

(e) Check whether the approval under Section 314 by a special resolution was obtained consenting to the holding of any office or place of profit in the company by any director or other persons specified under Section 314.

(f) Check whether necessary resolutions were passed for the making of company loans and inter company investments under Section 372A of the Act.

(f) Approvals of Financial Institutions

Examine covenants contained in the loan agreements thoroughly and check whether:

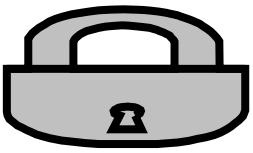
(i) all notices required to be sent to the financial institutions have been duly sent; and

(ii) necessary approvals were obtained from the financial institutions wherever required.

LESSON ROUND UP

- Every company having a paid-up share capital of rupees ten lakh or more but less than rupees two crores is required to file with the Registrar of Companies (ROC), a Compliance Certificate obtained from a secretary in whole-time practice and also attach a copy of the certificate with a report of the Board of Directors of the Company.
- Compliance Certificate not only acts as an effective mechanism to ensure that the legal and procedural requirements under the Companies Act are duly complied with but also instills professional discipline in the working of the company besides building up the necessary confidence in the state of affairs of the company.
- The scope of Compliance Certificate would comprise of certification of the compliance of various requirements under the Companies Act and the Rules thereunder.
- The Practising Company Secretary should certify compliance only in respect of matters specified in the Form prescribed under the Rules and where any matter is not applicable, he should specify accordingly.
- Practising Company Secretary for the purpose of issue of Compliance Certificate shall have right to access at all times to the registers, books, papers, documents and records of the company whether kept in pursuance of the Act or any other Act or otherwise and whether kept at the registered office of the company or elsewhere and shall be entitled to require from the officers or agents of the company, such information and explanations as the Practising Company Secretary may think necessary for the purpose of such certificate.
- Where a company fails to comply with the requirement of filing the Compliance Certificate with the Registrar of Companies or attaching the copy of such certificate with Board's report, in terms of Sub-section (1A) of Section 383A the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues.

SELF TEST QUESTIONS



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

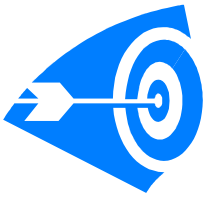
1. Describe the occasions where compliance certificate is not required?.

2. Explain in brief the Companies (Compliance Certificate) Rules, 2001.
3. State the Checklist for (i) General Meetings; (ii) Meetings of Directors; (iii) Status of the company.
4. Discuss professional responsibility in the context of Compliance Certificate and the penal provisions for false statements.
5. Who can issue a Compliance Certificate? Are there any disqualifications prescribed.

STUDY XVI

SEARCH/STATUS REPORTS

LEARNING OBJECTIVE



The objective of this study lesson is to enable the students to understand

- 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.

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.

Indian Banks' Association had issued a circular letter, recommending to the Chief Executives of all member banks that the latter may utilise the services of company secretaries for compilation of search/status reports and certification thereof.

SCOPE AND IMPORTANCE

The scope of a Search report depends upon the requirements of the Bank or Financial Institution concerned.

A Search report prepared by the Company Secretary in Practice 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

Prior to the launch of MCA-21 documents filed in the office of the ROC from time to time were taken-up for examination according to the date of filing.

When they were examined in the ROC's office, the documents if found complete and in order in all respects, were registered. Particulars of the registered documents were first entered in a loose-leaf register, an internal record in Registrar's office. Thereafter, they were sent to the Registry Section in Registrar's office for filing.

Only those documents which passed through all the aforesaid stages and had been duly filed in respective Document File of the Company at ROC were made available for inspection. Normally there was a time-lag between the date of filing and the date of availability of the documents for public inspection.

However, with the implementation of e-filing, this time lag will not be material.

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.

For knowing the volume number(s) and page number(s) in which the particulars are entered in the Register(s) of Charges by the Registrar prior to 17th April, 1989, it was necessary to examine in the Document File, respective Form 8 or Form 17 on which the number of the relevant volume/page were written.

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

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* Increased vide F.No. 1/15/91-CL.V dated 27.4.2000.

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 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:

Item	*Records to be verified*
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).

	1	2
(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 share-holders (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.
(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 1***.

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 Company Law Board Bench of the respective regions upon a petition (application) filed by the company or interested person.

The prescribed particulars in Form 8 or Form 10 together with copy of the instrument creating or modifying the charge and those relating to satisfaction of charge in 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

Sl. No.	*Relevant Provisions*	*Charges under Reference*	*Illustrative Instruments*	*To Verify Whether Or Not*
(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

(1)	(2)	(3)	(4)	(5)
		(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
		(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	

(1)	(2)	(3)	(4)	(5)
		(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

Event	*Time Limit*	*Effect*	*Relevant provisions*
(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
The last day when the Form is to be delivered for registration with the Registrar	Within thirty days after the date of creation/modification/acquisition or from the date of satisfaction	On the last day when the Form has to be filed if on that day, the Registrar's Office is closed, the Form can be filed on the next day onwards on which the office is open	Section 10 of the General Clauses Act, 1897

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

The Memorandum and Articles of Association of the company has to be examined for this purpose. Particularly the objects clause of the Memorandum of Association has a specified recital pertaining to borrowing powers of the company. The standard clause pertaining to borrowing powers included in the incidental or ancillary objects reads as follows:

> "To borrow or raise money or to receive money on deposit for the purposes of the company, in such manner and upon such terms as may seem expedient, and to secure the repayment thereof and of moneys owing or obligations incurred by the company, and to create, issue and allot redeemable or irredeemable bonds, mortgages or other instruments, mortgage debentures (such bonds or debentures being made payable to bearer or otherwise and issuable or payable either at par, premium, discount, or as fully paid), and for any such purposes to charge all or any part of the property and profits of the company both present and future including its uncalled capital".

A trading or commercial company has implied power to borrow even though there is no express authority in its Memorandum of Association.

Compliance of the provisions of Section 149 of the Companies Act, 1956, in

respect of public limited companies has to be ensured. Exercise of borrowing powers in contravention of Section 149 attracts levy of fine.

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.

ANNEXURES

ANNEXURE 1

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:

Sl. No.	*Date of registration*	*Instrument creating charge and date*	*Amount of charge Rs.*	*Short Particulars of property charged*
(1)	(2)	(3)	(4)	(5)

Name & address of Person in whose favour the charge is created	*Particulars of Modification*		
	Date of registration	*Instrument modifying the charge*	*Effect of modification*
(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: ……
Date: ……

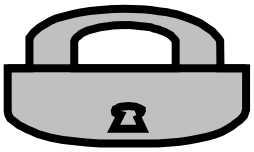
Certificate of Practice No. ……
Membership No. ……

* Now available on the website.

LESSON ROUND UP

- The search/status report enables furnishing of information to the under as to whether the charges created through various documents are infact registered with ROC and whether such particulars reflect the correct position of charges held by lenders.
- MCA21 offers the facility to view documents 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 prepared by PCS 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. What are the certifications recognised by Financial Corporations/Institutions to be furnished to them by Company Secretary in Practice.
4. 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.

STUDY XVII

SECURITIES MANAGEMENT AND COMPLIANCES

LEARNING OBJECTIVE

The objective of this study lesson is to enable the students to understand

- Meaning need and scope of securities management and compliances
- Securities management as a mechanism for self-regulation
- Advantages of securities management to company, regulator and investor

INTRODUCTION

SEBI was established with the twin objectives of protecting the interest of the investors in securities and also regulating and promoting the development of the securities markets. SEBI, in order to achieve its objectives, has formulated various Rules and Regulations along with guidelines applicable to all the players of capital market both primary and secondary market. However, inspite of existence of a number of Rules, Regulations and Guidelines the markets remained vulnerable to the non-compliances and shareholders grievances.

At present, the transactions in securities are governed, regulated and controlled by

- Companies Act, 1956,
- Securities and Exchange Board of India Act, 1992,
- Securities Contracts (Regulation) Act, 1956,
- Foreign Exchange Management Act, 1999,
- Depositories Act, 1996, Stamp Act, 1899,
- Information Technology Act, 2000,
- Competition Act, 2002

including rules, regulations made and guidelines and directions issued thereunder and bye-laws of stock exchanges and Listing Agreement, etc. Inspite of plethora of statutes, Rules, Regulations and Guidelines, there is no mechanism to ensure proper and comprehensive compliances, monitoring and management of these statutory provisions in relation to securities. In order to provide a mechanism to comprehensively ensure compliance of all provisions relating to securities, to redress the grievances of investors, strengthen the faith of investors in capital market, ensure the growth of capital market, prevent the fraudulent and unfair trade practices, instill professional discipline and to protect the interest of investors, it is necessary to introduce the mechanism of “Securities Management and Compliances”.

What are Securities?

The term 'securities' has been defined under Securities Contracts (Regulations) Act, 1956; Companies Act, 1956; Securities and Exchange Board of India Act, 1992 and Foreign Exchange Management Act, 1999.

As per Section 2(1)(i) of the Securities and Exchange Board of India Act, 1992 'securities' has the meaning assigned to it in Section 2 of the Securities Contracts (Regulation) Act, 1956.

As per Section 2(aa) of the Securities Contracts (Regulation) Act, 1956, *Derivative* includes –

(a) a security derived form a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

(b) a contract which derives its value from the prices or index of prices, of underlying securities.

A derivative is a product whose value is derived from the value of underlying asset, index, etc. The underlying assets can be equity, forex commodity, or any other asset.

As per Section 2(45AA) of the Companies Act, 1956 *'securities'* means securities as defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956, and includes hybrids.

As seen from above the term *'securities'* as defined in Companies Act, 1956 and Securities Exchange Board of India Act, 1992 is mainly dependent on the definition given in Securities Contract (Regulations) Act, 1956.

As per Section 2(h) of Securities Contract (Regulations) Act, 1956 securities include

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instruments issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of Section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities;

Many terms have been used in order to define the term Securities. However, Securities Contracts (Regulation) Act, 1956 defines only the terms 'derivatives' and

‘government securities’ out of all terms used in defining the term ‘securities’.

As per Section 2(b) of Securities Contract (Regulation) Act, 1956 ‘Government security’ means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in clause (2) of section 2 of the Public Debt Act, 1944.

As per Section 2(za) of the Foreign Exchange Management Act, 1999 ‘security’ means shares, stocks, bonds and debentures, government securities as defined in the Public Debt Act, 1944, savings certificates to which the Government Savings Certificates Act, 1959 applies, deposit receipts in respect of deposits of securities and units of the Unit Trust of India established under Sub-section (1) of Section 3 of the Unit Trust of India Act, 1963 or of any mutual fund and includes certificates of title to securities, but does not include bills of exchange or promissory notes other than government promissory notes or any other instruments which may be notified by the Reserve Bank as security for the purposes of the Act;

As per Section 2(12B) of the Companies Act, 1956 ‘derivative’ has the same meaning as in clause (aa) of Section 2 of the Securities Contracts (Regulations) Act, 1956.

As per Section 2(19A) of the Companies Act, 1956 ‘hybrid’ means any security which has the character of more than one type of security, including their derivatives.

Hybrid securities mean securities which have some of the attributes of both debt securities and equity securities. A type of security which, in the form of a debenture, contains elements of indebtedness and elements of equity stock also is an example of a hybrid.

The terms share and debenture used in the definition of securities have been defined in the Section 2(46) and 2(12) of Companies Act 1956, respectively. Share means share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied. A share reflects the contribution of a shareholder towards the share capital of the company. As per Section 82 of the Companies Act, 1956 share is a movable property. A share is a right to a specified amount of the share capital of a company, carrying with it certain rights and liabilities, while the company is a going concern and in the winding-up it represents the interest of the holder measured for purposes of a liability and divided by a sum of money. A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place and of the interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se.

Debenture means a document which either creates or acknowledges a debt. It is also a method of raising loans. As per Section 2(12) of the Companies Act, 1956. Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.

Debenture stock is of the same nature as debentures but instead of each lender having a separate debenture bond; he gets a certificate entitling him to a specified portion of one large loan. Debenture stock is consolidated borrowed capital which may be divided into and is transferable in convenient units of fixed amount.

Considering all the above-mentioned definitions it can be inferred that the term 'security' includes shares, debentures, government securities, derivatives, units and rights and interest in securities.

Securities Market

The Securities Market allows people to do more with their savings than they would otherwise could. It also provides financing that enables people to do more with their ideas and talents than would otherwise be possible. The people's savings are matched with the best ideas and talents in the economy. Stated formally, the Securities Market provides a linkage between the savings and the investment across the entities, time and space. It mobilises savings and channelises them through securities into preferred enterprises.

The Securities Market also provides a market place for purchase and sale of securities and thereby ensures transferability of securities, which is the basis for the joint stock enterprise system. The existence of the Securities Market makes it possible to satisfy simultaneously the needs of the enterprises for capital and the need of investors for liquidity.

The liquidity the market confers and the yield promised or anticipated on security ownership may be sufficiently great to attract net savings of income which would otherwise have been consumed. Net savings may also occur because of other attractive features of security ownership, e.g. the possibility of capital gain or protection of savings against inflation.

The Securities Market allows individuals who can not carry an activity in its entirety within their resources to invest whatever is individually possible and preferred in that activity carried on by an enterprise. Conversely, individuals who can not begin an enterprise, they can attract enough investment from others to make a start. In both cases individuals who contribute to the investment made in the enterprise share the fruits.

The Securities Market, by allowing an individual to diversify risk among many ventures to offset gains and losses, increases the likelihood of long-term, overall success.

Securities Market and Economic Growth

A well functioning securities market is conducive to sustained economic growth. There have been a number of studies, starting from World Bank and IMF to various scholars, which have established robust relationship not only one way, but also the both ways, between the development in the securities market and the economic growth. The securities market fosters economic growth to the extent that it—(a) augments the quantities of real savings and capital formation from any given level of national income, (b) increases net capital inflow from abroad, (c) raises the productivity of investment by improving allocation of investible funds, and (d) reduces the cost of capital.

It is reasonable to expect savings and capital accumulation and formation to respond favourably to developments in securities market. The provision of even simple securities decouples individual acts of saving from those of investment over both time and space and thus allows savings to occur without the need for a

concomitant act of investment. If economic units rely entirely on self-finance, investment is constrained in two ways: by the ability and willingness of any unit to save, and by its ability and willingness to invest. The unequal distribution of entrepreneurial talents and risk taking proclivities in any economy means that at one extreme there are some whose investment plans may be frustrated for want of enough savings, while at the other end, there are those who do not need to consume all their incomes but who are too inert to save or too cautious to invest the surplus productively. For the economy as a whole, productive investment may thus fall short of its potential level. In these circumstances, the securities market provides a bridge between ultimate savers and ultimate investors and creates the opportunity to put the savings of the cautious at the disposal of the enterprising, thus promising to raise the total level of investment and hence of growth. The indivisibility or lumpiness of many potentially profitable but large investments reinforces this argument. These are commonly beyond the financing capacity of any single economic unit but may be supported if the investor can gather and combine the savings of many. Moreover, the availability of yield bearing securities makes present consumption more expensive relative to future consumption and, therefore, people might be induced to consume less today. The composition of savings may also change with fewer saving being held in the form of idle money or unproductive durable assets, simply because more divisible and liquid assets are available.

International Linkage

The securities market facilitates the internationalisation of an economy by linking it with the rest of the world. This linkage assists through the inflow of capital in the form of portfolio investment. Moreover, a strong domestic stock market performance forms the basis for well performing domestic corporate to raise capital in the international market. This implies that the domestic economy is opened up to international competitive pressures, which help to raise efficiency. It is also very likely that existence of a domestic securities market will deter capital outflow by providing attractive investment opportunities within domestic economy.

Concept And Need Of Securities Management And Compliances

The functions, operation and management of a company are governed by various Acts, Rules and Regulations. The Companies Act, 1956 is one of the major legislations dealing with various activities of a company, and it has to be complied with even before the company comes into existence. Every company needs funds for the smooth functioning of its business, to expand its business, diversify its business etc. The company has to issue various types of securities to meet its requirement of funds. The issuance of any kind of security is again subject to the compliances of various Acts, Rules, Regulations and Guidelines. Once the securities have come into existence, the transactions in the securities are also governed by various Acts, Rules and Regulations. Not only the issuer of the securities but also the holder of the securities are required to comply with the statutory provisions to transact in the securities of the company.

The concept of Securities Management and Compliances thus signifies and includes in its ambit examination, verification or checking of registers, records, forms, returns and documents relating to securities issued by a company and certification of timely and proper compliance of all statutory provisions related to securities applicable to a company.

Thus Securities Management and Compliances, can provide an umbrella mechanism to ensure better compliances of all the statutory provisions relating to securities by the companies.

The Company Secretary of a company, shall ensure the management of securities issued by the company, timely compliance of relevant provisions of law applicable to the securities so issued and maintain all records and documents relating to securities issued by the company.

Scope of Securities Management and Compliances

The four main legislations governing the securities market are: (a) the SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

Legislations

SEBI Act, 1992: The SEBI Act, 1992 establishes SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. SEBI has full autonomy and authority to regulate and develop an orderly securities market. The details have been covered ahead in the chapter.

Securities Contracts (Regulation) Act, 1956: It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives central government/SEBI regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with prescribed conditions of Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules. The details have been discussed in the Chapter on Stock Exchanges.

Depositories Act, 1996: The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerialising the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities

electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with. The details have been dealt in the chapter on Depositories.

Companies Act, 1956: It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

Rules and Regulations

The Government has framed rules under the SCRA, SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, and for prevention of unfair trade practices, insider trading, etc. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars which need to be complied with by market participants.

Regulators

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Ministry of Corporate Affairs, Reserve Bank of India (RBI) and SEBI. The activities of these agencies are coordinated by a High Level Committee on Capital Markets. The orders of SEBI under the securities laws are appellable before a Securities Appellate Tribunal.

Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also con-currently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and carry forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies.

Advantages of Securities Management and Compliances

The Beneficiaries of Securities Management & compliances may be classified as

1. Advantages to Company

(a) Elimination of Incidences of Misstatement

Misstatement/fraud may not only be committed by company or its directors/employees etc. but also by the persons holding the securities. If the Securities Management and Compliances are undertaken as an ongoing process, it would be possible to eliminate the chances of fraud in relation to securities of the company as and when they arise.

(b) Maintenance and Updation of Records

Securities Management and Compliances ensures proper maintenance and updation of register of members, share transfer register, and share certificate register etc. Hence, dividends, bonus shares, rights shares and other entitlements relating to the securities are received by the persons entitled to them.

(c) Early Corrective Measures

It is commonly said that, "To err is human". The persons entrusted with the responsibility of and dealing in matters relating to securities, may commit mistakes by either providing security related entitlements to wrong persons, or by entering the name of a person, who is not the shareholder, in the register of members; or removing the name of a member from the register of members even if he is holding the shares or issuing the share certificate or refund order to the person not entitled to it and so on. All such unintended mistakes committed with respect to securities can be detected and made good with the mechanism of Securities Management and Compliances.

(d) Expeditious Redressal of Investors' Grievances

Securities Management and Compliances ensures the early detection of mistakes and frauds, proper compliance of statutory provisions and reduction in efforts involved in securities related matters due to which considerable time and energy of such human resources can be deployed in disposal of investor's grievances. In other words, speedy disposal of investors' grievances can be ensured with the introduction of Securities Management and Compliances.

(e) Relief from Unintended Violation of Laws

A number of prosecutions are instituted by regulatory authorities against companies and their officers in default for violation of various statutory provisions relating to securities. As the mechanism of Securities Management and Compliances ensures proper compliance of statutory provisions, unintended violation of statutory provisions can be prevented with the professional support of securities' auditors.

(f) Reduction in Litigation

As already stated, Securities Management and Compliances ensures reduction in mistakes and speedy disposal of investors' grievances. Therefore, litigations arising out of investors' grievances can be prevented to a large extent with the help of mechanism of Securities Management and Compliances. Reduction in securities related litigations also save valuable time and energy of judiciary, which in turn help courts in expeditious disposal of cases.

(g) Expeditious Disposal of Securities Related Matters

Securities Management and Compliances assists the management of companies in complying with various statutory and procedural requirements and also acts as a pre-emptive check to monitor such compliances. Hence, securities related matters can be smoothly handled by the management of the company when the mechanism of Securities Management and Compliances is in operation.

(h) Sustained Investors' Confidence

Considerable reduction in investors' grievances, smooth processing of securities

related matters and negligible chances of fraud will help restore the sustained confidence of investors which will encourage them to have interest in the securities market and also in the company resorting to the mechanism of Securities Management and Compliances.

2. Advantages to Investor

It is the investors' money which is being pumped into the business of the company. It is natural that invests are concerned about the safety of their investment and also expect reasonable return on it. Securities management helps in ensuring such safety by complying with various laws through which unnecessary penalties are minimized.

3. Regulator

Securities management and securities audit will have a salutary effect of substantially lessening the burden of the regulatory authorities like SEBI, stock exchanges who are in charge of administration of the law by reducing the level of reduction of time in initiating prosecution against offences.

4. Compliance officers

Securities Audit helps compliance officers in taking proactive and corrective actions and thereby helps them in performing as efficient corporate managers.

5. Statutory Auditor

Securities management and compliances enables the work of statutory auditor easier due to the systematic procedures involved in the same.

Role of Company Secretary in Securities Management and Compliances

The role of company secretary in securities management and compliances takes in the form of certifications, appearances before authorities, audit etc, which are described as below.

Role of practicing Company Secretary (PCS)

1. The Securities and Exchange Board of India Act, 1992/rules/regulations/ guidelines/circulars

1. SEBI has authorized the practicing company secretary to appear before the Securities Appellate Tribunal as an authorized representative of an appellant
2. Practicing Company Secretary can, certify non-promoter holdings as per clause 35 of Listing Agreement in demat mode in case of the companies which have established connectivity with both the depositories.
3. PCS is authorized to o issue certificate of compliance of conditions of corporate governance for companies who have listed their equity shares, debt instruments and Indian Depositories in stock exchanges. .
4. PCS can issue certificate regarding maintenance of adequate security cover in respect of listed debentures by either a Practising Company Secretary or a Practising Chartered Accountant, every quarter.

5. PCS can conduct Internal Audit of Portfolio Managers/brokers and sub-brokers.
6. PCS can issue a certificate to listed companies to the effect that all refund orders/certificates to allottees of the previous issues were dispatched within prescribed time and manner and securities were listed on the stock exchanges specified in the offer document.

2. Securities Contracts (Regulation) Act, 1956 (SCRA); and Securities Contracts (Regulation) Rules, 1957 (SCRR)

PCS role under SCRA and SCRR takes in the following forms

(i) To appear as authorized representative before the Securities Appellate Tribunal

(ii) Certificate to the effect that allotment has been made by the company on the basis approved by the Stock Exchange.

3. Depositories Act/SEBI (Depositories Participants) Regulations, 1996/NSDL/ CDSL bye-laws Rules etc.

(a) PCS are authorized to issue quarterly certificate with regard to reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, details of changes in share capital during the quarter, and in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

(b) PCS is authorized to carry out internal audit of depository participants.

(c) NSDL has authorized PCS to carry out Concurrent Audit in case of Demat Account opening, Control and Verification of Delivery Instruction Slips.

4. Stock exchange requirements

(a) Bombay Stock Exchange Limited

PCS are authorized to

(i) To issue Networth Certificate to be submitted by all active members including representative members of Cash segment, Limited Trading members & Trading and/or Clearing members of the Derivatives segment of the Bombay Stock Exchange.

(ii) Certificy to the effect that RTA and/or In-house Share transfer facility of Listed Companies have issued all certificates within one month of the lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/ allotment monies. This certificate is to be issued within one month of the end of each half of the financial year

(iii) certify that equity share certificates held by promoters, etc. have been stamped “Not to be sold/transferred/hypothecated until …..” in case of listing of new equity shares issued to the shareholders of the company pursuant to the reduction of capital/BIFR order and if there are non-transferable shares in existence.

(b) National Stock Exchange Limited

PCS are authorized to do the following certifications

- Details of directors/proprietor in format C-3 of Annual Return submitted by Trading Member to the Stock Exchange
- Details of shareholding pattern/sharing pattern of corporates in format C-6 of Annual Return submitted by Trading Member to the Stock Exchange
- Details of shareholding pattern/sharing pattern of firms in format C-6 of Annual Return submitted by Trading Member to the Stock Exchange.
- Details of Dominant group of corporates in format C-7 of Annual Return submitted by Trading Member to the Stock Exchange.
- Details of Dominant group of firms in format C-7 of Annual Return submitted by Trading Member to the Stock Exchange
- Undertaking from Relative of Persons constituting Dominant Promoter Group in format C–8 of Annual Return submitted by Trading Member to the Stock Exchange
- Undertaking from Corporates supporting Dominant Promoter Group in format C–8 of Annual Return submitted by Trading Member to the Stock Exchange
- Grant of approval for listing under clause 24(a) of the Listing Agreement – Certificate from Practising Company Secretary confirming that the entire pre-preferential holding of the allottee (mentioning the quantity) is locked in for the period starting from relevant date up to a period of six months from the date of allotment (source: www.nseindia.com)
- Grant of approval under clause 24(f) of the Listing Agreement (Amalgamation – Wholly Owned Subsidiary / other than Wholly Owned Subsidiary/Reduction of Capital under Section 100) – Certificate from Practising Company Secretary for Networth of the Company pre and post scheme under section 101, 391 and 394 of the Companies Act, 1956. (source: www.nseindia.com)
- Listing of shares arising out of Conversion of Debentures/Warrants/Notes/ Bonds into Equity Shares – Certificate from Practising Company Secretary for receipt of money at the time of allotment of Convertible Debentures/ Warrants/Notes, etc. (source: www.nseindia.com)
- Listing of shares/securities issued on Preferential/Private Placement basis – Certificate from Practising Company Secretary for the following confirmations:
  - The pricing of the issue along with the detailed working of the same
  - The company has received the entire consideration payable prior to the allotment of shares
  - The total shares under lock-in (along with the dates of lock-in and distinctive numbers) and additionally confirming that the locked in equity shares if issued in physical form have been enfaced with non transferability condition

— The entire pre-preferential holding of the allottee (mentioning the quantity) is locked in for the period starting from relevant date upto a period of six months from the date of allotment. (source: www.nseindia.com)

— Listing of shares/securities issued on Preferential/Private Placement basis in case allotment under Section 81(3) of Companies Act –A confirmation signed by the compliance officer of the company duly counter confirmed by the Practising Company Secretary confirming that the said allotment has been made in accordance with the provisions of section 81(3) of the Companies Act, 1956. (source: www.nseindia.com)

— Certificate from Practising Company Secretary confirming securities under lock-in (the certificate should include the distinctive numbers of securities under lock-in and date from and upto which these shares are under lock-in) (source: www.nseindia.com)

(c) Other regional exchanges

Certificate to the effect that the RTA has completed all transfers within the stipulated time.

5. Foreign Exchange Management (Transfer of Issue of Securities by a Person Resident Outside India) Regulations, 2000

Practicing company secretaries are authorized to give certification which has to be accompanied by form FC-GPR, being submitted with respect to issue of shares under FDI Scheme.

Company secretary in employment

As per the listing agreement for equity, Debt instruments and Indian Depository Receipts, a Company Secretary or any other person has to be designated as compliance officer. The Company secretary as compliance officer has the following role to play.

Company Secretary of a listed company, in addition to Board Meeting and other documentation and filing formalities are expected to do the certain activities relating to securities laws and compliance. The following are the few of the main activities

— Compliance with SEBI and Listing agreement

— Publication of financial results

— Intimations and disclosures to stock exchanges and SEBI

— Implementation of Employee Stock Option plans if any

— Cautious about takeovers

— Continuous watch on stock price movements

— Watch on insider trading

— Taking steps to prevent money laundering activities

— Carrying out necessary certifications required by stock exchanges as compliance officer of the company.

Self Regulation

As stated earlier, there are plethora of Acts, Rules, Regulations and Guidelines relating to Securities. Inspite of it, serious securities scams have been committed and there has been an increase in investor grievances and litigations. This lays emphasis on implementation of the laws, not only in letter but also in spirit which helps in achieving the objectives of introducing the statutory provisions. Implementing the statutory provisions is not only the responsibility of the Government but also of the corporate world to ensure the proper compliance of statutory provisions. The corporate world should not treat the compliance as burden on it but should be self-motivated to ensure the compliances of statutory provisions in spirit.

Furthermore, in the era of liberalization and globalization, government has accepted the policy of rule by exception. As a consequence, the concept of certification has been introduced in many areas where relaxation has been made. Various procedural requirements have been simplified and greater confidence in relation to compliance has been posed on the corporate world itself. The concept of self-regulation is touching the new heights. The self-regulation in securities related matters can be achieved with a comprehensive mechanism of Securities Audit. Securities audit ensures self-regulation and compliance of statutory provisions governing securities related matters. Securities audit by experienced and knowledgeable company secretary in practice can ensure the path of professional discipline in the corporate world.

Securities Audit is a mechanism relieving the company and its directors from the consequences of unintended non-compliance by timely corrective actions.

There are several penal provisions in the Companies Act, 1956, Securities and Exchange Board of India Act, 1992, Foreign Exchange Management Act, 1999, Securities Contracts (Regulations) Act, 1956 and other securities related laws. As securities audit ensures the timely and proper compliances of all statutory provisions and early detection of errors and frauds, it provides trustworthy mechanism relieving the company and its directors from the consequences of unintended non-compliances of statutory provisions. Securities audit is also a powerful tool for proper compliance of all obligations and also for investors' protection.

It is also a mechanism for self-regulation by companies and relieves the management, directors and officers in default from the consequences of inadvertent non-compliance of various provisions relating to securities by taking timely corrective actions. It further prevents fraudulent and unfair trade practices and helps to achieve an orderly growth of capital market. It also helps the management in improving the corporate image and helps to attain good corporate governance. Securities Audit Mechanism not only protects the interest of investors but also helps companies in proper compliance and helps regulators in regulating the capital market.

The Securities Audit shall be conducted by a company secretary in practice encompassing compliance of all rules, applicable regulations, guidelines in relation to issue of securities, issue of certificates in relation to all transactions of company's securities, physical verification of relevant records and documents and also entering qualification, if any. The company shall be at the option to either take a

comprehensive Securities Audit or a transaction specific audit such as Audit under Public Issue, Takeover Code, Insider Trading Regulations or Buy-back of Securities Regulations.

Securities Management & Compliances As A Risk Management Tool

Compliance demands are going to increase and require a holistic view from the organization and ongoing maintenance of compliance processes, technology and outcomes. Non compliances results in hefty penalty, which may shake the working of the organization itself. For example non compliance of listing agreement may result in a penalty which may extend upto 25 crores. Thus management of compliance risk is an essential process.

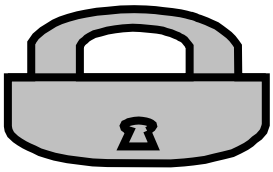
Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies, and procedures, or ethical standards. . Compliance risk can lead to diminished reputation, reduced customer value, limited business opportunities, reduced expansion potential, and an inability to enforce contracts.

Securities management & compliances helps in complying with various legislations such as SEBI Act, SCRA, Depositories Act, listing agreement, certain important provisions of Companies Act, SEBI rules, Regulations, Guidelines, Rules and regulations of depositories etc. It has a major contribution to risk management as it is the major aspect of managing compliance risk.

LESSON ROUND UP

- The four main legislations governing the securities market are: (a) the SEBI Act, 1992 (b) the Companies Act, 1956, (c) the Securities Contracts (Regulation) Act, 1956, and (d) the Depositories Act, 1996.
- The concept of Securities Management and Compliances thus signifies and includes in its ambit examination, verification or checking of registers, records, forms, returns and documents relating to securities issued by a company and certification of timely and proper compliance of all statutory provisions related to securities applicable to a company.
- Securities Management and Compliances has several advantages to Company, investor, regulator, auditor, financial institutions etc/
- The role of company secretary in securities management and compliances takes in the form of certifications, appearances before authorities, audit etc

SELF TEST QUESTIONS



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

1. Describe and significance and advantages of securities management and compliances.
2. Explain the role of Practising company secretary in securities management and compliances.
3. Describe securities management and compliances as a risk management tool.

PROFESSIONAL PROGRAMME

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

PP-DD&CCM/2011

TEST PAPERS

This Test Paper set contains five test papers. Test Paper 1/2011, 2/2011, 3/2011, 4/2011 and 5/2011. The maximum time allowed to attempt each test paper is 3 hours.

Students are advised to attempt atleast **one Test Paper from Test Papers 3/2011, 4/2011 and 5/2011 i.e. either Test Paper 3/2011 or Test Paper 4/2011 or Test Paper 5/2011** and send the response sheet for evaluation to make him/her eligible for Coaching Completion Certificate. However, students may, if they so desire, are encouraged to send more response sheets including Test Paper 1/2011 and 2/2011 for evaluation.

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.

W A R N I N G

It is brought to the notice of all the students pursuing Company Secretaryship Course that they should follow strict discipline while writing response sheets to various Test Papers appended at the end of this Study Material. Any attempt of unfair means by students in completing the postal coaching by way of submitting response sheets in different handwritings or by way of copying from the study material/suggested answers supplied by the Institute or from the answers of the students who have already completed the course successfully, etc., will be viewed seriously by the Institute. Students are, therefore, advised to write their response sheets in their own handwriting without copying from any original source.

Student may note that use of any malpractice while undergoing postal or oral coaching is a misconduct as per certain provisions of Company Secretaries Regulations and accordingly the registration of such students is liable to be cancelled or terminated.

PROFESSIONAL PROGRAMME

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

TEST PAPER 1/2011

(This test paper is based on Study Lesson I to XI)

Time allowed : 3 hours *Maximum marks : 100*

Note: Attempt any SIX questions including Question No. 4 which is COMPULSORY.

1. (a) Explain the concept of data room relating to due diligence. *(8 marks)*

   (b) Distinguish between due diligence and audit. *(8 marks)*

2. Write short notes on

   (i) Compensation Committee *(5 marks)*

   (ii) Post issue monitoring reports *(6 marks)*

   (iii) Private placement. *(5 marks)*

3. (a) What are various types of risks involved on trading in debt securities? Illustrate with the help of examples. *(8 marks)*

   (b) What are the requirements with respect to Voluntary Offer under SEBI (SAST) Regulations, 2011? *(8 marks)*

4. (a) Explain the requirements regarding public announcement under SEBI (SAST) Regulations, 2011. *(10 marks)*

   (b) What are the different disclosures under SEBI (SAST) Regulations, 2011? *(10 marks)*

5. (a) What are the various types intimations/submissions which are to be made to the stock exchange? *(8 marks)*

   (b) Describe the scope and objectives of Internal Audit of Depository Participants. *(8 marks)*

6. (a) Briefly explain the working mechanism of GDRs? *(8 marks)*

   (b) Describe the process involved in legal due diligence in general? Describe briefly the role of a company secretary in legal due diligence. *(8 marks)*

7. (a) Describe the points to be checked in case of foreign direct investment through automatic route. *(8 marks)*

   (b) Explain penal provisions relating to IDRs under Companies Act 1956 and FEMA 1999. *(8 marks)*

TEST PAPER 2/2011

(This test paper is based on Study Lesson XII to XVII)

Time allowed : 3 hours *Maximum marks : 100*

Note: Attempt any SIX questions including Question No. 1 which is COMPULSORY.

1. (a) What is the significance of compliance management? *(8 marks)*

   (b) What are the objectives of Secretarial Audit? *(6 marks)*

   (c) Explain about the scope of securities management and compliances. *(6 marks)*

2. Write short notes on

   (i) Need for Secretarial Audit *(5 marks)*

   (ii) MCA Portal *(6 marks)*

   (iii) Compliance with Spirit of Law *(5 marks)*

3. (a) What are the elements of an effective compliance management programme? *(8 marks)*

   (b) Discuss professional responsibility in the context of Compliance Certificate and the penal provisions for false statements. *(8 marks)*

4. (a) Explain about the social responsibility of the Secretarial Auditors. *(8 marks)*

   (b) Explain the advantages of securities management and compliances to company. *(8 marks)*

5. (a) What are the safe guards to be taken in case of electronic transfer? *(10 marks)*

   (b) Describe the scope of share transfer audit. *(6 marks)*

6. (a) What is the process involved in corporate compliance Management. *(8 marks)*

   (b) What is the role of company secretary in corporate compliance management? *(8 marks)*

7. (a) What is the scope and importance of search/status reports? *(8 marks)*

   (b) Write short note on verification of documents relating to charges. *(8 marks)*

TEST PAPER 3/2011

(Based on entire Study Material)

Time allowed : 3 hours *Maximum marks : 100*

Note: Attempt any SIX questions including Question No. 1 which is COMPULSORY.

1. (a) State with reasons whether the following statements are True or False
   - (i) Due diligence is a scientific process
   - (ii) Dataroom may be physical or electronic
   - (iii) IPO grading has been made Mandatory
   - (iv) Cultural differences form the part of evaluation of synergy possibilities.
   - (v) Reporting of Foreign Direct Investment is made in form FC-GPR.

   (2 marks each)

   (b) Critically examine the following

   (i) Company Secretary is a key member of IPO team who ensures that the company has complied with issue obligations. *(5 marks)*

   (ii) Companies issuing GDR has to comply with SEC Regulations. *(5 marks)*

2. (i) Choose the appropriate answer *(1 mark each)*

   (a) Rights Issue (RI)
   - (i) is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date
   - (ii) conveys special rights for equity shareholders
   - (iii) brings preferential rights to certain shareholders
   - (iv) None of the above

   (b) The draft prospectus is filed with ……through Merchant Banker.
   - (i) ROC
   - (ii) DGFT
   - (iii) SEBI
   - (iv) Regional Director

   (c) When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management, it is called……..
   - (i) Friendly takeover
   - (ii) Hostile Takeover
   - (iii) Takeover through consensus
   - (iv) None of the above

(d) The company is required to file shareholding pattern with the Exchange on a quarterly basis, within ……from the end of each quarter

(i) 21 days

(ii) 30 days

(iii) 45 days

(iv) 60 days

(e) Corporate actions are…….

(i) actions taken by corporates

(ii) benefits given by a company to its members

(iii) actions taken on behalf of aggrieved investors by corporates

(iv) None of the above

(f) Issue of GDRs are mainly governed by …….

(i) Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003.

(ii) Companies Act, 1956

(iii) Depositories Act, 1996

(iv) Depository Rules

(ii) Describe the obligation of debenture trustee. *(6 marks)*

(iii) Write short notes on Company Secretary as a compliance officer. *(4 marks)*

3. (a) State with reasons whether the following actions of ABC Limited, are right or wrong.

(i) The Company has proposed a bonus issue when it has defaulted in the principal and interest amount of fixed deposits.

(ii) The Lead Merchant Banker has accepted to act as Registrar to an issue and to handle post issue responsibilities.

(iii) The company has altered its articles of association after passing Special Resolution at a General Meeting.

(iv) The company has kept its register of members and debenture holders at its corporate office which is situated in the same city where the registered office is situated.

(v) The Company does not generally send any document to the members by certificate of posting or registered post. *(2 marks each)*

(b) Write short note on securities market and economic growth with reference to global linkages. *(6 marks)*

4. (a) Fill in the Blank spaces with appropriate words

(i) ……. due diligence is often undertaken during the information technology procurement process to ensure that risks are uncovered.

(ii) Public issues can be further classified into ……. and ……...

(iii) At least ……% of the post issue paid up capital has to be contributed by the promoters.

(iv) …… is the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security.

(v) For the redemption of the debt securities issued by a company, the issuer shall create …….. in accordance with the provisions of the Companies Act, 1956.

(vi) A …….. is made by the acquirer through a merchant banker, primarily disclosing his intention to acquire shares of the target company from existing shareholders by means of an open offer.

(1 mark each)

(b) Explain the regulatory framework in respect of issue of IDRs. *(10 marks)*

5. (a) Explain the need and scope of share transfer audit. *(8 marks)*

(b) Discuss the circumstances where compliance certificate is required. *(8 marks)*

6. (a) What are the various documents involved in the issue of GDRs? *(8 marks)*

(b) What are the preliminary considerations to be taken care of while entering into a Joint Venture Agreement? *(8 marks)*

7. (a) What is the process involved in legal due diligence? *(8 marks)*

(b) What are the elements of an effective compliance management programme? *(8 marks)*

TEST PAPER 4/2011

(Based on entire Study Material)

Time allowed : 3 hours *Maximum marks : 100*

Note: Attempt any SIX questions including Question No. 1 which is COMPULSORY.

1. (i) Choose the appropriate answer. *(1 mark each)*

   (a) A Search report prepared by the Company Secretary in Practice enables ……to evaluate the extent up to which the company has already borrowed moneys and created charges on the security of its movable and/or immovable properties.

   (i) the Bank/Financial Institution

   (ii) Depositories

   (iii) Stock Exchange

   (iv) Investors

   (b) Practicing Company Secretary will be attracting…….., for any false statement in any material particular or omission of any material fact in the Compliance Certificate.

   (i) the penal provisions of Section 628 of the Companies Act, 1956

   (ii) provisions of SCRA 1956

   (iii) SEBI Act, 1992

   (iv) None of the above

   (c) All companies listed on stock exchanges are required to do the processing of share transfers and effect transfers in accordance with the provisions …….

   (i) of the Companies Act, 1956, Listing Agreement and the Guidelines issued by SEBI.

   (ii) only Companies (issue of Share certificate) Rules 1960

   (iii) only Companies Act, 1956

   (iv) only Listing Agreement

   (d) For safer transfer of dematerialized securities……..has to be preserved carefully.

   (i) Cheque book

   (ii) Monthly statements

   (iii) Delivery instruction slips

   (iv) None of the above

   (e) Transfer of physical shares has to be made through execution of form…..

   (i) 7B

   (ii) 7A

(iii) 24AA

(iv) None of the above

(f) Intimation to be given to the Company Law Board in respect of any default made by the company in repayment of any deposits from small depositors has to be made……. from the date of default.

(i) Within 60 days

(ii) Within 45 days

(iii) Within 30 days

(iv) Within 7 days

(ii) Draft a check list for an acquirer company who proposes to take over another company. *(8 marks)*

(iii) Draft a compliance check list in respect of rights issue of a listed company. *(6 marks)*

2. (a) Describe the procedure of operation of escrow account under SEBI (SAST) Regulations 2011. *(8 marks)*

(b) What transactions are exempted from public announcement? *(8 marks)*

3. (a) Describe the significance of search report. *(8 marks)*

(b) Describe the compliances by Merchant Banker with respect to post issue monitoring report in an IPO. *(8 marks)*

4. (a) Fill in the Blanks

(i) Indian Company has to report the particulars of foreign inward remittance within ……. days of its receipt.

(ii) The legal framework for a depository system has been laid down by the……..

(iii) Clause…….. of Listing Agreement deals with publication of financial statement

(iv) A company shall, within ……. hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated

(v) Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 1993 regulates the issue of ……..

(vi) In terms of Clause 47 of Listing Agreement a Company is required to appoint the …… to act as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Company's Board in each meeting. *(1 mark each)*

(b) Write short notes on

(i) Application Supported by Blocked Account

(ii) Foreign Indirect Investment *(5 marks each)*

5. (a) What are the important clauses to be covered in a joint venture agreement? *(6 marks)*

   (b) When is an acquirer required to make a public announcement and what are its contents? *(10 marks)*

6. (a) What are the various parties involved in the issue of GDRs? *(8 marks)*

   (b) Explain intellectual property due diligence. *(8 marks)*

7. (a) Write a descriptive note on regulatory framework for issue of IDRs. *(8 marks)*

   (b) What are the advantages of securities management and compliances? *(8 marks)*

TEST PAPER 5/2011

(Based on entire Study Material)

Time allowed : 3 hours *Maximum marks : 100*

Note: Attempt any SIX questions including Question No. 1 which is COMPULSORY.

1. (i) Choose the appropriate answer. *(1 mark each)*

   (a) Indian Depository Receipt means any instrument in the form of a depository receipt created by ……..
      (i) Overseas Depository
      (ii) Depository Participant
      (iii) Domestic Depository in India
      (iv) None of the above

   (b) Foreign Investment which does not qualify under Automatic route…
      (i) Will have to be cancelled and refunded
      (ii) is prohibited
      (iii) has to go for Government approval.
      (iv) None of the above

   (c) Investment Outside India is regulated by
      (i) Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000
      (ii) Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000
      (iii) Listing Agreement
      (iv) None of the above

   (d) Dematerialisation is the process of conversion of…… in-to electronic balances
      (i) Physical Shares
      (ii) Bank Account
      (iii) Materials
      (iv) None of the above

   (e) It is desirable that the compliance management process is so designed that it is able to generate …….for secretarial and legal data providing the key information
      (i) a complete MIS Report
      (ii) a compliance chart
      (iii) data analysis
      (iv) None of the above

   (f) Foreign investment can be in the form of……..
      (i) Technical Collaboration only

(ii) Financial Collaboration only

(iii) Technical and/or financial collaboration

(iv) MOU

(ii) Critically examine and comment on the following

(i) Due diligence is an Audit

(ii) Detailed Public Statement is mandatory in case of takeovers.

(4 marks each)

(iii) Write short notes on prohibited sectors for foreign investment. *(6 marks)*

2. (a) Describe the provisions of listing agreement with respect to minimum public holdings. *(8 marks)*

(b) What are the disclosures to be made in the Directors' Report with respect to ESOP scheme of a company? *(8 marks)*

3. (a) Write a short note on reservation for retail individual investor with examples. *(8 marks)*

(b) Write any three important event based intimations that are required to be given to the stock exchange. *(8 marks)*

4. (a) State with reasons whether the action of XYZ Limited is correct.

(i) XYZ Limited employed a practicing company secretary, who is also an ICWAI as its cost auditor.

(ii) It has rolled over its non-convertible debentures.

(iii) It passed a special resolution for changing its object clause of Memorandum of Association but has not filed e-form 23 for 6 months from the date of passing the Special Resolution.

(2 marks each)

(b) Write a short note with respect to SEBI (SAST) Regulations 2011

(i) Conditional offer

(ii) Control *(5 marks each)*

5. (a) Explain the compliances with respect to constitution of Audit Committee under Clause 49 of listing agreement? *(6 marks)*

(b) Explain the Compliances under Clause 41 of the Listing Agreement.

(10 marks)

6. (a) Describe the process involved in the issue of GDRs. *(8 marks)*

(b) What are the advantages of data room? Explain the concept of virtual data room. *(8 marks)*

7. (a) What are the requirements under clause 49 on the composition of the Board? *(8 marks)*

(b) Explain about acquisition of foreign company through bidding or tender process. *(8 marks)*

PROFESSIONAL PROGRAMME

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

QUESTION PAPERS OF PREVIOUS SESSIONS

Question papers of immediate past two examinations of Due Diligence and Corporate Compliance Management are appended to this study material for reference of the students to familiarize with the pattern and its structure. Students may please note that answers to these questions should not be sent to the Institute for evaluation.

DECEMBER 2010

Time allowed: 3 hours Maximum marks: 100

NOTE: Answer SIX questions including Question No. 1 which is COMPULSORY.

1. (a) State, with reasons in brief, whether the following statements are true or false:

   (i) A Practising Company Secretary will be attracting the penal provisions of the Companies Act, 1956 for any false statement in the compliance certificate.

   (ii) Normally, the register of members or of debentureholders of an unlisted company is closed before the annual general meeting.

   (iii) Each due diligence review is unique but the overall aim is to provide an investor with sufficient, relevant and timely information in order to assist in the investment decision.

   (iv) Foreign investment can be taken in the form of technical collaboration but not in the form of financial collaboration.

   (v) Under the takeover regulations, once the public announcement has been made, the Board of directors of the target company can appoint an additional director or fill in any casual vacancy.

   (2 marks each)

   (b) Critically examine and comment on the following:

   (i) The proportionate allotment of securities in an issue that is oversubscribed shall be subject to reservation for retail individual investors.

   (ii) Payment of royalty by Indian companies is allowed under automatic route under the FEMA regulations. *(5 marks each)*

2. (a) Choose the most appropriate answer from the given options in respect of the following:

   (i) The merger of subsidiary company into its parent company is called—
      (a) De facto merger
      (b) Up stream merger
      (c) Down stream merger
      (d) Reverse merger.

   (ii) Which of the following committees is a non-mandatory under the listing agreement —
      (a) Remuneration committee
      (b) Share transfer committee
      (c) Shareholders/investors grievance committee
      (d) Audit committee.

   (iii) The circular of National Securities Depository Limited (NSDL) providing for the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to—
      (a) Statutory audit
      (b) Concurrent audit
      (c) Internal audit
      (d) Continuous audit.

   (iv) Which of the following sources is not allowed to Indian companies to raise resources from the international market—
      (a) Global depository receipts
      (b) American depository receipts
      (c) Indian depository receipts
      (d) Foreign *currency convertible bonds.*

   (v) Which of the following is not involved in the issue of Indian depository receipts—
      (a) Foreign company
      (b) Overseas custodian bank
      (c) Domestic depositor*y*
      (d) Foreign investors.

   (vi) Under the approval route, the foreign investor or the Indian company requires prior approval from—
      (a) Securities and Exchange Board of India
      (b) Reserve Bank of India
      (c) Company Law Board
      (d) Foreign Investment Promotion Board. *(1 mark each)*

   (b) Distinguish between the following :

   (i) Amalgamation' and 'takeover',

   (ii) 'Liaison office' and 'project office'. *(3 mark each)*

(c) Mention the sectors which are prohibited for foreign investment in India. *(4 marks)*

3. (a) Rosy Trading Ltd. borrowed a sum of ₹20 lakh from a bank on the mortgage of entire assets of the company and on execution of personal guarantee by all its directors, who stood as sureties for the loan. After one year, the company went into liquidation. For paying off the bank loan, on passing a Board resolution, the directors advanced money to the company to discharge the liability towards the bank loan. However, no action for satisfaction of charge against the property of the company with the Registrar of Companies was taken. Directors claimed that they were subrogated to the position of mortgagee bank on paying off the debt and thus wanted to claim the money in priority to others. You have been engaged to decide their claim. Decide giving reasons and citing case law. *(6 marks)*

(b) Ankur, a shareholder of Radha Financial Services Ltd., requested for copies of the register under section 301 of the Companies Act, 1956. His request was turned down stating that the register contains details about interest of directors and contracts in which they are interested, it is therefore confidential and copies thereof cannot be given. As a Practising Company Secretary, advise Ankur whether the refusal is valid. *(5 marks)*

(c) Sonia Enterprises Ltd. is having a good track record for payment of dividend in past five years. The company has paid dividend in the last five years as follows:

Year Ended	Rate of Dividend Paid
31st March, 2005	12.0%
31st March, 2006	12.5%
31st March, 2007	12.5%
31st March, 2008	15.0%
31st March, 2009	18.0%

It is apparent frcm the annual accounts for the year ended 31st March, 2010 that the profits are inadequate to declare dividend for the year ended 31st March, 2010 but the Board of directors of the company wants to declare a dividend @ 14% on the equity shares so as to maintain the image of the company. The company has some accumulated profits earned in the previous years which were not transferred to reserves.

The company seeks your advice as to how it can pay dividend at the rate of 14% on the equity shares. *(5 marks)*

4. (a) Mention any six cases where approval from shareholders is mandatory by way of special resolution. *(6 marks)*

(b) Prepare a check-list of takeover process in India when there is no competitive bid. *(5 marks)*

(c) Ash Ltd. and Cash Ltd. are contemplating setting-up a project in joint venture. To guide them, you are required to state the advantages and disadvantages of joint ventures. *(5 marks)*

5. (a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :

   (i) _____ 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.

   (ii) _____ is a mechanism for subscribing to an issue containing an authorisation to block the application money in a bank account.

   (iii) _____ instruments help in reducing the risk of investing in fixed income instruments.

   (iv) A _____ is a technique which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

   (v) The aggregate of foreign investment made either directly or indirectly (through depository receipts mechanism) shall not exceed _____ of the issued and subscribed capital of the issuing company.

   (vi) Under section 113 of the Companies Act, 1956, a company is required to deliver the certificate within _____ after the allotment of any of its securities. *(1 mark each)*

   (b) Nalini, a Practising Company Secretary, was engaged to perform secretarial audit of Hindustan Fibres Ltd. Draft the audit report to be submitted by her, assuming at least three qualifications. *(10 marks)*

6. (a) Bharat Foods Ltd., has decided to invite the public to subscribe its equity capital. List out the services which a Practising Company Secretary can render in respect of the initial public offering (IPO). *(6 marks)*

   (b) Tej Speed Ltd., an unlisted public company, has issued bonus shares in the ratio 2:1. You are required to prepare a check-list to confirm that every requirement has been fulfilled. Further, if the company is a listed company, what are the additional requirements which are required to be met? *(6 marks)*

   (c) Mention the provisions regarding obtaining of compliance certificate by a company from a Secretary in Whole-time Practice. Also, state the action to be taken on such certificate by the company. (4 marks)

7. (a) Distinguish between any two of the following:

   (i) 'Initial public offering' and 'further public offering'.

   (ii) 'Physical data room' and 'virtual data room'.

   (iii) 'Joint venture' and 'wholly owned subsidiary'. *(4 marks each)*

   (b) Write notes on any two of the following:

   (i) Transfer of unpaid amount to the Investor Education and Protection Fund

   (ii) Whistle blower policy

   (iii) Depository participants. *(4 marks each)*

8. Critically examine and comment on any four of the following:

   (i) The objective of due diligence is to allow the investigator to consider the various options, considering the facts found in the course of due diligence.

   (ii) Whenever a corporate action is announced, the issuer or its Registrar and Transfer Agent (RTA) should inform its depository just after the day of communication of the same to the relevant stock exchange(s).

   (iii) A limited two-way fungibility scheme has been put in place by the Government of India for ADRs/GDRs.

   (iv) Overseas investments by established proprietorship or unregistered partnership exporter firms will be subject to certain conditions.

   (v) Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws. *(4 marks each)*

JUNE 2011

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *Answer* ***SIX*** *questions including Question No.1 which is COMPULSORY.*

1. (a) State, with reasons in brief, whether the following statements are true or false :
   - (i) A company registered under section 25 of the Companies Act, 1956 shall be required to have minimum paid-up capital of ₹5 lakh or such higher paid-up capital as may be prescribed from time-to-time.
   - (ii) Rematerialisation means the conversion of physical holdings back into the electronic holdings.
   - (iii) All fees/compensation, if any, paid to non-executive directors can be fixed by the Board of directors without the previous approval of the shareholders in a general meeting.
   - (iv) The Securities Contracts (Regulation) Act, 1956 states that if a company fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it shall be liable to a penalty not exceeding ₹20 crore.
   - (v) A company not eligible to raise funds from the Indian capital market will not be eligible to issue foreign currency convertible bonds.

   (2 marks each)

   (b) Critically examine and comment on the following :
   - (i) A remuneration committee may be set-up by the Board of directors.
   - (ii) As per SEBI regulations, every issuer is required to submit audit report on a quarterly basis. *(5 marks each)*

2. (a) Write the most appropriate answer from the given options in respect of the following :
   - (i) Where a company fails to comply with the requirement of filing the compliance certificate with the Registrar of Companies, every officer of the company and the company shall be punishable with fine which may extend to —
     - (a) ₹250 per day during which the default continues
     - (b) ₹1,000 per day during which the default continues
     - (c) ₹500 per day during which the default continues
     - (d) ₹750 per day during which the default continues.
   - (ii) As per clause 49 of the listing agreement, the Board of directors shall meet in a year at least —
     - (a) 2 Times
     - (b) 3 Times
     - (c) 4 Times
     - (d) 5 Times.

(iii) When a charge on the assets of the company is satisfied, which one of the following forms is required to be filed with the Registrar of Companies —

(a) Form No.10

(b) Form No.12

(c) Form No.8

(d) Form No.17.

(iv) As per FEMA regulations, an Indian party is permitted to make an investment in overseas joint venture/wholly owned subsidiaries not exceeding —

(a) 100%

(b) 200%

(c) 400%

(d) 500%

of its net worth as on the date of the last audited balance sheet.

(v) The proceedings of each general meeting of the company should be entered within —

(a) 60 Days of the meeting

(b) 45 Days of the meeting

(c) 90 Days of the meeting

(d) 30 Days of the meeting.

(vi) Which of the following Acts does not come under the purview of the securities laws —

(a) Securities and Exchange Board of India Act, 1992

(b) Foreign Contribution (Regulation) Act, 1976

(c) Securities Contracts (Regulation) Act, 1956

(d) Depositories Act, 1996. *(1 mark each)*

(b) Distinguish between the following :

(i) 'Equity shares' and 'sweat equity shares'.

(ii) 'Buy-back of shares' and 'redemption of shares'. *(5 marks each)*

3. (a) You are a Company Secretary holding certificate of practice. While issuing the secretarial compliance certificate to Keya Co. Ltd., you observe that in the calendar year 2010, the following meetings of the Board of directors were held :

1st meeting — 26th February, 2010
2nd meeting — 30th March, 2010
3rd meeting — 26th May, 2010
4th meeting — 30th June, 2010
5th meeting — 1st October, 2010
6th meeting — 28th December, 2010

Do you feel that there is any violation of the provisions of the Companies Act, 1956 ? Explain. *(6 marks)*

(b) Swadesh has applied for shares under employees stock option scheme (ESOS) and his option was granted by the company. Now, Swadesh wants to transfer his option to his friend, Vinod. Comment on the check points for non-transferability of option under the ESOS. *(5 marks)*

(c) "MCA-21 offers the facility to view documents and also search and other facilities of public documents online." Explain the statement and narrate the procedure for examination of records filed by a company with the Registrar of Companies. *(5 marks)*

4. (a) What do you mean by 'persons acting in concert' ? Who will be deemed to be persons acting in concert as per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ? *(6 marks)*

(b) Sunil is a Company Secretary holding certificate of practice. He has accepted the assignment of secretarial audit of XYZ Ltd. for the financial year ended 31st March, 2010. He received the notice of his assignment on 15th April, 2010 and signed the audit report on 30th June, 2010. It is noticed that Sunil ceased to be a Company Secretary in practice from 1st June, 2010. Examine the validity of the report dated 30th June, 2010 signed by Sunil. *(5 marks)*

(c) Amar Properties Pvt. Ltd. was incorporated by Amar and his three sons. The issued and paid-up capital was ₹4 lakh comprising 4,000 shares of ₹100 each. After few years, Amar died in an accident. At that time his name appeared in the following manner in the register of members.

Name	*No. of Shares*
Amar	100
Amar and his first son	600
Amar and his second son	600
Amar and his third son	500
Total :	1,800

On the demise of Amar, his wife claimed that her late husband held 1,800 equity shares jointly and severally. He had left behind a will and she accordingly obtained a probate in her favour in respect of the above mentioned shares from the court and applied to the company for transmission of all the 1,800 shares in her favour. The company transmitted only 100 shares in the name of Amar's wife because of complaints made by the other survivors. Amar's wife has filed a petition under sections 111(2) and 111(4) of the Companies Act, 1956 challenging the action of the company. Prepare a note for the company about the defences it may take. *(5 marks)*

5. (a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :

(i) Promoters' contribution has to be brought in as per the SEBI guidelines before the _____ of public issue.

(ii) Indian depository receipt means any _____ in the form of depository receipt created by domestic depository in India.

(iii) The depository participant shall redress the grievances of the beneficial owners within _____ of the date of receipt of the complaint.

(iv) Form No. _____ is required to be filed with the Registrar of Companies in case any existing director was appointed as managing director or manager.

(v) Legal due diligence is a _____ operation through which one can know the strengths and weaknesses of a company.

(vi) Every company accepting deposits from the public has to file with the Registrar of Companies the return of deposits under section 58A of the Companies Act, 1956 on or before _____ every year. *(1 mark each)*

(b) Katreena Ltd., a listed company, wants to make an issue of securities through a rights issue and the aggregate value of the securities including premium exceeds ₹70 lakh. As a Company Secretary of Katreena Ltd., advise the company about the procedures to be followed for making the rights issue. *(5 marks)*

(c) While conducting the secretarial audit of Rainbow Pharmaceuticals Ltd., it came to notice that a Board meeting held on 24th March, 2011 was convened and conducted by Jagat alone as a director of the company. On enquiry, it was found that except Jagat, all other directors of the company had resigned and in order to constitute the quorum and to carry out the business activities, two additional directors were appointed with immediate effect in the said single director Board meeting. Decide the validity of the Board meeting and the appointment of the two additional directors in the meeting held on 24th March, 2011. *(5 marks)*

6. (a) Mention the possible hurdles in carrying out a legal due diligence. *(6 marks)*

(b) MPS Ltd. is an educational institution registered as a society under the Societies Registration Act, 1860. It wishes to make overseas investment in United Kingdom by establishing a wholly owned subsidiary to run schools in that country. Explain the provisions relating to overseas investments by a registered society. *(5 marks)*

(c) Mention the various records required to be maintained by depository participants under the Depositories Act, 1996. *(5 marks)*

7. (a) Explain the compliances required with regard to ***any two*** of the following:

(i) Removal of a director.

(ii) Triangular merger.

(iii) Statutory meeting. *(4 marks each)*

(b) Write notes on ***any two*** of the following :

(i) Sectors where foreign investment is prohibited

(ii) Eligibility for issuance of Indian depository receipts (IDRs)

(iii) Closure of register of members. *(4 marks each)*

8. Critically examine and comment on ***any four*** of the following :

(i) An Indian company planning to make a public offer in the United States of America need not register its securities.

(ii) The preferential allotment made to any person shall be locked-in for a period of two years.

(iii) It is not the duty of the lead merchant banker to ensure the despatch of share certificates/refund orders.

(iv) The depository system functions very much like the banking system.

(v) Companies may fall a prey to contravention of the provisions of the Companies Act, 1956 in the absence of professional support as compared to companies which have a qualified Company Secretary.

(4 marks each)