Supplement For

PROFESSIONAL PROGRAMME
(New syllabus)

- ADVANCED COMPANY LAW AND PRACTICE (Module 1, paper 1)
- SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE (Module 1, paper 2)
- CORPORATE RESTRUCTURING, VALUATION AND INSOLVENCY (Module 1, paper 3)
- ETHICS, GOVERNANCE AND SUSTAINABILITY (Module 2, paper 6)
- ADVANCED TAX LAWS AND PRACTICE (Module 3, paper 7)
- DRAFTING, APPEARANCES AND PLEADINGS (Module 3, paper 8)
- CAPITAL, COMMODITY AND MONEY MARKET (Module 3, Elective paper 9.2)

This supplement is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (Including amendments / clarifications / circulars issued there under upto June, 2014). In respect of sections of the Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with.

The students having 2013 edition of Study Material (New Syllabus) are advised to read their Study Material with reference to this supplement. This supplement is updated upto 30th June, 2014.
Disclaimer-

In the event of any doubt, students may write to the Directorate of Academics in the Institute for clarifications at academics@icsi.edu

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Please refer the study material of July 2014 edition for this paper. The soft copy would be available on the ICSI website under the head ‘Academic Corner’ on July 31st, 2014.
PROFESSIONAL PROGRAMME

SECRETARIAL AUDIT,
COMPLIANCE MANAGEMENT
AND DUE DILIGENCE

MODULE 1 - PAPER 2
Lesson 1
Secretarial Audit and Secretarial Standard – An Overview

LEARNING OBJECTIVES
Timely examination of compliance reduces risks as well as potential cost of non-compliance and also builds better corporate image. Secretarial Audit establishes better compliance platform by checking the compliances with the provisions of various statutes, laws, rules & regulations, procedures by a Practicing Company Secretary to make necessary recommendations/ remedies. The primary objective of the Compliance Management backed Secretarial Audit is to safeguard the interest of the Directors & officers of the companies, shareholders, creditors, employees, customers etc. With the introduction of concept of ‘Secretarial Audit’ in Voluntary Corporate Governance Guidelines (CGV) 2009 and the ‘Companies Act 2013, it has gained immense importance.

After reading this lesson the students would be able to understand the need, objectives, scope, benefits of secretarial audit, professional responsibilities and penalties etc.

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

MCA CORPORATE GOVERNANCE VOLUNTARY GUIDELINES 2009
INTRODUCTION

Section 204 of the Companies Act, 2013 provides for mandatory secretarial audit for every listed company and companies belonging to other prescribed class of companies.

Such companies are required to annex a secretarial audit report with its Board’s report.

As per rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the prescribed class of companies is as under:

(a) every public company having a paid-up share capital of fifty crore rupees or more; or
(b) every public company having a turnover of two hundred fifty crore rupees or more.

Company secretary in practice has been exclusively recognised for conducting secretarial audit. The section further provides that Secretarial Audit Report is to be submitted in a format prescribed under rules. As per sub-rule (2) of Rule 9, the format of the Secretarial Audit Report shall be in Form No. MR.3 (Annexure A).

Section 134 and Sub-section (3) of section 204 provides that the Board of Directors, in its report, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in the secretarial audit report.

The Objectives of Secretarial Audit

The objectives of Secretarial Audit may be briefed as under.

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

Scope of Secretarial Audit

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

(i) The Companies Act, 2013 (the Act) and the Rules made thereunder:

The Act is divided into 29 chapters, 470 sections and VII Schedules. On various matters; Central Government has been empowered to make rules. A perusal of the scheme of the Act makes it clear that compliances under the Act may be divided into two categories. Compliances of the first type are annual and non-event based such as filing of the annual return, annual report including secretarial audit report, wherever applicable, etc. The compliances of second category are event based i.e. on happening of certain event. These events require compliance of various provisions of the Act.

While secretarial audit envisages the verification of all secretarial records of a company. For ease of presentation, the following key areas have been highlighted for verification.

Under Companies Act, 2013

1. Maintenance of registers and records.
2. Filing of forms, returns and documents.
3. Memorandum and/or Articles of Association.
4. Meetings of directors/committees thereof, shareholders and other stakeholders.
5. Secretarial standards.
6. Directors and key managerial personnel ("KMP")
7. Disclosures.
8. Issue of shares and other securities.
9. Transfer and transmission of shares and other securities and related matters.
10. Dividend.
11. Deposits.
13. Loans, investments, guaranties and securities.
14. Loans to directors etc. and Related party transactions.
15. Charges.
16. Corporate Social responsibility

(ii) Other major Acts and Regulations:

a. The Securities Contracts (Regulation) Act, 1956 and the Rules made under that Act; (where applicable): With special reference to listing, delisting and continuous listing of any of the securities.

b. The Depositories Act, 1996 and the Regulations and Bye-laws framed under that Act; (where applicable)

c. The 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; (where applicable)

d. The regulations and guidelines made under the Securities and Exchange Board of India Act, 1992 (where applicable). The various laws/regulations/guidelines which could be considered under this are:

   (i) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

   (ii) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;

   (iii) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

   (iv) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;

   (v) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;

   (vi) 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;

   (vii) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
viii) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;

e. The Listing Agreement, (where applicable).

(iii) Other Applicable Laws include:

- Competition Law
- Labour Laws
- Environmental Laws
- Industry/sector Specific Laws
- Other applicable state Laws

The Secretarial Auditor should prepare a list of specific laws as applicable to the company whose secretarial audit is being conducted and verify compliance with the same.

(iv) Adherence to board process and compliance mechanism

The scope of Secretarial Audit should include the assessment of the adequacy and quality of board process and compliance mechanism. In preparing the Audit Report, the secretarial auditor shall consider the following matters (illustrative):

1. Instances of non-compliance during the defined audit period, in relation to the statutes, rules, regulations, etc. applicable to the company, continuing non-compliance, if any, and the reasons therefor;

2. Significant litigation(s) initiated by the company or filed against the company with brief details of the cases;

3. (a) Board structure –
   (i) Composition of the Board
   (ii) Is there a stated process to ascertain the suitability of directors?
   (iii) Is there a stated process in place for succession planning?

(b) Deficiencies in the Board systems and processes -
   (i) In convening meetings.
   (ii) In the circulation of agenda (whether the agenda is made available to the Board along with supporting papers/presentations sufficiently in advance of the meetings).
   (iii) In conducting the meetings (frequency and length).
   (iv) In the decision making process of the Board.
   (v) Adequacy and integrity of minutes recorded.
   (vi) In the functioning of Board constituted Committees.

4. The existence and adequacy of internal control systems, procedures and processes, commensurate with the size of the company and the nature of its business, for ensuring compliance with laws applicable to the company;

5. Any material event(s) that have happened, after the end of the financial year but before the date of the report, having a significant impact on any of the above reported items.

6. Whether any event occurred or action was taken in the auditee company which may have bearing on the Compliances under various laws, regulations, guidelines and standards etc.
SECRETARIAL AUDIT

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

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

SECRETARIAL AUDIT & COMPANY SECRETARY IN PRACTICE (PCS)

A Company Secretary in practice is considered to be a professional well-versed in matters of statutory, procedural and practical aspects of laws applicable to companies, both listed and unlisted public and private companies. A strong knowledge base makes him a competent professional to conduct Secretarial Audit.

In order to provide guidance to its members who are in practice to adopt a robust and efficient process of Secretarial Audit, the Institute of Company Secretaries of India has issued this guidance note.

SECRETARIAL AUDIT – THE PROCESS

![Process Flowchart]

Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/regulations/procedures; adherence to good governance practices with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for the business and activities of the company, carrying out activities in a lawful manner and the maintenance of
minutes and records relating to such approvals or decisions and implementation. The secretarial auditor is also expected to express an opinion, after satisfying himself, that there exist 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. The secretarial auditor has to verify whether diverse requirements under applicable laws have been complied with.

**Appointment of Secretarial Auditor**

As per Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, read with section 179 of the Companies Act, 2013 secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting.

**Communication to earlier Incumbent**

Whenever a company secretary in practice is engaged as a secretarial auditor in place of an earlier incumbent, he shall communicate to the earlier incumbent about the proposed engagement in writing to be sent by registered/speed post or any other mode of delivery, as may be recognised by the Institute of Company Secretaries of India.

**Acceptance of Appointment**

A formal letter for appointment should be issued by the company to the secretarial auditor along with the copy of the board resolution for appointment. The secretarial auditor shall confirm acceptance of appointment in writing.

**Preliminary Discussions/Surveys**

It is important to have relevant information about the company. The secretarial auditor is expected to take general overview of the operations of the company and interact with the personnel involved to know about the nature of the business. He may opt for surveys for generating information about the company.

**Preliminary Meeting**

The preliminary meeting with the senior management and the administrative staff involved in the audit will give a fair idea of what is expected and the manner in which audit activities are to be undertaken. At this stage a time frame of the secretarial audit should be determined and finalized. The secretarial auditor shall discuss the scope and objectives of the audit, gather information on important Board processes, evaluate existing control systems and prepare the audit plan. He is advised to get Management Representation letter for the purpose of secretarial audit.

**Finalization of Audit Plan and Briefing the Staff**

It is important to work out an audit plan. The plan involves briefing the audit staff as to allotment of work, fieldwork responsibilities and other roles. The audit plan should comprehensively outline the fieldwork and usage of auditing tools. The review of controls helps the auditor determine the areas of highest risk and design tests to be performed in the fieldwork section. It is essential that the audit plan adheres to the timelines. Detailed checklist for each aspect of secretarial audit should be prepared and audit staff should be properly sensitized before commencement of audit.

**Testing, Interviews and Analysis**

The secretarial auditor may use a variety of tools and technology to gather information about the company's
operations. The secretarial auditor should determine whether the controls identified during the preliminary review are operating properly and in the manner described by the Company. Fieldwork typically consists of interviewing with staff of the company whether formally or informally, reviewing procedure manuals, processes, testing and analyzing compliance with applicable policies and procedures and laws, rules, regulations and assessing the adequacy of controls. This exercise may result in significant findings which the secretarial auditor may bear in mind while preparing the secretarial audit report.

The Act places the secretarial auditor on the same footing as the statutory auditor in terms of powers, duties and responsibilities while conducting the audit.

**Working Papers**

Working papers are a vital tool of the audit process. They form the basis for expression of the audit opinion. They connect the management's records and information to the auditor's opinion. They are comprehensive and serve many functions.

**Audit Summary for Discussions**

It is recommended that the findings during the course of audit are summarized and presented for initial discussions with the management for their views/clarifications/replies.

**Submission of Secretarial Audit Report**

After considering the clarifications/replies of the management, the secretarial auditor shall prepare the secretarial audit report in form MR. 3 (Annexure A). The report is addressed to the members but is to be submitted to the Board. The report shall contain the opinion on the statutory compliances examined by the auditor and shall state whether in his opinion the Company is carrying out/not carrying out due compliances of the applicable provisions of the various laws. The report shall be provided with or without qualifications.

**Benefits and Beneficiaries of Secretarial Audit**

**The Benefits**

The benefits of secretarial audit includes the following:

(a) It can be an effective due diligence exercise for the prospective acquirer of a company or controlling interest or a joint venture partner.

(b) It assures the owners that management and affairs of the company are being conducted in accordance with requirements of laws, and that the owners stake is not being exposed to undue risk.

(c) It ensures the Management of a company that those who are charged with the duty and responsibility of compliance with the requirements of law are performing their duties competently, effectively and efficiently.

(d) It ensures the Management that the company has complied with the laws and, therefore, they are not likely to be exposed to penal or other liability or to action by law enforcement agencies for non-compliance by the company.

(e) Secretarial Audit being proactive measure for compliance with a plethora of laws, it will have a salutary effect of substantially lessening the burden of the law-enforcement authorities.

(f) Instilling professional discipline and self-regulations.
(g) Reduces the work load of the regulators due to better and timely compliances.

**The beneficiaries**

The major beneficiaries of Secretarial Audit include:

(a) **Promoters**

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

(b) **Management**

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

(c) **Non-executive directors**

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

(d) **Government authorities/regulators**

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

(e) **Investors**

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

(f) **Other Stakeholders**

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

**Secretarial Audit-Periodicity**

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

**Reporting with Qualification**

Qualifications/reservations or adverse remarks, if any, should be stated by the secretarial auditor at the relevant places in his report in bold type or in italics.

If the secretarial auditor is unable to express an opinion on any matter, he should mention that he is unable to express an opinion on that matter and the reasons therefor. If the scope of work required to be performed is restricted on account of restrictions imposed by the company or on account of circumstantial limitations (like certain books or papers being in the custody of another person who is not available or a Government
Authority), the Report should indicate such limitations. If such limitations are so material that the secretarial auditor is unable to express any opinion, the secretarial auditor should state that in the absence of necessary information and records, he is unable to report on compliance(s) relating to such areas by the Company.

**Professional Responsibility and Penalty for Incorrect Audit Report**

While the Companies Act, 2013 provides a new and significant area of practice for Company Secretaries it casts immense responsibility on the practicing company secretaries. Company Secretaries must take care while conducting such audits. Any failure or lapse on the part of secretarial auditor may attract penalty for incorrect report and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980. Further section 448 of Companies Act, 2013 deals with penalty for false statements. The section provides that if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

(a) which is false in any material particulars, knowing it to be false; or

(b) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

Section 447 deals with punishment for fraud which provides that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. In case, the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

In view of this, a company secretary in practice will be attracting the penal provisions of section 448, for any false statement in any material particulars or omission of any material fact in the Secretarial Audit Report. However, a person will be penalised under section 448 in case he makes a statement, which is false in any material particulars, knowing it to be false, or which omits any material fact knowing it to be material.

It is pertinent to note that section 448 applies to “any person”. In view of this, a company secretary in practice, who is an independent professional, will be attracting the penalty, as prescribed in Section 448 in case his observations in the secretarial audit report turns out to be false or omits any material fact, knowing it to be false or material, along with the other signatories to the Annual Return.

Section 204(4) also cast responsibility on the company secretary in practice in case of default of provision of section 204 and shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

**SECRETARIAL STANDARD**

**Secretarial Standards - Meaning**

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

**Establishment of Secretarial Standards Board And its Objectives**

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

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

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

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

**Scope and Functions of the Secretarial Standards Board**

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

The main functions of SSB are:

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

**Scope of Secretarial Standards**

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

Secretarial Standards that are issued will be in conformity with the provisions of the applicable laws. However, if, due to subsequent changes in the law, a particular Standard or any part thereof becomes inconsistent with such law, the provisions of the said law shall prevail.

**Procedure for issuing Secretarial Standards**

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

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

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

5. On the basis of the preliminary draft and the discussion with the bodies/organisations referred to in 4 above, an Exposure Draft will be prepared and published in the “Chartered Secretary”, the journal of ICSI, and also put on the Website of ICSI to elicit comments from members and the public at large.

6. The draft of the proposed Secretarial Standard will generally include the following basic points:

   (a) Concepts and fundamental principles relating to the subject of the Standard;
   (b) Definitions and explanations of terms used in the Standard;
   (c) Objectives of issuing the Standard;
   (d) Disclosure requirements; and
   (e) Date from which the Standard will be effective.

7. After taking into consideration the comments received, the draft of the proposed Secretarial Standard will be finalised by SSB and submitted to the Council of ICSI.

8. The Council will consider the final draft of the proposed Secretarial Standard and finalise the same in consultation with SSB. The Secretarial Standard on the relevant subject will then be issued under the authority of the Council.

**Need for Secretarial Standards**

Companies follow diverse secretarial practices. These practices have evolved over a period of time through varied usages and as a response to differing business cultures. As an illustration, the Companies Act, 1956, provides that companies must convene their Board Meetings by giving notice to directors in this regard. However, no minimum period for giving such Notice has been laid down and, companies are at liberty to give any or no length of notice for convening a Board Meeting. Further, there is no requirement for sending Agenda for the Meeting. Companies, therefore, follow varied practices with regard to giving Notices and sending Agenda and Notes on Agenda for Meetings of the Board of Directors. Some companies specify the business to be transacted in the Notice itself, while others send a separate Agenda. In addition, some companies also send detailed Notes, explaining each item on the Agenda. While some companies send the Agenda in advance of the Meeting, others place the Agenda at the Meeting itself. Even in case of those companies which send the agenda in advance, the period varies. These divergent practices need to be harmonised by laying down the best practices in this regard.

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

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

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

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

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

SECRETARIAL STANDARDS UNDER THE COMPANIES ACT, 2013

Introduction and Need

It was observed that Companies follow diverse secretarial practices while following the provisions of company law. Therefore, a need emerged to integrate, harmonise and standardise such practices so as to promote uniformity and consistency in corporate practices.

Recognising this need for integration, harmonisation and standardisation of diverse secretarial practices, the Institute of Company Secretaries of India, (ICSI), had constituted the Secretarial Standards Board (SSB) in the year 2000 with the objective of formulating Secretarial Standards.

The term ‘Secretarial Standard’ is defined as an explanation to section 205 of the Companies Act, 2013 to mean secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government. Thus, for the first time, Secretarial Standards have been accorded statutory recognition under the Companies Act, 2013.

Secretarial Standards and the Companies Act, 2013

The Companies Act, 2013 has recognised the need for every company to observe Secretarial Standards.

Section 118 (10) of the Companies Act, 2013 requires every company to observe secretarial standards with respect to General and Board meetings.

Also, as per section 205(1)(b), it is the duty of the company secretary to ensure that the company complies with the applicable secretarial standards.

Therefore, the companies are required to ensure the observance of all the secretarial standards once these are issued by the Institute of Company Secretaries of India and approved by the Central Government.

So far, the ICSI has issued ten Secretarial Standards, viz.

SS-1: Secretarial Standard on Meetings of the Board of Directors
SS-2: Secretarial Standard on General Meetings
SS-3: Secretarial Standard on Dividend
SS-4: Secretarial Standard on Registers and Records
SS-5: Secretarial Standard on Minutes
SS-6: Secretarial Standard on Transmission of Shares and Debentures
SS-7: Secretarial Standard on Passing of Resolutions by Circulation
SS-8: Secretarial Standard on Affixing of Common Seal
SS-9: Secretarial Standard on Forfeiture of Shares and
SS-10: Secretarial Standard on Board’s Report.

These standards are under revision in the light of the provisions of the Companies Act, 2013 and would require approval by Central Government.

To begin with, the Secretarial Standards Board of the Institute has revised the following four Secretarial Standards in the light of the provisions of the Companies Act, 2013:

- Exposure Draft SS-1: Meetings of the Board of Directors
- Exposure Draft SS-2: Secretarial Standard on General Meetings
- Exposure Draft SS-5: Secretarial Standard on Minutes
- Exposure Draft SS-7: Secretarial Standard on Passing of Resolutions by Circulation
- Exposure Draft SS-9: Secretarial Standard on Forfeiture of Shares and

Once finalised by the Institute and approved by the Central Government, these finalised standards would be ready for observance by the companies.

The Checklist with respect to the above four draft secretarial standards is given later in the chapter.

**Secretarial Standards Board (SSB) and Secretarial Standards**

The SSB identifies the areas in which Secretarial Standards need to be issued. Once areas are identified, the standards are formulated by the Board which constitutes eminent professionals from the industry, nominees of professional bodies, regulators and industry associations.

These are prepared taking into consideration, the applicable laws, business environment and best secretarial practices.

SSB also clarifies the issues arising out of such Standards and issues guidance notes for the benefit of members of ICSI, the corporate sector and other users.

Secretarial Standards that are issued are prepared in conformity with the provisions of the applicable laws. However, if, due to subsequent changes in the law, a particular Standard or any part thereof becomes inconsistent with such law, the provisions of the said law shall prevail.

The Secretarial Standards issued by the ICSI generally contain the following:

(a) Concepts and fundamental principles relating to the subject of the Standard.

(b) Definitions and Explanations of terms used in the Standard.

(c) Objectives of issuing the standard.
(d) The standard.
(d) Disclosure requirements.
(e) Date from which the standard would be effective.

It is the beginning of a new era where non financial standards have been given due importance and statutory recognition.

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

Convening a Meeting

1. the Meeting has been convened by the authorised person

2. the original and the adjourned Meeting was held at the place and the time prescribed under the Act

3. the Notice of the Meeting (original or adjourned) was given in writing to all directors and persons concerned within the stipulated period by any of the stipulated modes

4. the notice specified the day, date, time and full address of the venue of the Meeting.

5. the notice provided all necessary information to enable the Directors to access the facility of participation through Electronic Mode, if made available.

6. the Agenda setting out the business to be transacted at the Meeting, and Notes on Agenda for the Meeting had given to all persons concerned within the stipulated period

7. In case of a Meeting at shorter notice, whether due procedure as per the Standard was followed

8. In case of any supplementary item which had not been included in the Agenda, whether provisions of the Standard were duly followed

Frequency of the Meeting

9. In case of the first Meeting of the Board, it was held within the period specified in the Act.

10. The specified number of meetings were held in a year—gaps between two consecutive meetings did not exceed the period specified in the Act or Standard.

11. Meetings of the Committees were held as stipulated by the Board or as prescribed by any law or authority.

Quorum
12. The requisite quorum as per the Act and Rules was present in each meeting.

13. The Quorum was present throughout the Meeting and no business was transacted when the Quorum was not present.

14. Where an Interested director was present, the Interested director had disclosed his interest at the Board meeting where the transaction was considered and abstained from participating in the discussions and voting thereon.

15. The Interested Directors were counted for quorum or not and they were present, or were kept off if participating through Electronic Mode, during discussion and voting on items in which they were interested.

16. A Director participating in a Meeting through Electronic Mode has been counted for Quorum. If so, whether in respect of restricted items under the Act or any other law.

17. Stipulated Quorum requirements for Meetings of the Committees were followed.

18. Check that Meetings of the Audit Committee to consider periodic financial statements and financial results of the company were not held through Electronic Mode.

Attendance at the Meetings

19. The Attendance Register of Meetings was duly maintained.

20. In case of Directors participating through Electronic Mode, the attendance of Directors had been confirmed by the Chairperson.

21. The proceedings of Meeting through Electronic Mode were duly recorded and preserved.

22. Leave of absence was granted to a Director as per the Standard, if requested for.

Chairperson

23. The Chairperson of the Board or any other director duly elected conducted the Meetings of the Board.

24. Check whether the Chairperson of the Committee or any other member of the Committee duly elected conducted the Meetings of the Committee.

Passing of Resolutions by Circulation

25. Covered in detail in checklist for SS-7 below

Minutes
26. Check whether the Minutes of the Board Meetings were entered within 30 days of the conclusion of the Meeting.

27. Check that the Minutes of the Board Meetings was signed by the Chairperson of that particular meeting or the next meeting.

Preservation of Minutes and other Records

28. Minutes of all Meetings are being preserved permanently.

29. Minutes Books are kept in custody as prescribed under the Standard.

30. Office copies of Notices, Agenda, Notes on Agenda and other related papers are duly preserved in good order in physical or electronic form for the stipulated period.

31. In case of a scheme of arrangement, Minutes of all Meetings of the transferor company, as handed over to the transferee company, are being duly preserved.

32. Office copies of Notices, Agenda, Notes on Agenda and other related papers of the transferor company, as handed over to the transferee company, are being duly preserved for the stipulated period.

33. Necessary approval had been taken, where any records had been destroyed.

Disclosure

34. Check whether the Annual Report and Annual Return of the company disclosed the number and dates of Meetings of the Board and Committees held during the financial year besides indicating the number of Meetings attended by each Director.

Illustrative list of items of business which should be placed before the Board

35. Check whether 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

Checklist : Secretarial Standard on General Meetings (SS-2)*

Convening a General Meeting

1. A General Meeting had been convened on the authority of the Board.

2. The Notice of the Meeting had been duly given in writing to all members of the company and other persons entitled within the stipulated period by any of the stipulated modes.

3. The Notice was hosted on the website, if any, of the company and other websites prescribed under the Act.
4. Proof of despatch of the notice was available.

5. The notice clearly specified the day, date, time and full address of the venue of the Meeting and site-map wherever required besides clearly specifying the nature of the Meeting and the business to be transacted thereat.

6. The notice prominently contained a statement on entitlement to appoint proxy.

7. The notice provide all necessary information to enable the Members to access facility of voting by Electronic Mode, if made available and specifies the mode of declaration of the results of the voting by Electronic Mode; whether advertisement providing all necessary information in this regard had been duly published.

8. In respect of items of Special Business and where the Auditors or Directors were to be appointed, each such item was in the form of a Resolution and was accompanied by an explanatory statement setting out all such facts as would enable a Member to understand the meaning, scope and implications of the item of business and to take a decision thereon.

9. The nature of the concern or interest (financial or otherwise), if any, of the prescribed persons, in any item of business or in a proposed Resolution, was disclosed in the explanatory statement.

10. In case of Meetings at shorter notice, due procedure as per the Standard had been followed.

11. Check that Copies of Financial Statements, Directors’ Report and Auditors’ Report were not sent at a shorter period of time.

12. Check that No items of business other than those specified in the Notice and those specifically permitted under law were taken up for consideration at the Meeting.

13. Check that A Meeting convened upon due Notice had not been postponed or cancelled, except for reasons beyond the control of the Board. In such case, check whether it had been duly reconvened.

**Frequency of the Meeting**

14. The AGM had been duly held.

15. In case of an Extra-Ordinary General Meeting or a postal ballot, only items of business of an urgent nature had been transacted.

**Quorum**

16. The requisite quorum was present in the meeting.
17. The Quorum was present throughout the Meeting.

18. Proxies had been excluded for determining the Quorum.

**Presence of Directors and Auditors**

19. Directors of the company had attended the General Meetings of the company, particularly the Annual General Meeting.

20. If any Director was unable to attend the Meeting, the Chairperson had explained such absence at the Meeting.

21. The Auditors of the company unless otherwise exempted, attended the General Meetings of the company either by themselves or through their authorised representative, and were given the right to be heard at such Meetings on that part of the business which concerns them as Auditors.

22. Secretarial Auditor attended the Annual General Meeting, either by himself or through his authorised representative.

**Chairperson**

23. Check that the Meetings of the Board was conducted either by Chairperson of the Board or any other director or any other Member duly elected as per the Articles or the Standards, as the case may be.

24. Check whether the Chairperson had explained the objective and implications of the Resolutions before they were put to vote.

25. Check that the Chairperson had not proposed any Resolution in which he was deemed to be concerned or interested or whether he participated in the discussion or voted on any such Resolution.

**Voting**

26. The Resolution had been duly proposed.

27. Every Resolution, in the first instance, was put to vote on a show of hands.

28. A poll was ordered to be taken by the Chairperson of the meeting, wherever required as per law or the Standard.

29. Resolutions requiring voting by poll had not been put to vote by show of hands.

30. Voting by Electronic Mode was conducted by the company in the manner prescribed under the Act

**Proxies**

31. Requirements in the Standards relating to Notice of Right to Appoint Proxies, Form of Proxy, Stamping of Proxies, Execution of Proxies,
Proxies in Blank and Incomplete Proxies, Deposit, Revocation, Inspection and Record of Proxies have been duly complied with.

Conduct of Voting by Electronic Mode

32. The Board appointed an Agency to provide and supervise electronic platform for voting by Electronic mode and had obtained their consent.

33. The Board duly appointed one scrutinizer, who was not an officer or employee of the company for the e-voting process.

34. The Chairperson or any other person authorised by the Chairperson in writing for this purpose had duly announced the final results as to whether the Resolution had been carried or not.

35. Other requirements of the Standard w.r.t. conduct of voting by Electronic mode and placing/publishing of results had been duly complied with.

Conduct of Poll

36. The Chairperson got the validity of the demand verified and, if the demand was valid, ordered the poll as prescribed in the Standard.

37. In the case of a poll not taken forthwith, the Chairperson had announced the date, venue and time of taking the poll to enable Members to have adequate and convenient opportunity to exercise their vote.

38. Each Resolution on which a poll was demanded had been put to vote separately.

39. The Chairperson appointed such number of scrutinizers, as necessary, including at least one Member who was present at the Meeting and not an officer or employee of the company.

40. Other requirements of the Standard w.r.t. conduct of poll and placing/publishing of results had been duly complied with.

Withdrawal of Resolutions

41. Check that no Resolution for items of business which were likely to affect the market price of the securities of the company had been withdrawn.

Rescinding of Resolutions

42. Check that no Resolution passed at a Meeting has been rescinded subsequently without a Resolution.

Modifications to Resolutions

43. Check that no Modifications to any Resolution were made which changed the purpose of the Resolution materially.

Reading of Report/Certificate

44. Check whether the qualifications, observations or comments on the financial statements or matters which have any adverse effect on the
functioning of the company, if any, mentioned in the Auditor’s Report and Secretarial Audit Report were read at the Annual General Meeting.

45. Check whether the attention of the Members present was drawn to the explanations / comments given by the Board of Directors in their report.

Adjournment of Meetings

46. Check that a duly convened Meeting was not adjourned arbitrarily by the Chairperson.

47. Check whether

• a Notice of the adjourned Meeting was given in accordance with the provisions contained in the Standard

• If a Meeting, other than a requisitioned Meeting, stood adjourned for want of Quorum, the adjourned Meeting was held as per the law and Standard

• Quorum requirements were fulfilled in adjourned meetings

• only the unfinished business of the original Meeting were considered at an adjourned Meeting.

48. Check that any Resolution passed at an adjourned Meeting was deemed to have been passed on the date of the adjourned Meeting and not on any earlier date.

Minutes

49. Check whether the Minutes of the General Meetings were drawn up and signed within 30 days of the conclusion of the Meeting.

Preservation of Minutes and other Records

50. Minutes Book to record Minutes of General Meetings had been kept separately from those books used to record Minutes of any other meetings and were kept at the Registered Office of the company.

51. Minutes of all General Meetings are being preserved permanently.

52. Office copies of Notices, Agenda, Notes on Agenda and other related papers are duly preserved in good order in physical or electronic form for the stipulated period.

53. In case of a scheme of arrangement, Minutes of all Meetings of the transferor company, as handed over to the transferee company, are being duly preserved.

54. Office copies of Notices, Agenda, Notes on Agenda and other related papers of the transferor company, as handed over to the transferee company, are being duly preserved for the stipulated period.
55. Necessary approval had been taken, where any records had been destroyed.

Report of the Annual General Meeting

56. In case of listed public company, check whether a report of the Annual General Meeting, including a confirmation that the meeting was convened, held and conducted as per the provisions of the Act was prepared in the prescribed form and duly filed with the Registrar of Companies.

Disclosure

57. Check whether the Annual Report and Annual Return of a company disclose the number and dates of all Meetings held during the last three financial years.

Checklist : Secretarial Standard on Minutes (SS-5)*

Maintenance

1. Check whether:
   • Minutes are being recorded in books maintained for that purpose
   • Distinct Minutes book are being maintained in respect of each type of Meeting
   • The pages of the Minutes book are being consecutively numbered.

2. Check that the Minutes are not being pasted or attached to Minutes Book.

3. Check that there are no alterations in the Minutes.

4. Check that the Minutes Books are being kept at the Registered Office of the company and in case of Minutes of the Board Meetings at such other place as may be approved by the Board.

5. In case the Minutes are maintained in loose-leaf form, check whether it is being bound periodically depending on size and volume, coinciding with one or more financial years of the company.

Contents

6. Check whether
   • Minutes begin with the number and type of the Meeting, name of the company, day, date, venue and time of commencement.
   • Minutes record the names of the Directors present and the Secretary in attendance at the Meeting
   • Minutes contain a record of all appointments made at the Meeting
   • Minutes contain other contents as per the Standard.

7. In case of Board Meetings, check whether Minutes mention the brief background of all proposals and summarise the deliberations thereof. In case of major decisions, check whether the rationale thereof are also mentioned.
8. In respect of Resolutions passed by Postal Ballot, check whether a brief report on the Postal Ballot conducted including the Resolution proposed, the result of the voting thereon and the summary of the scrutinizer’s Report are duly recorded in the Minutes Book and signed as stipulated in the Standard.

**Recording**

9. Each item of business taken up at the Meeting were numbered.

10. Minutes of the preceding Board Meeting were noted at the next Board Meeting.

11. Minutes of the Meetings of any Committee were noted at the Board Meeting held immediately following the date of signing of such Minutes.

12. Where an earlier resolution or decision is superseded or modified in case of Board Meetings, the Minutes contain a reference to the earlier resolution or decision.

**Finalisation**

13. Check whether the requirements of the Standards in respect of circulation of minutes for comments and finalisation thereafter were duly complied with.

**Entry**

14. Check whether the requirements of the Standards in respect of entry of minutes in the Minutes book and alterations thereafter were duly complied with.

**Signing and dating**

15. Check whether the Minutes are initialled, dated and signed by the Chairman as required by the Standard.

**Inspection & Extracts**

16. Check whether the requirements of the Standards in respect of inspection of Minutes and providing extracts thereof were duly complied with.

**Preservation of Minutes and other Records**

17. Minutes of all Meetings are being preserved permanently.

18. Minutes Books are kept in custody as prescribed under the Standard.

19. Office copies of Notices, Agenda, Notes on Agenda and other related papers are duly preserved in good order in physical or electronic form for the stipulated period.

20. In case of a scheme of arrangement, Minutes of all Meetings of the transferor company, as handed over to the transferee company, are being duly preserved.

21. Office copies of Notices, Agenda, Notes on Agenda and other related papers of the transferor company, as handed over to the transferee company, are being duly preserved for the stipulated period.

22. Necessary approval had been taken, where any records had been destroyed.

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Checklist : Secretarial Standard on Passing of Resolutions by Circulation (SS-7)*
1. Check whether provisions of Section 175 of the Companies Act, 2013 and the Rule thereunder have been complied with in respect of resolutions, if any, passed by circulation

**Authority**

2. Check whether the decision of obtaining approval of the Board for a particular business by means of a resolution by circulation had been taken by an authorised person as per the Standard.

3. Check that no resolution was taken up for passing by circulation in cases where it was required by the requisite number of Directors to be taken up at a Board Meeting.

**Procedure**

4. Check that the resolution passed by circulation alongwith necessary papers had been circulated to all the directors of the company.

5. Check whether the procedure laid down by the Standard in respect of sending of draft resolution and necessary papers, contents of the note thereof, mode of circulation etc. had been duly followed.

6. Check whether the note indicated the last date by which the Director had to respond and manner thereof

**Approval**

7. Check whether the resolution, if passed, had been as per the Act and provisions of the Standard had been complied with.

**Recording**

8. Check whether the resolutions passed by circulation had been noted at the next Board meeting and the text thereof with dissent or abstention, if any, were recorded in the minutes of such Meeting alongwith the fact that Interested Director, if any did not vote on the resolution.

Illustrative matters which should not be passed by circulation but should be passed only at a duly convened Meeting of the Board.

9. Check whether the items required to be transacted only at a meeting of the Board had not been passed by way of resolution by circulation.

*Note:* These Checklist are a draft checklists prepared on the basis of the Exposure Drafts put up for public comments in April 2014 and will be undergoing a change in the light of the comments received and further suggestions on the Exposure Drafts.
Form No. MR-3
SECRETARIAL AUDIT REPORT
FOR THE FINANCIAL YEAR ENDED … … …

[Pursuant to section 204(1) of the Companies Act, 2013 and rule No.9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014]

To,
The Members,
……….… Limited

I/We have conducted the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by…… (name of the company), (hereinafter called the company). Secretarial Audit was conducted in a manner that provided me/us a reasonable basis for evaluating the corporate conducts/statutory compliances and expressing my opinion thereon.

Based on my/our 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/We hereby report that in my/our 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/we 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, 2013 (the Act) and the rules made thereunder;
(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 thereunder;
(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, 2011;
(b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
(c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
(d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
(e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
(f) The Securities and Exchange Board of India (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;
(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 company)

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

(i) Secretarial Standards issued by The Institute of Company Secretaries of India.

(ii) The Listing Agreements entered into by the Company with ..... Stock Exchange(s), if applicable;

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/we 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 Act.

Adequate notice is given to all directors to schedule the Board Meetings, agenda and detailed notes on agenda were sent at least seven days in advance, and 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/we 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/we 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 section 180 of the Companies Act, 2013.

(iv) Merger / amalgamation / reconstruction, etc.

(v) Foreign technical collaborations.

Place:                  Signature

Date:               Name of Company secretary in Practice

ACS/FCS No.

CP No.
Note: Parawise details of the Audit finding, if necessary, may be placed as annexure to the report.

**LESSON ROUND UP**

- Secretarial Audit is the process of verification of compliance with rules, procedures, maintenance of books, records etc. by an independent professional to monitor compliance with various legal requirements.

- Secretarial Audit not only ensures that the company has complied with the provisions of various laws but also extends professional help to the company in carrying out effective compliances and establishment of proper systems with appropriate checks and balances.

- Secretarial Audit can prove to be an effective and multipurpose mode to assure the regulator, generate and repose confidence amongst the shareholders, creditors and other stakeholders in companies, assure Financial Institutions, including state level Financial Institutions etc. and instill self regulation and professional discipline in companies.

- Secretarial Audit is of immense benefit even to larger companies which otherwise have a whole-time Company Secretary in its employment.

- Secretarial Audit is an area of practice for company secretaries which demands the expertise and specialised and comprehensive knowledge of Companies Act, 2013 and laws relating to Competition Act, SEBI, regulations relating to capital issue, takeover code, insider trading, mutual funds, depositories and participants regulations, Foreign exchange/collaborations etc.

- Secretarial Audit is recognized as a good governance tool by corporates.

- Secretarial Audit is recognized in MCA voluntary Guidelines on Corporate Governance and emerging laws like Companies Act 2013.

**SELF TEST QUESTIONS**

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

1. Secretarial Audit is essential for developing better reputation of the company. Comment.

2. Discuss the process involved in secretarial Audit.

3. What should be the scope of secretarial Audit?

4. Who are the beneficiaries of Secretarial Audit?
Lesson 2
Checklist – Secretarial Audit

LESSON OUTLINE

- Introduction
- Check list - Secretarial Audit under
  1. The Companies Act, 2013 and the rules made thereunder
  2. Foreign Exchange Management Act, 1999 and the Rules and Regulations made thereunder

LEARNING OBJECTIVES

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

The objective of the study lesson is to familiarize the students with the various aspects of legal compliance requirements stipulated under the Secretarial Audit, covering the Provision of Companies Act, 2013, FEMA Act and Rules and Regulations made thereunder. The compliances relating to capital market and SEBI Regulations are dealt in Lesson 4.

It may be noted that Secretarial Audit checklist requirements are inclusive and differs from company to company. This lesson attempts to give general idea about compliances under different legislations.
INTRODUCTION

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

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

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

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

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

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

CHECKLISTS UNDER THE COMPANIES ACT, 2013

Companies are required to operate within the applicable legislative environment. Protection of interest of the stakeholders viz. shareholders, lenders, employees, customers, vendors, service providers, regulators, etc. is paramount.

A company will be failing in its duty and commitment to be a responsible and good corporate citizen, if it does not comply with the provisions of law. This proposition is based on the premise that every provision of law in the statute book is made in the public interest.

GENERAL COMPLIANCE REQUIREMENTS

As per section 204 of the Companies Act, 2013 (the Act) read with Rule 9 of the Companies (Appointment
and Remuneration of Managerial Personnel) Rules, 2014, every listed company and a company belonging to other class of companies as may be prescribed i.e. as per the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 (a) every public company having a paid-up share capital of fifty crore rupees or more; or (b) every public company having a turnover of two hundred fifty crore rupees or more, are required to annex to its Board’s report a secretarial audit report, given by a company secretary in practice. Members are advised to refer to any changes in rules, which may occur from time to time.

The secretarial auditor should inter-alia verify about the Maintenance of registers and records and compliances in respect of

I. Memorandum and/or Articles of Association.
II. Disclosures
III. Issue of shares and other securities
IV. Transfer and transmission of shares and other securities and related matters
V. Deposits
VI. Charges
VII. Meetings of directors/committees thereof, security holders and other stakeholders.
VIII. Secretarial Standards
IX. Dividend
X. Corporate Social Responsibility (CSR)
XI. Directors and Key Managerial Personnel (KMP)
XII. Loans to Directors, etc, and related party transactions
XIII. Loans, Investments, Guarantees and Securities
XIV. Registers, Filing of forms, returns and documents

A Practising Company Secretary (PCS) in order to verify the compliances has to verify the secretarial records of the company with the help of following checklist.

**MEMORANDUM AND/OR ARTICLES OF ASSOCIATION**

*Alteration of memorandum*

**Check whether**

1. The company has passed the special resolution and filed MGT.14 as per Companies (Management and Administration) Rules, 2014.
2. The company has altered its name with the approval of Central Government.
3. The company has obtained fresh certificate of incorporation from the registrar in Form No.INC.25 as per Companies (Incorporation) Rules, 2014.
4. The company has shifted the registered office from one state to another state, with the approval from the Central government.
5. The company has raised money from public through prospectus and still has any unutilised amount out of the money so raised, and if so, a special resolution has been passed by the company and—

- the details, were published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and was placed on the website of the company, indicating therein the justification for such change;
- the dissenting shareholders have been given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

Alteration of Articles

Check whether

6. The company has passed special resolution with respect to alteration of articles and has filed form MGT 14.

7. In case of the conversion of a private company into a public company or vice versa, the application was filed in Form No.INC.27

8. A copy of order of the competent authority approving the alteration has been filed with the Registrar in Form No. INC.27 together with the printed copy of the altered articles within fifteen days of the receipt of the order from the competent authority.

9. Provision for entrenchment has been made by alteration of Articles, with the consent from all the members/by passing special resolution.

DISCLOSURES

- The address of its registered office is displayed at its registered office and all local offices as per section 12;
- The authorised share capital in its official publications and if yes, subscribed/paid-up share capital as per section 60;
- Company has disclosed its CIN, website address etc as contemplated by section 12.

ISSUE OF SHARES AND OTHER SECURITIES

_Private Placement U/S 42 (Read with Companies (Prospectus and Allotment of Securities) Rules, 2014_

_Public and Private Company:

May allot securities as:

1. Rights issue
2. Bonus issue
3. Private placement

_Private Placement u/s 42_

Check the following compliances

1. To ensure that persons to whom offer may be made not to exceed 200 in a financial year for each kind of security.
2. No allotment against any previous offer / invitation of any kind of security is pending.

3. Company has passed special resolution for each offer / invitation (except in case of NCDs, where one resolution in a year for all offers during the year is sufficient).

4. Explanatory statement contains justification for price and premium, if any.

5. Issue a private placement offer letter was in form PAS-4.

6. Requirement of private placement offer letter--
   a. Was accompanied by serially numbered application form
   b. Addressed specifically to the person to whom offer is being made
   c. Sent to only such person in writing / electronically
   d. Within 30 days of recording names in the list
   e. No person other than the addressee was allowed to apply through application form.
   f. Value of offer / invitation per person was not less than Rs. 20,000 of face value of the security

7. Private placement was offered to such persons whose names are recorded prior to the invitation to subscribe.

8. The Company has maintained record of offer letters in PAS-5.

9. Company has filed offer letter with ROC along with record of offer letters within 30 days of circulation of offer letter.

10. Amount against offer to be received only by cheque / demand draft / other banking channels but not by cash – only from the bank account of the subscriber.

11. Company to maintain record of the bank account from which payments received.

12. In case of joint holders, payment was received from first applicant only.

13. Allotment was completed within 60 days from date of receipt of application form. If not application money repaid within 15 days of completion of 60 days. If not repaid, the application money along with interest at 12 percent per annum from expiry of 60th day was paid.

14. Board resolution to specifically contain authority for issuance of share certificates to 2 directors and CS/one authorized person. One of the two directors should be director other than MD / WTD.

15. Share application money to be kept in separate bank account and was utilized only for (a) adjustment against allotment or (b) repayment.

16. Company filed Return of allotment in form PAS-3 within 30 days.

17. Share certificates were issued within 2 months of allotment of shares / 6 months of allotment of debentures.

18. Incase of contravention, money was refunded within 30 days of order.

19. Company has made entry in Register of Members.

### PREFERENTIAL ALLOTMENT U/S 62

*Applicable to Private and Public Company*

Kinds of securities covered:

i. equity shares,
ii. fully convertible debentures,

iii. partly convertible debentures,

iv. any other security which would be convertible into equity shares at a later date

**Whenever a company wants to increase its subscribed capital**: It shall allot further shares to

I. **Existing equity shareholders in proportion to the paid up share capital held by them.**

a. Letter of offer to be sent to existing equity shareholders as notice by registered post / speed post / electronic mode at least 3 days before opening of the issue

b. Contents of letter of offer: (1) Specify number of shares offered (2) time limit of minimum 15 and maximum 30 days from date of offer within which the offer if not accepted, was deemed have been declined (3) offer to included a right exercisable by person concerned to renounce the shares offered to him in favour of any other person concerned to renounce the shares offered to him in favour of any other person

  c. On expiry of period / renunciation, Board disposed of the shares in a manner not disadvantageous to the company and shareholders

II. Employees under ESOP Scheme; subject to prior special resolution.

III. Any persons; (1) subject to prior special resolution; (2) either for cash or for consideration other than cash, (3) if price is determined by valuation report of registered valuer.

This section does not apply where increase in subscribed capital is caused by exercise of option to convert debentures/loan into shares of the company provided terms of issue of debentures / loan have been approved by special resolution before issue of debentures / raising of loan.

### Procedure for issue of shares to any persons other than existing equity shareholders u/s 62 (1) (c) (taking into account procedure u/s 42 also):

1. Prepare a list of persons (not exceeding 200 in a financial year for each kind of security) to whom offer may be made.

2. Ensure that no allotment against any previous offer/ invitation of any kind of security is pending Issue to be authorized by AOA.

3. Issue to be authorized by AOA.

4. Pass special resolution for such issue.

5. Explanatory statement to contain justification for price and premium, if any and also other matters as prescribed by the rules.

6. Determine issue price by valuation report of registered valuer / independent merchant banker / independent CA.

7. Only fully paid securities can be issued.


9. Requirements of Offer letter:

   a. To be accompanied by serially numbered application form

   b. Addressed specifically to the person to whom offer is being made
(c) Sent to only such person in writing / electronically
(d) Within 30 days of recording names in the list
(e) No person other than the addressee allowed to apply through application form
(f) Value of offer / invitation per person not less than Rs. 20,000 of face value of the security
(g) To also comply with requirement of contents of notice about renunciation etc.

10. Maintain record of offer letters in PAS-5.
11. File offer letter with ROC along with record of offer letters within 30 days of circulation of offer letter.
12. Amount against offer to be received only by cheque / demand draft / other banking channels but not by cash – only from the bank account of the subscriber.
13. Company to maintain record of the bank account from which payments received.
14. In case of joint holders, payment was received from first applicant only.
15. Allotment was completed within 12 months from date of passing special resolution. If not, another special resolution was passed to complete allotment.
16. Where convertible securities are offered, price of resultant shares shall be determined beforehand on basis of valuation report.
17. Board resolution to specifically contain authority for issuance of share certificates to 2 directors and CS / one authorized person. One of the two directors should be director other than MD / WTD.
18. Share application money was kept in separate bank account and was utilized only for (a) adjustment against allotment or (b) repayment.
19. Return of allotment in form PAS-3 within 30 days.
20. Share certificates to be issued within 2 months of allotment of shares / 6 months of allotment of debentures.
21. Entry in Register of Members.
22/ In case of consideration other than cash, accounting treatment as specified in Rules, was complied.

In case a charge is required to be created in connection with the issue of the securities, check if the same has been done in accordance with the provisions of the Act and other applicable legal requirements and prescribed returns have been filed.

 Bonus issue (section 63) 

1. Check whether it is authorised by its articles;
2. Whether it has, on the recommendation of the Board, been authorised in the general meeting of the company;
3. Whether the company has defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
4. Whether it has defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
5. Whether the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
6. Ensure that the company which has once announced the decision of its Board recommending a bonus issue does not subsequently withdraw the same;
7. Check whether Return of allotment is filed with the registrar in Form PAS.3

### Issue of Sweat Equity Shares

1. Section 2 (88) defines “sweat equity shares” so as to mean such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

2. In case of Listed Company, ensure that the issue of Sweat Equity Shares is in compliance with the SEBI (Issue of Sweat Equity) Regulations, 2002. (Check list is given under Chapter….)

**In case of an unlisted company**

**Check whether**

3. The issue is authorised by a special resolution passed by the company, ensuring that the special resolution authorising the same is valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

4. Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business;

5. The company has not issued sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. Further it is to be ensured that the issuance of sweat equity shares in the Company has not exceeded twenty five percent of the paid up equity capital of the Company at any time.

6. The company is maintaining Register of Sweat Equity Shares in Form No. SH.3

7. The Register of Sweat Equity Shares is maintained at the registered office of the company or such other place as the Board may decide.

8. The entries in the register are authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

### Calls on Shares/Debentures

**Check whether**

1. call on shares/debentures was made by the Board of directors by means of resolutions passed at the Board meeting;

2. call on shares/debentures complied with the stipulations contained in the Articles of Association;

3. 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.

### Buy-back of Shares/Securities

**Check whether**

1. The Articles of association authorizes buy back of securities. If not, a special resolution for
amending the articles of association under section 14 of the Companies Act, 2013 has been passed by the company in the general meeting.

2. Form No. MGT.14 as per Companies (Management and Administration) Rules, 2014 has been filed with RoC within 30 days of passing the special resolution.

3. In case, buy back of securities are up to 10% of total paid up equity capital & free reserves, whether a board resolution was passed authorizing the buy-back.

4. A special resolution has been passed in general meeting, authorizing the board to buy-back.
   
   (Note: This is not applicable in case the buyback is ten percent or less of the paid up capital and free reserves of the company)

5. Form No. MGT.14 as per Companies (Management and Administration) Rules, 2014 has been filed with RoC within 30 days of passing the special resolution.

6. The explanatory statement is required to be annexed to the notice of general meeting pursuant to section 102 contains the disclosures mentioned in the Rule 17 (1) of Companies (Share Capital and Debentures) Rules, 2014 in this behalf. [Note: Refer Rule 17(1)]

7. After passing of special resolution but before buy-back, the letter of offer has been filed with RoC in Form No. SH.8 with the requisite fee.

8. The letter of offer has been dated and signed on behalf of the board by not less than two directors of the company, one of whom shall be the managing director, where there is one.

9. The shares or other securities so bought back are extinguished and physically destroyed within seven days of the completion of buy-back.

10. The declaration of solvency required pursuant to Section 68 (6) of the Companies Act, 2013 has been filed in Form No. SH.9 as per Companies (Share Capital and Debentures) Rules, 2014 with RoC.

11. The declaration of solvency has been signed and verified by at least two directors, one of whom shall be the managing director of the company, if any.

12. The company maintains a register of shares or other securities which have been bought back in Form No. SH.10 as per Companies (Share Capital and Debentures) Rules, 2014.

13. The company has filed a return containing within 30 days of completion of buy-back in Form No. SH.11 as per Companies (Share Capital and Debentures) Rules, 2014 with RoC.

14. The certificate of compliance in Form No. SH.15 signed by two directors of the company including the managing director, if any, and the practising Company Secretary is annexed to the return filed with RoC in Form No. SH.11.

Employee Stock Option under Companies Act, 2013 and Rules made thereunder

For private and unlisted public companies

The Companies Act, 2013 lays down the provisions for issue of employee stock option under Section 62 (1)(b) and Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014. A PCS is required to verify the following:

1. Whether the company has passed the special resolution as required under Section 62 (1) (b) of the Companies Act, 2013.
2. If passed, check the copy of the special resolution for approving the scheme of ESOP.

3. Check whether special resolution has been filed with ROC in Form No. MGT.14 as per Companies (Management and Administration) Rules, 2014.

4. Check that the explanatory statement to the notice of the meeting contains the disclosures required to be made under the sub-rule 2 of rule 12 of Companies (Share Capital and Debentures) Rules, 2014.

5. Check that the Director’s Report contains the disclosures required to be made in such report under sub-rule 9 of the rule 12 of Companies (Share Capital and Debentures) Rules, 2014.

6. Verify the Register of Employee Stock Options maintained in Form No. SH.6 of Companies (Share Capital and Debentures) Rules, 2014 and that the register is duly authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

**Debentures**

An issue of secured debentures may be made, provided the date of its redemption has not exceed ten years from the date of issue.

Where the company is engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years (Rule 18 Companies (Share Capital and Debentures) Rules, 2014)

**Check whether**

1. The company has appointed a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders.

2. A trust deed in Form No. SH.12 or as near thereto as possible has been executed by the company issuing debentures in favour of the debenture trustees within sixty days of allotment of debentures.

3. The company has created a Debenture Redemption Reserve for the purpose of redemption of debentures.

**Issue and redemption of preference shares (section 55)**

**Check whether**

1. A company is authorized by its articles to issue preference shares;

2. The issue of preference shares has been authorized by passing a special resolution in the general meeting of the company;

3. The company, at the time of such issue of preference shares has no subsisting default in the redemption of preference shares issued either before or after the commencement of the Act or in payment of dividend due on any preference shares.

4. The articles of association of the company has set out the following matters relating to preference shares:
   
   (a) priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;

   (b) participation in surplus dividend;
(c) participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;
(d) payment of dividend on cumulative or non-cumulative basis.
(e) conversion of preference shares into equity shares.
(f) voting rights;
(g) redemption of preference shares.

TRANSFER AND TRANSMISSION OF SHARES AND OTHER SECURITIES AND RELATED MATTERS.

**Issue of Certificates for Shares and other Securities**

**Check whether**

1. The company has allotted shares/debentures and entered the names of allottees in the register of members/debenture holders;
(Note: where the register and index of beneficial owners is maintained by a depository it shall be deemed to be corresponding to the register of members)
2. The company has issued and delivered share certificates as per section 46 of the Act;
3. The company has executed Debenture Trust Deed in case of secured debentures;
4. The company has complied with delivery of certificates within the time limits prescribed under section 56(4).
5. Proper stamp duty has been paid.

**Transfer and Transmission of Shares**

I. Transfer of Shares

**Check whether**

1. The requirements contained in the Articles of Association have been complied with;
2. The transfer of shares/debentures and the issue of certificates thereof have been made within the stipulated time under section 56 in accordance with the procedures prescribed;
3. The company receives instrument of transfer in form SH-4 in respect of physical form of securities.
4. An application has been made in respect of partly paid up shares of the company. If yes, the company has given notice of application in form SH-5 to the transferee and received no objection to the transfer.
5. All transfers have been properly included in the Annual Return.
6. The company has taken indemnity in respect of instrument of transfer that has been lost or not delivered within the prescribed limit.
7. Entries in the register of transfers have been made from time to time.

II. Transmission of shares

**Check whether**

8. 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);

9. 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.

DEPOSITS

Check whether

1. The Company has not accepted any deposits which is repayable on demand or upon receiving a notice within a period of less than six months or more than 36 months from the date of acceptance or renewal of deposit. If, accepted so, the company has complied with the conditions prescribed in Rule 3.

2. The company has issued circular to all its members by registered post acknowledgement due or speed post or by electronic mode in Form DPT-1, while intending to invite deposits from them.

3. The company, being an eligible Company as defined under the Rules, has issued circular in the form of advertisement in Form DPT-1.

4. Whether the company filed Return of deposits with the Registrar in form DPT-3.

5. The company (accepting deposits form members or eligible companies) has entered into a contract for providing deposit insurance as prescribed in Rule 3.

6. The company has provided for security by way of charge as prescribed in Rule 6.

7. The company has executed deposit trust deed from DPT-2 at least seven days before circular or advertisement.

CHARGES

Check whether

1. The company has registered the particulars of creation or modification of charge with the Registrar within thirty days of its creation or modification or within the extended period after payment of additional fees; [Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification)].

2. The copy of every instrument evidencing any creation or modification of charge is required to be filed with the Registrar has been verified as per Rule 4.

3. The company has reported satisfaction of charge to the Registrar within the period of thirty days of its payment/satisfaction [CHG-4/CHG-5].

4. The notice of appointment or cessation of a receiver of, or of a person to manage, the property, subject to charge, of a company has been filed with ROC in Form CHG-6.

5. The company has maintained the register of charges in form CHG -7.

6. The application for condonation of delay, if any, has been filed with the Central Government in form no. CHG-8.

7. The order passed by Central Government w.r.t. condonation of delay has been filed with the ROC in Form INC-28.
MEETINGS OF DIRECTORS/COMMITTEES THEREOF, SHAREHOLDERS AND OTHER STAKEHOLDERS.

Meetings of directors/committees

Check whether

1. the requisite number of Board meetings as required under section 173 the Act were held during the year;
2. notice of each Board meeting in writing was issued to all the directors;
3. attendance records are maintained and the requirements of Board meetings regarding quorum, chairman, minutes etc., have been complied with and leave of absence is granted to Directors who have requested for the same;
4. the items required to be transacted only at the meeting of the Board were transacted at the meeting. Following is the list of resolutions which are required to be passed only at the board meeting:

(a) Resolutions for exercising following powers:
   i. Make call
   ii. Buy back of securities
   iii. Issuing securities
   iv. Borrowing monies
   v. Investing funds
   vi. Granting loans/ giving guarantees/providing securities
   vii. Approving financial statement and Board’s report
   viii. Diversifying business
   ix. Approving amalgamation/merger/reconstruction
   x. Taking over of a company/acquiring control in substantial stake in another company (I-X) above as per section 179(3)
   xi. Making political contributions
   xii. Appointing or removing KMP
   xiii. Noting appointment/ removal of personnel one level below KMP
   xiv. Appointing internal auditor
   xv. Appointing secretarial auditor
   xvi. Noting disclosure of interest by directors
   xvii. Buying and selling investments(other than trade investments) in excess of 5% of paid up capital and free reserves of investee company
   xviii. Inviting/accepting/renewing public deposits
   xix. Changing terms of public deposits
   xx. Approving periodical financial results
Serial No. (xi-xx) above are as per Companies (Meetings of Board and its Powers) Rules, 2014

5. 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;

6. The notices of disclosure of general interest under section 184 have been received from all the directors and were, placed before and read at the first Board meeting in each year;

7. Entries thereof have been made in the Register of Contracts or arrangements in which Directors are interested in pursuance to section 189 and noted by the Board and such disclosures have been renewed every year;

8. If the Board had constituted any committees; whether requirements regarding quorum, chairman, minutes, etc., of committee meetings were duly complied with;

9. Resolutions by circulation have been approved in accordance with the provisions of the Act and in cases where it was required by the requisite number of Directors to be taken up at a Board meeting, whether the same has been taken up at a Board meeting;

10. The resolutions passed by circulation were put up at the next Board meeting for taking note of the same and has been made part of the minutes;

11. All directors have given a declaration in Form Dir-8 about their not being disqualified to act as a Director at the beginning of each financial year and such declarations have been placed before the Board and taken note of;

12. Independent Directors have given declaration about their status;

13. The director has attended at least one board meeting in a year either in person or through video conferencing;

**Minutes Book of Meetings of Directors**

**Check whether**

1. All appointments made at the meeting are included in the minutes.

2. Names of the directors who are present at the meeting are recorded in the minutes.

3. Names of the directors dissenting from or not concurring were recorded.

4. Secretarial Standard viz. SS1, SS2, SS5 have been complied with.

5. The pages of the minutes book have been consecutively numbered.

6. Each page of minutes of proceedings of a meeting of the Board or of a committee thereof are initialled or signed and the last page of the record of proceedings of each meeting is dated and signed by the chairman of the said meeting or the chairman of the next succeeding meeting.

7. Each page of minutes of proceedings of a general meeting are initialled or signed and the last page of the record of proceedings of each meeting is dated and signed by the chairman of the same meeting or within the aforesaid period of thirty days.

8. The minute books of general meetings, and the minutes books of the Board and committee meetings are maintained in the custody of the company secretary or any director duly authorised by the board.
9. In case directors have participated in any Board Meeting by video conference or other audio visual means whether they have complied with the checklist in the below checklist.

Meetings of Board through video conferencing or other audio visual means

**Check whether**

1. The company has made necessary arrangements to avoid failure of video or audio visual connection

2. Sufficient security and identification procedures were ensured for safeguard the integrity of the meeting by the Company Secretary/Chairman.

3. The Chairman/Company Secretary has taken Reasonable care to ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;

4. Proper arrangements were made to record proceedings and prepare the minutes of the meeting;

5. Proper arrangement were made to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year.

6. Proper system security and physical security arrangement were made to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and

7. Participants attending the meeting through audio visual means were able to hear and see the other participants clearly during the course of the meeting:

8. The differently abled people were allowed to accompany them on their request.

9. The notice of the meeting was sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Companies Act, 2013.

10. The notice of the meeting contained the information regarding the option available to the directors to participate through video conferencing mode or other audio visual means, and provided all the necessary information to enable them to participate through video conferencing mode or other audio visual means.

11. The intention of the director intending to participate through video conferencing or audio visual means was received by the Chairperson or the company secretary of the company well in advance (preferably in the beginning of year) so as to enable them to make proper arrangement in this behalf.

12. At the commencement of the meeting, a roll call was taken by the Chairperson when every director participating through video conferencing or other audio visual means stated the following namely:-
   (a) name;
   (b) the location from where he is participating;
   (c) that he has received the agenda and all the relevant material for the meeting; and
   (d) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in clause (b);
13 After the roll call, the Chairperson or the Company Secretary informed the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairperson and confirmed that the required quorum is complete.

14 The required quorum was present throughout the meeting.

15 The participating Directors had given their consent for recording of their signature electronically in the register to be signed by them and it is recorded in the minutes.

16 The participating directors introduced him at the time of speaking on any agenda item and in case of any interruption, the director repeat reiterate his statement.

17 In case of an objection on a motion, roll call was made by the Chairperson and vote of each director is recorded only on identification by the director.

18 At the end of discussion on each agenda item, the Chairperson of the meeting announced the summary of the decision taken on such item along with names of the directors, if any, who dissented from the decision taken by majority. The minutes of the meeting has disclosed the particulars of the directors who attended the meeting through video conferencing or other audio visual means.

19 The draft minutes of the meeting was circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.

20 Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, has confirmed or given his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.

21 After completion of the meeting, the minutes had been entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

22 None of the following matters were dealt with in the meeting held through video conferencing or other audio visual means.-

   (i) the approval of the annual financial statements;

   (ii) the approval of the Board’s report;

   (iii) the approval of the prospectus;

   (iv) the Audit Committee Meetings for consideration of accounts; and

   (v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

### ANNUAL GENERAL MEETING - Notice, Conduct of the meeting and minutes

#### Annual General Meeting

**Check whether**

1. The provisions of section 96 of the Companies Act read with the Companies (Management and Administration) Rules, 2014, Listing Agreement, if applicable, etc have been complied with.

2. The first AGM is held within a period of nine months from the date of closing of the first financial year of the company.
3. Subsequent AGM was held in each case, within a period of six months from the date of closing of the financial year.

4. AGM was called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday.

5. The AGM was held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate.

6. The meeting was held within 15 months of meeting last held.

7. Notice convening the meeting specifically mentioned that it was AGM.

8. Extension for holding the meeting was obtained from the Registrar.

9. Meeting was not held on a National Holiday.

10. In case of requisition meeting provisions of section 100 were complied with.

11. Notice of 21 clear days was given for the meeting.

12. Consent of atleast 95% of the members was obtained for convening the meeting for shorter notice.

13. Day, Date and hour of the meeting was mentioned in the meeting alongwith the statement of business to be transacted.

14. Notice was given to
   a. Every member/ assignee of insolvent member/legal representative of the deceased member
   b. Auditor
   c. Director

15. Explanatory statement setting out material facts was attached to the notice in respect of special business as contemplated by section 102.

16. Appropriate quorum i.e. 2/5/15/30 was present at the meeting.

17. Meeting was adjourned for want of quorum and was held as per section 103(2).

18. Chairman of the meeting was elected by the members on show hands/poll.

19. None of the proxies represented more than 50 members.

20. Appropriate statement in respect of proxies appeared in the notice.

21. Instrument of proxy was in the prescribed form.

22. Inspection of Proxy register was offered to the members within 24hours before the meeting as well as during the meeting.

23. None of the members was prevented from voting except were company had lien/ calls were due.

24. Voting through electronic means was carried out in compliance with relevant rules.

25. Poll was conducted in compliance with section 109.

26. Postal Ballot was conducted in compliance with the provisions of section 110.

27. Members’ resolution were circulated in compliance with section 111.

28. Resolution requiring special notice had the backing of members holding atleast 1% of the voting power/holding shares of Rs. 5,00,000.
DIVIDEND

Check whether

1. The company has paid dividend from the 30 days from date of declaration.

2. The company has transferred the total amount of dividend which remains unpaid or unclaimed within 30 days from the date of declaration to unpaid dividend account, within seven days from the expiry of the said 30 days.

3. The company has prepared a statement containing the names and other details to whom the unpaid dividend is to be paid along with the amount of unpaid dividend and place the same on the website of the company within 90 days.

4. The rate of dividend declared has not exceeded average rate of dividends by three years preceding the year.

5. The company has not declared and paid any dividend from reserves other than free reserves.

6. The company has deposited the dividend in a scheduled bank in separate account within five days from the date of declaration.

7. The dividend is paid by the company by cheque or warrant or an electronic mode.

8. The company has transferred required percentage of profits to reserves before declaration of dividends.

9. The company has filed the Statement of amounts to be credited to IEPF in form DIV-5.

10. The company has followed the procedures prescribed in Rule 3 before the dividend is declared out of reserves (as applicable).

CORPORATE SOCIAL RESPONSIBILITY (CSR)

[Section 135 read with Companies (Corporate Social Responsibility) Rules, 2014]

Check Whether

1. The company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year has constituted a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director is an independent director.

2. The Board has approved the CSR Policy of the company as recommended by CSR Committee.

3. The Composition of CSR Committee is disclosed in the Board's Report.

4. The company has instituted a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

5. The company has disclosed the contents of the policy in Board's report and at its website, if any.

6. in case the company does not spend the specified amount (i.e. at least two percent of the average net profits made during the immediately preceding three financial years), Board’s report specifies the reason for not spending.

7. The company has complied with the procedure specified under rules.
DIRECTORS AND KEY MANAGERIAL PERSONNEL ("KMP")

Check whether

1. The number of directors is as per the provisions of section 149 of the Act.

2. Under Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014), the company has appointed at least one woman director, if the company falls under following category -
   
   (i) a listed company;
   
   (ii) other public company having -
       
       (a) paid–up share capital of one hundred crore rupees or more; or
       
       (b) turnover of three hundred crore rupees or more:

3. Company being the listed company has at least one-third of the total number of directors as independent directors.

4. If the company falls under the following class or classes of companies, whether the company has at least two directors as independent directors -
   
   (i) the Public Companies having paid up share capital of ten crore rupees or more; or
   
   (ii) the Public Companies having turnover of one hundred crore rupees or more; or
   
   (iii) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees:

5. In case it is a listed company, whether it has any director elected by small shareholders and if so, whether such appointment is in compliance with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014).

6. The company is following the provisions for determination of office of directors by retirement by rotation (Section 152).

7. The company has ensured the eligibility of directors for election to the office of a director (Section 160).

8. The appointment of additional director, alternate and nominee director, filling up of casual vacancies has been done as provided in section 161.

9. The company has ensured that the appointment of directors is voted individually (Section 162).

10. The company has received the consent to act as directors (Section 152) and form DIR.2 was filed for appointment of director.

11. None of the directors is disqualified from continuing to be a director (Section 164).

12. None of the directors has vacated office during the year (Section 167).

13. The provisions of section 168 were complied with at the time of resignation of director.

14. None of the directors was removed from the board.

15. If the company is either a listed company or any other public company having a paid-up share capital of ten crore rupees or more, if yes, it has appointed whole-time key managerial personnel and filed a return as per DIR 12 with registrar within thirty days of such appointment or of any changes therein.

16. Appointment is made by a board resolution.
17. If the company has appointed a Manager or whole-time director, whether it has complied with the provisions of Chapter XIII of the Act read with Schedule V.

18. Whether the company has complied with section 203 with respect to appointment of a manager or managing director.

19. Check whether the provisions relating to appointment and remuneration of Managerial Persons are complied under sections 196, 197, 203 and Schedule V.

20. Ensure that as per section 197, the total managerial remuneration payable by a public company does not exceed 11% of the net profits of the company and where the limit is exceeded, the same is approved in general meeting and approved by the Central Government. It must be noted that if a company has no profits or when its profits are inadequate, the company shall pay no remuneration to its directors, except in accordance with schedule V.

21. Ensure that the procedural aspects relating to appointment of managing director or whole-time director or manager including the filing of the necessary return are complied with.

**Resignation of director**

*Check whether*

1. The letter of resignation of the director is received by the company.
2. The Board takes note of the resignation and intimate the Registrar in Form DIR-12 within thirty days from the date of receipt of notice of resignation.
3. The information about the resignation is posted on the website of the company, if any.
4. The notice was received as on ______date.

**Retirement of Directors**

*Check whether*

1. 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, the number nearest to one third, retired from office at first annual general meeting and at every subsequent annual general meeting;
2. The directors retiring by rotation are those who have been longest in office since their last appointment;
3. 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;
4. The company has filled up such vacancy by appointing the retiring director or some other person;
5. The director has expressed his willingness for his reappointment;
6. The provisions of the Act, Articles of Association and other applicable rules have been complied with.

**Removal of Director**

*Check whether*

1. A special notice as required under sub-section (2) of section 169 was given to the company to remove a director;
2. 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;

3. The representation, if any, made by concerned director was notified to the members on the request of the director along with the notice of the resolution.

4. A copy of the representation was not sent because the same was received too late or because of company’s default, it was read out at the meeting.

5. The director who was removed from office was not reappointed as a director by the Board of directors;

LOANS TO DIRECTORS, ETC AND RELATED PARTY TRANSACTIONS (Section 185 & 188)

Check whether

Loans

1. The company has not directly or indirectly advanced any loans/provided any security/given guarantee to its directors or any other person in whom the director is interested.

Related Party Transactions

2. The company has entered into a contract/arrangement with any related party through a board resolution at a meeting of the board.

3. The company has obtained prior approval of the shareholders by a special resolution in case the paid up capital is ten crore or more and wherever the other conditions specified in Rule 15 subsists.

4. The company has annexed explanatory statement to the notice of the meeting disclosing the details required under rule 15.

LOANS, INVESTMENTS, GUARANTEES AND SECURITIES (SECTION 186)

Check whether

1. The board resolution/special resolution has been passed with respect to loans and investments by the company.

2. The company cannot make investment through more than two layers of investment companies.

3. The company has not defaulted repayment of deposit while granting loans/giving guarantee/providing security.

4. The company has disclosed financial statements the full particulars of the loans given investment made or guarantee given as prescribed under the Act.

5. The company maintains register containing such particulars in form MBP-2 at the registered office of the company.

6. The company has obtained prior approval of the public financial institution if term loan is subsisting.

REGISTERS, FILING OF FORMS, RETURNS AND DOCUMENTS

Register of Renewed or Duplicate Share Certificate {Rule 6 of Companies (Share Capital and Debentures), Rules, 2014}

Check whether

1. The renewed share certificate of any share or shares have not been issued unless the certificate in lieu of which it is issued is surrendered to the company.
2. The renewed certificate issued in case of sub-division or consolidated or in replacement of those which are defaced, mutilated, torn or old, decrepit, worn out, or where the pages on the reverse for recording transfers have been duly utilised state on the face of it, that it is “Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation”.

3. Board consent was obtained before issuance of the duplicate share certificate in lieu of those certificates that are lost or destroyed.

4. The certificates issued under above stated circumstances state prominently on the face of it that it is “duplicate issued in lieu of share certificate No......”. and the word “duplicate” is stamped or printed prominently on the face of the share certificate.

5. The entries relating to issuance of renewed/ duplicate certificates are recorded in the Register for Renewed or Duplicate Share Certificate.

6. In case unlisted companies, the duplicate share certificates issued within a period of three months from the date of submission of complete documents with the company.

   In case of listed companies such certificate are issued within fifteen days, from the date of submission of complete documents with the company.

7. The register for renewed or duplicate share certificate is maintained in Form SH-2 in accordance with Companies (Share Capital and Debentures) Rules, 2014 and is kept at the registered office of the company or at such other place where the Register of Members is kept.

8. The simultaneous entries are incorporated in Register of members maintained under section 88.

9. All entries made in the Register of Renewed and Duplicate Share Certificates shall be authenticated by the company secretary or such other person as may be authorised by the Board for the purposes of sealing and signing the share certificate.

10. The register is preserved permanently and kept in the custody of company secretary of the company or any other person authorized by the Board for the purpose.

Register of sweat equity shares (Section 54) {Rule 8 of Companies (Share Capital and Debentures), Rules, 2014}

Check whether

1 The company has maintained a Register of Sweat Equity Shares in Form No. SH.3 in accordance with Companies (Share Capital and Debentures) Rules, 2014.

2 The Register of Sweat Equity Shares is maintained at the registered office of the company or such other place as the Board may decide.

3 Whether the entries have been made forthwith.

4 The entries in the register are authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Register of Employee Stock Option (Section 62(1)(b)) {Rule 12 of Companies(Share Capital and Debentures), Rules, 2014}

Check whether

1 The company has maintained a Register of Employee Stock Options in Form No. SH.6 in accordance with Companies (Share Capital and Debentures) Rules, 2014.
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2. The Register of Employee Stock Options has been maintained at the registered office of the company or such other place as the Board may decide.

3. Whether the entries have been made forthwith.

4. The entries in the register are authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

Register of securities bought-back (Section 68)

**Check whether**

1. The Register of Shares or other securities bought back by the company is maintained in Form No. SH.10 in accordance with Companies (Share Capital and Debentures) Rules, 2014.

2. The register is maintained at the registered office of the company.

3. The custody of the register is with company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

4. The entries in the register are authenticated by the secretary of the company or by any other person authorized by the Board.

Register of Deposits [Companies (Acceptance of Deposits) Rules, 2014]

**Check whether**

1. The company has entered in the register, the entries specified under Rule 14 of these rules.

2. The company has entered the particulars in the register within seven days from the date of issuance of the receipt, in accordance with the aforesaid rules.

3. The aforesaid receipt is duly authenticated by a director or secretary of the company or by any other officer authorised by the Board.

4. The register is preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

Register of Charges (Section 85)

**Check whether**

1. The company has maintained register of charges as per Form CHG.7 in accordance with the Companies (Registration of Charges) Rules, 2014.

2. The register contains particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company.

3. The register contains the particulars of the property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

4. The register is maintained at the registered office of the company and is preserved since incorporation of the company.

5. Entries in the register are authenticated by a director or the secretary of the company or any other person authorised by the Board.
Register of Members (Section 88)

Check whether

1. The company having share capital has maintained register of members as per Form No. MGT.1 prescribed under Companies (Management and Administration) Rules, 2014.

2. The Register contains particulars as mentioned in the aforesaid rules.

3. The company maintains register of debenture holders or any other security holders as per Form No.MGT.2 prescribed under Companies (Management and Administration) Rules, 2014.

4. Aforesaid Registers are maintained at the Registered office of the Company.

5. If the aforesaid registers are maintained at some other place in which more than one-tenth of the total members entered in the register of members reside or some other place within the city where registered office is situated, whether a special resolution has been passed.

6. An index of members is maintained by the company, when the number of member is equal to or more than fifty.

7. Every change is incorporated within seven days of such change.

8. The entries in the aforesaid registers index included therein are authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose, and the date of the board resolution authorising the same is mentioned therein.

9. The company has made a note of the declaration received in form MGT. 4 in duplicate, w.r.t. beneficial interest in any shares, in the register of members.

10. The company has filed Form No. MGT.6 with the Registrar within a period of thirty days from the date of receipt of aforesaid declaration.

   In case of Foreign Registers, check whether:

11. The Articles of the company authorises maintenance of the foreign register.

12. The company has within thirty days from the date of the opening of any foreign register, filed with the Registrar notice of the situation of the office where such register is kept in Form No.MGT.3 in accordance with the Companies (Management and Administration) Rules, 2014.

13. Notice of every change is incorporated in the aforesaid register or its discontinuance is filed with registrar within thirty days in Form MGT. 3.

14. The company maintains a duplicate register at its registered office and changes are duly incorporated from time to time.

15. The entries are authenticated by the company secretary of the company or person authorised by the Board by appending his signature to each entry.

Minutes Book of Meetings (Section 118 and Rule 25 of the Companies (Management and Administration) Rules, 2014)

Check whether

1. Minutes book has been maintained in respect of:
   a. General meetings of the members;
   b. Meetings of the creditors.
c. Meetings of the Board; and

d. Meetings of each of the committees of the Board.

Resolutions passed by postal ballot are recorded in the minute book of general meetings.

2. The pages of the minutes book have been consecutively numbered.

3. Each page of minutes of proceedings of a meeting of the Board or of a committee thereof is initialled or signed and the last page of the record of proceedings of each meeting is dated and signed by the chairman of the said meeting or the chairman of the next succeeding meeting.

4. Each page of minutes of proceedings of a general meeting is initialled or signed and the last page of the record of proceedings of each meeting is dated and signed by the chairman of the same meeting within the aforesaid period of thirty days.

5. The minute books of general meetings, and the minutes books of the Board and committee meetings are maintained in the custody of the company secretary or any director duly authorised by the board.

6. In case of a listed company or a company having not less than one thousand shareholders, whether the company has provided e-voting facilities to its members to exercise their vote at general meetings and if so, whether Rule 20 of the Companies (Management and Administration) Rules, 2014 has been complied with.

Register of Directors and Key Managerial Personnel and their Shareholding (Section 170 read with Rule 17 of Companies (Appointment and Qualification of Directors) Rules, 2014.)

**Check whether**

1. The necessary particulars as prescribed in the Rules are incorporated in the register.

2. The register is maintained at the registered office of the company.

Register of Loans and Investments (Section 186).

**Check whether**

1. The company from the date of its incorporation, has maintained a register in Form MBP 2 as per Companies (Meetings of Board and its Powers) Rules, 2014 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions of securities.

2. The entries in the register are made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition. The entries in the register (either manual or electronic) are authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

3. The register is kept at the registered office of the company.

4. The register has been preserved since incorporation and is kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

Register of Investments (Section 187)

**Check whether**

1. A register of investment is maintained as per Form MBP 3, in accordance with Companies (Meetings of Board and its Powers) Rules, 2014.
2. The entries in the register are made chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name are to be entered.

3. The company has also recorded the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

4. The company has also recorded when such investments are held in a third party’s name for the time being or otherwise.

5. The register is maintained at the registered office of the company and is preserved permanently.

6. The custody of the register is with company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

7. The entries in the register are authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

Register of Contracts (Section 189).

Check whether

1. The company has maintained one or more registers in Form MBP 4 as prescribed under Companies (Meetings of Board and its Powers) Rules, 2014.

2. The entries in the register(s) are authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

3. The register(s) is kept at the registered office of the company and is preserved since incorporation and is in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

4. The register(s) is signed by all the directors present at the succeeding meeting in which such contract or arrangement was considered.

Register of Directors’ Attendance

Check whether

1. The company has maintained a Register of Directors’ Attendance as prescribed in the Secretarial Standards.

2. The Directors have signed against their respective names after the meeting has been held.

Other Registers. These registers are not statutory but statistical in nature and PCS is advised to comment about the maintenance of these registers though he need not qualify his report in case of non-compliance.

Check whether

Register of Shareholders’ Attendance

1. 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.

Register of Proxies
2. The register of proxies containing details of proxies lodged in respect of every general meeting is maintained.

3. All Proxies received by the company are recorded chronologically in a register kept for that purpose, in pursuance with Secretarial Standards.

4. In case any Proxy entered in the register is rejected, the reasons there of have been entered in the remarks column.

Register of Transfers

5. Register of Transfers contains details of transfer of securities and the procedure of transfer meets the statutory requirements pursuant to Section 56 read with Rule 11 of Companies(Share Capital and Debentures) Rules,2014.

6. All transfer of securities held in physical form are in Form.No.SH.4

Register of Documents, where common seal was affixed

7. The company has maintained a register of documents on which common seal is affixed.

8. The register contains the following:
   - Number and date of the minutes authorising the use of the seal.
   - Date of sealing.
   - Persons in whose presence the seal was affixed.
   - Document sealed.
   - Location of document.

Periodical Returns: Annual Return (section 92)

Check whether

1. The company has filed annual return within sixty days from the date of holding of the annual general meeting(AGM)

2. The annual return has been filed within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, if the annual general meeting has not been held.

3. The annual return is prepared in Form No. MGT.7 referred to in Rule 11 of the companies (Management and Administration) Rules, 2014.

4. In case company does not have a company secretary the annual return signed by Company secretary in practice.

5. In case of a listed company or a company having paid-up share capital of ten crore rupees or more or turnover of fifty crore rupees or more, the annual return is certified by a Company Secretary in practice and the certificate is in Form No. MGT.8 of aforesaid rules.

6. The extract of the annual return is attached to the Board’s report in Form MGT. 9 (See Rule 12.1).

Annual Report containing the Financial statements (Section 137)

Check whether

1. The company has filed financial statements duly adopted at the annual general meeting of the
company, within thirty days of the date of annual general meeting.

2. The company has filed the financial statements with the Registrar together with Form AOC-4 as per Rule 12(1) of the Companies (Accounts) Rules, 2014.

3. Whether the company falls in the class of companies notified by the Central Government from time to time to mandatorily file their financial statement in Extensible Business Reporting Language (XBRL) format, and if yes, whether it has been filed in such manner.

4. Financial statements even if not adopted by members have been filed within the 30 days from the date of AGM.

5. After the holding of adjourned AGM, adopted financial statements are filed within 30 days of the date of adjourned AGM.

### Secretarial Audit Report (section 204)

**Check whether**

The Secretarial Audit Report in Form No. MR.3, pursuant to section 204 read with the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 is annexed to the Board’s report forming part of the financial statements.

### Report on Annual General Meeting( section 121)

**Check whether**

1. In case of a listed company, it has filed with the Registrar in Form No. MGT.15 of the Companies (Management and Administration) Rules, 2014 the report on the AGM, within thirty days of the conclusion of the annual general meeting.

2. The report is duly signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing director, if there is one and company secretary of the company.

### Other Important Returns

**Return of Allotment (Section 39)**

**Check whether**

1. In case company makes any allotment of its securities, it has, within thirty days thereafter, filed with the Registrar a return of allotment in Form PAS-3 as per Companies (Prospectus and Allotment of Securities) Rules, 2014.

2. A certified list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees was attached with PAS-3. Certification has been done by the same person who certifies PAS-3.

3. If the company has allotted securities as fully or partly paid up for consideration other than cash, whether a copy of the contract, duly stamped, or where the contract is not in writing complete particulars of the contract stamped is attached to the Form PAS-3. In such a case, whether a report of a registered valuer in respect of valuation of the consideration was also attached to PAS-3.

4. In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares was attached to the Form PAS-3.
Return on Buy-Back of Securities (section 68)

**Check Whether**

1. The buy back of securities has been in accordance with Section 68 read with Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014.
2. The buy-back of securities has been authorized by a special resolution passed in general meeting.
3. The company has filed the Letter of Offer in Form No. SH-8 in accordance with Companies (Share Capital and Debentures), Rules, 2014, with the Registrar.
4. The company has filed the Declaration of Solvency in Form No. SH-9 in accordance with Companies (Share Capital and Debentures), Rules, 2014 with the Registrar along with the Letter of Offer. In case of Listed company, the Letter of Offer has also to be filed with SEBI.
5. The Declaration of Solvency is signed by two directors, one of whom shall be Managing Director, where there is one and is verified by an affidavit.
6. The Letter of Offer is dispatched to the security holders not later than twenty days from its date of filing with the Registrar. For this purpose, the proof of dispatch may be verified.
7. The company has maintained a Register of Securities bought back in Form No. SH-10 and the entries therein have been authenticated by the Secretary or by any other person authorized by the Board.
8. The company has, after the completion of the buy-back, filed with the Registrar and where it is a listed company, with SEBI, a return on buy-back in Form No. SH-11 as per the Companies(Share Capital and Debentures) Rules, 2014 within 30 days of such completion.
9. A certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder was attached with the return.

Notice for alteration of share capital (section 64)

**Check whether**

1. Articles of Association contains the power to alter share capital.
2. Company has filed a notice with the registrar within a period of thirty days of such alteration along with altered memorandum.
3. The notice is in Form No. SH.7 of the Companies (Share Capital and Debentures) Rules, 2014.

Return of changes in shareholding position of Promoters and top 10 shareholders (Section 93 read with Rule 13 of the Companies (Management and Administration) Rules, 2014)

**Check whether**

1. In the case of a Listed Company, the company has filed Form No. MGT.10 with the Registrar with fee with respect to changes relating to either increase or decrease of two percent, or more in the shareholding position of promoters and top ten shareholders of the company in each case, either by value or volume of the shares, within fifteen days of such change.

Registration of Resolutions and Agreements (section 117)

Following resolutions are required to be filed with ROC:

(a) **special resolution**

Section 114 (2) provides that a resolution shall be a special resolution when-
i. the intention to propose the resolution as a special resolution has been duly specified in the notice
calling the general meeting or other intimation given to the members of the resolution;

ii. the notice required under this Act has been duly given; and

iii. the votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll,
as the case may be, by members who, being entitled so to do, vote in person or by proxy or by
postal ballot, are required to be not less than three times the number of the votes, if any, cast
against the resolution by members so entitled and voting.

The following matters require sanction by special resolution:

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c) Board Resolution/agreement relating to appointment etc of managing director

d) Resolution passed by class of members

e) Members' resolutions authorising the board to excercise powers under section 180(1)(a) &(c)

(f) Resolutions for winding up under section 304

(g) Board resolutions for exercising following powers:
   i. Make call
   ii. Buy back of securities
   iii. Issuing securities
   iv. Borrowing monies
   v. Investing funds
   vi. Granting loans/ giving guarantees/providing securities
   vii. Approving financial statement and Board’s report
   viii. Diversifying business
   ix. Approving amalgamation/merger/ reconstruction
   x. Taking over of a company/acquiring control in substantial stake in another company
      Serial No. (I-X) above as per section 179(3)
   xi. Making political contributions
   xii. Appointing or removing KMP
   xiii. Noting appointment/ removal of personnel one level below KMP
   xiv. Appointing internal auditor
xv. Appointing secretarial auditor
xvi. Noting disclosure of interest by directors
xvii. Buying and selling investments (other than trade investments) in excess of 5% of paid up capital and free reserves of investee company
xviii. Inviting / accepting / renewing public deposits
xix. Changing terms of public deposits
xx. Approving periodical financial results


Check whether

1. A copy of every resolution as above or any agreement, together with the explanatory statement under section 102, if any, is filed with the Registrar within thirty days of the passing or making thereof in Form No. MGT.14 as per Companies (Management and Administration) Rules, 2014, along with the fee.

2. The copy of every resolution which has the effect of altering the articles and the copy of every agreement has been embodied in or annexed to every copy of the articles issued after passing of the resolution or making of the agreement.(Sec 117(1) proviso).

Return of Appointment of Managerial Personnel (section 196)

Check whether

1. The Board has passed a resolution for the appointment of Managerial Personnel, viz. managing director, whole-time director or manager, subject to approval by members at the next general meeting.

2. The notice convening the board/general meeting for considering the appointment includes the terms and conditions of such appointment and remuneration payable and other matters, including interest of director(s) in such appointments, if any.

3. a return of appointment of a Managing Director, Whole Time Director or Manager, Chief Executive Officer (CEO), Company Secretary and Chief Financial Officer (CFO) has been filed within sixty days of the appointment, with the Registrar in Form No. MR.1 as per Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 along with such fee as may be specified for this purpose.

4. The provisions of Section 203 of the Act relating to the appointment of Key Managerial Personnel and the Rules thereunder have been complied with i.e.
   (a) Company was required to have whole time KMP and as such has appointed KMP.
   (b) Chairperson of the company is not the Managing director or CEO of the company.
   (c) Chairperson of the company is the Managing director or CEO of the company, but has been authorised by the articles.
   (d) Chairperson of the company is the Managing director or CEO of the company, since company has multiple business.
   (e) Board Resolution was passed for appointment of company secretary containing terms and conditions and remuneration.
   (f) None of the KMPs hold such office in more than one company.
(g) KMPs hold a similar position which is a subsidiary company.
(h) None of the KMPs is a director in any other company.
(i) KMPs are directors in other companies with the permission of the Board.
(j) KMPs holding such position as on 1st April 2014 in more than one company have chosen to be KMP of only one company within a period of six months.
(k) A person is appointed as managing director/manager in two companies with the unanimous approval of the board for which specific notice was given.
(l) Vacancy created in the position of KMP was filled in six months.

**Particulars of Appointment of Directors and key managerial personnel (section 170)**

**Check whether**

*In case of appointment:*

1. The person to be appointed as director has given his consent to act as director to the company in Form No. DIR-2.
2. The company has filed Form No. DIR-12 as per Companies (Appointment and Qualification of Directors) Rules, 2014 along with such consent in DIR-2 with the Registrar within thirty days of such appointment.

*In case of change*

3. The company has received the notice of resignation from the director in writing.
4. The company has filed Form No. DIR-12 as per Companies (Appointment and Qualification of Directors) Rules, 2014 along with notice of resignation within thirty days of such change.

**Return of Deposits (Chapter V)**

**Check whether**

1. Every company referred to in sub-section(2) of section 73 and every eligible company intending to accept deposits has issued a circular or a circular in the form of advertisement respectively in Form DPT-1 and has complied with the requirements of Rule No. 4 of Companies (Acceptance of Deposits) Rules, 2014.
2. Whether the provisions relating to Deposit Insurance have been complied with; (Rule 5)
3. Whether the company has created security for repayment of deposit and interest; (Rule 6)
4. Whether the company has appointed Trustees for secured deposit in the manner and Deposit Trust Deed has been executed; (Rule 7)
5. Whether the company has maintained liquid assets and created a Deposit Repayment Reserve Account; (Rule 13);
6. The company has on or before the 30th day of June, of every year, filed with the Registrar, a return in Form DPT-3.(Rule 16)
7. Check whether the form DPT-3 contains the information therein as on the 31st day of March of that year duly audited by the auditor of the company.
8. Whether Register of Deposits has been maintained; (Rule 14)
Particulars of Beneficial Interest in Shares (section 89)

Check whether

1. The company has received the declaration from the member/beneficial owner in the prescribed form MGT-4/MGT-5.

2. Such declaration is noted in the register of members.

3. The company has filed within 30 days of the receipt of the declaration, a return in Form No.MGT.6 as per Companies (Management and Administration) Rules, 2014 with the Registrar in respect of such declaration with fee.

Registration of Creation/Modification/Satisfaction of Charge

Check whether

1. The company has created or modified charge on its property, and the particulars of the charge created or modified are filed with the Registrar within thirty days of its creation or modification in Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification).

2. A copy of every instrument evidencing any creation or modification of charge, filed with the Registrar is verified as follows-
   (a) Where the instrument or deed relates solely to the property situated outside India, the copy is verified by a certificate issued either under the seal of the company, or under the hand of any director or company secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;
   (b) Where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy is verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

3. The company has given intimation to the Registrar of the payment or satisfaction in full of any charge within a period of thirty days from the date of such payment or satisfaction in Form No.CHG-4 along with the fee.

4. In case the particulars of creation or modification of charge has not been filed within 300 days of the date of creation or modification with additional fees or the particulars of satisfaction of charge are not filed within 30 days from the date of satisfaction, the delay has been condoned by Central Government. [Rule 12 of the Companies (Registration of Charges) Rules, 2014].

CHECKLIST- FEMA REGULATIONS

The students are advised to refer to the master circular from RBI website to know the details of compliances referred in the check list given in this chapter

FOREIGN DIRECT INVESTMENT

The Reserve Bank of India (RBI) has issued Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000 (the Regulations) which inter alia provides for the issue or acquisition of shares/convertible debentures and preference shares, manner of receipt of funds, pricing guidelines and reporting of the investments to the Reserve Bank.
Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issues a “Consolidated FDI Policy Circular” on an yearly basis elaborating the policy and the process in respect of FDI in India, that incorporates the amendments made to the regulations. Reserve Bank of India also compiles all the circulars issued, through a master circular on foreign investment in India(master circular)which is issued on July 01st of every year. The circular is available at www.rbi.org.in.

Under the Foreign Direct Investments (FDI) Scheme, investments can be made in shares, mandatorily and fully convertible debentures and mandatorily and fully convertible preference shares of an Indian company by non-residents through two routes.

**Automatic Route:** Under the Automatic Route, the foreign investor or the Indian company does not require any approval from the Reserve Bank or Government of India for the investment.

**Government Approval Route:** Under the Government Route, the foreign investor or the Indian company should obtain prior approval of the Government of India(Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, as the case may be) for the investment.

**Prohibited activities/ sector as provided under FDI Policy:**

1. Lottery business including Government/ private lottery, online lotteries, etc.
2. Gambling and betting including casinos, etc.
3. Chit funds
4. Nidhi company
5. Trading in TDRs
6. Real estate business or construction of farm houses
7. Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
8. Activities/ sectors not open to private sector investment, e.g., Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems).Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities.

**Type of instruments to be issued to person resident outside India**

Indian companies can issue equity shares, fully and mandatorily convertible debentures and fully and mandatorily convertible preference shares.

Issue of other types of preference shares such as non-convertible, optionally convertible or partially convertible, has to be in accordance with the guidelines applicable for External Commercial Borrowings (ECBs).

**Checklist on Foreign Direct Investment under Automatic Route**

1. Check the eligibility of the person investing in FDI.
2. Check whether the total FDI is within the sectoral cap and not under prohibited sectors.
3. Check whether the company has complied with pricing guidelines for FDI while issuing fresh shares
to persons resident outside India.

4 Check whether consideration received for FDI is as per the permitted modes of payment.

5 Check whether any rights/bonus issue has not resulted in FDI exceeding sectoral cap.

6 Check whether the Company has issued shares under ESOP scheme to persons resident outside India. If so check whether the face value of shares under ESOP scheme does not exceed 5% of the paid up capital of the company. Check whether the shares are allotted to citizens of Bangladesh/Pakistan.

7 Check whether the Company has converted ECBs into equity shares? If so whether the conditions stipulated are fulfilled.

8 Check whether the Company issued equity shares against import of capital goods/machinery, equipment etc. If so whether conditions stipulated in this regard is complied.

9 Check whether the company has complied with issue of shares if any against pre-operative/pre-incorporation expenses.

10 Check whether the company has issued shares under ADR/GDR. If so whether conditions stipulated are fulfilled.

11 Check whether the FDI does not exceed sectoral cap as a result of issue of shares under the scheme of merger.

12 Check whether the guidelines is followed while calculating total foreign investment.

13 Check whether the company as complied with requirements with respect to transfer of shares from person Resident to non resident or non resident to resident, resulting in change in FDI.

14 Check whether the company has informed about the inflow of funds within 30 days from the date of receipt.

15 Check whether the equity instruments are issued within 180 days of receipt of funds.

16 Check whether the company issuing shares under automatic route has reported the issue of shares(including shares issued under ESOP) in form FC-GPR within 30 days from the date of issue of shares. Also check whether a certificate from PCS is attached for compliance.

17 Check whether the reporting for FDI for transfer of shares is made in Form FC-TRS.

18 Check whether the reporting of conversion of ECB into equity in form ECB-2 along with FC-GPR.

19 Check whether the company has reported the issue of ADR/GDR in prescribed form.

**Foreign Direct Investment under Approval Route**

1 Check whether prior approval of Foreign Investment Promotion Board is obtained for FDI which are in excess of sectoral cap.

2 Check whether the shares issued to person who is a citizen of Bangladesh or an entity incorporated in Bangladesh/ Pakistan under the FDI Scheme is with the prior approval of the FIPB. And is subject to the prohibitions applicable.

3 Check whether the conversion of import payables / pre incorporation expenses / share swap is treated as consideration for issue of shares with the approval of FIPB.

4 Check whether the FDI in a non SME has exceeded 24% of paid up capital or sectoral cap whichever is lower, if such non SME has industrial licence for products reserved for SMEs? If so prior approval of FIPB is obtained?
5. Check whether there is any transfer of shares from resident to non-resident which requires FIPB approval.

6. Check whether the issue of shares to a non-resident against shares swap i.e., in lieu for the consideration which has been paid for shares acquired in the overseas company, can be done with the approval of FIPB.

7. Check whether the company has complied with reporting requirements for issue of shares under approval route.

**Direct Investment by Residents in Joint Venture/Wholly Owned Subsidiary Abroad**

Overseas investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues for promoting global business by Indian entrepreneurs. Joint Ventures are perceived as a medium of economic and business co-operation between India and other countries. Transfer of technology and skill, sharing of results of R&D, access to wider global market, promotion of brand image, generation of employment and utilisation of raw materials available in India and in the host country are other significant benefits arising out of such overseas investments. They are also important drivers of foreign trade through increased exports of plant and machinery and goods and services from India and also a source of foreign exchange earnings by way of dividend earnings, royalty, technical know-how fee and other entitlements on such investments.

Section 6 of the Foreign Exchange Management Act, 1999 provides powers to the Reserve Bank to specify, in consultation with the Government of India the classes of permissible capital account transactions and limits up to which foreign exchange is admissible for such transactions. Section 6(3) of the aforesaid Act provides powers to the Reserve Bank to prohibit, restrict or regulate various transactions referred to in the sub-clauses of that sub-section, by making Regulations.

Accordingly Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 vide Notification No. FEMA.120/RB-2004 dated July 7, 2004 was notified which seeks to regulate acquisition and transfer of a foreign security by a person resident in India i.e. investment by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India.

**General Permission**

In terms of Regulation 4 of the Notification, general permission has been granted to persons residents in India for purchase/acquisition of securities in the following manner:

- (a) out of the funds held in RFC account;
- (b) as bonus shares on existing holding of foreign currency shares; and
- (c) when not permanently resident in India, out of their foreign currency resources outside India.

General permission is also available to sell the shares so purchased or acquired.

**Overseas Investment can be made under two routes viz. Automatic Route and Approval Route.**

**Prohibitions**

Indian parties are prohibited from making investment in a foreign entity engaged in real estate (meaning buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or bridges) or banking business, without the prior approval of the Reserve Bank.

An overseas entity, having direct or indirect equity participation by an Indian party, shall not offer financial
products linked to Indian Rupee (e.g. non-deliverable trades involving foreign currency, rupee exchange rates, stock indices linked to Indian market, etc.) without the specific approval of the Reserve Bank. Any incidence of such product facilitation would be treated as a contravention of the extant FEMA regulations and would consequently attract action under the relevant provisions of FEMA, 1999.

A master circular on Overseas Direct Investment was issued by RBI on July 01 every year which is available at www.rbi.org.in.

**Direct Investment outside India – Automatic Route**

1. Check whether the investment (total financial commitment) in overseas Joint Ventures/Wholly Owned Subsidiaries(WOS) does not exceed 100% of the networth as on the date of last audited Balance Sheet of Indian Party/
2. Check whether the Indian entity has extended loan or guarantee if any only to overseas JV/WOS in which it has equity participation?
3. Ensure that the company has not created any change on immovable/movable property/financial assets of Indian party in favour of a non-resident entity.
4. Ensure that the Indian party is not in RBI’s Exporters caution list/list of defaulters.
5. Ensure that all transactions relating to JV/WOS is routed through one branch of an authorised dealer bank to be designated by Indian Party.
6. In case of partial/full acquisition of an existing foreign company, where investment is more than USD 5 million, the valuation of shares was made by Category I Merchant Banker/appropriate regulatory authority in a host country and in other cases by a chartered accountant.
7. Ensure that shares acquired in any in exchange of ADRs/GDRs fulfils the criteria specified.
8. Ensure that investment if any, in Nepal is made only in Indian Rupees.
9. Ensure that the reporting of ODI is made in form ODI within 30 days from the date of transaction
10. Check whether the issue of guarantee by an Indian Party to stepdown subsidiary of JV/WOS is as per the conditions stipulated.
11. Ensure that the funding of ODI is as per the norms prescribed.
12. Ensure that the capitalisation of exports and other dues is as per the conditions stipulated.
13. Ensure that additional conditions for financial services sectors is fulfilled, if applicable.
14. Check whether the transfer of shares by resident to another resident or non-resident as the case may be subject to the prescribed conditions.
15. Check whether the obligation of Indian party is fulfilled such as reporting of remittances, Annual Performance Report.

**Direct Investment outside India – Approval Route**

1. Check whether prior approval of Reserve Bank of India is obtained in all cases which are not covered under the automatic route.
2. Check whether specific approval of RBI is obtained for creating charge on immovable / moveable property and other financial assets (except pledge of shares of overseas JV / WOS) of the Indian party / group companies in favour of a non-resident entity within the overall limit fixed (presently 100%) for the financial commitment subject to submission of a ‘No Objection’ by the Indian party and their group companies from their Indian lenders
3. Whether approval of RBI is obtained for issuance of corporate guarantee on behalf of second
generation or subsequent level step down operating subsidiaries.

4. Check whether the investment by Indian Mutual funds registered with SEBI is as per the norms

5. Check whether FIPB approval is obtained if the investment is by share swaps.

**EXTERNAL COMMERCIAL BORROWING**

ECBs refer to commercial loans in the form of bank loans, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares), buyers' credit, suppliers' credit availed of from non-resident lenders with a minimum average maturity of 3 years.

Foreign Currency Convertible Bonds (FCCBs): FCCBs mean a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency. The bonds are required to be issued in accordance with the scheme viz., "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993", and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments. The ECB policy is applicable to FCCBs. The issue of FCCBs is also required to adhere to the provisions of Notification FEMA No. 120/RB-2004 dated July 7, 2004, as amended from time to time.

Preference shares: Preferences Shares (i.e. non-convertible, optionally convertible or partially convertible) for issue of which, funds have been received on or after May 1, 2007 would be considered as debt and should conform to the ECB policy. Accordingly, all the norms applicable for ECB, viz. eligible borrowers, recognized lenders, amount and maturity, end use stipulations, etc. shall apply. Since these instruments would be denominated in Rupees, the rupee interest rate will be based on the swap equivalent of LIBOR plus the spread as permissible for ECBs of corresponding maturity.

Foreign Currency Exchangeable Bonds (FCEBs): FCEBs means a bond expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency, issued by an Issuing Company and subscribed to by a person who is a resident outside India, in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments. The FCEBs must comply with the "Issue of Foreign Currency Exchangeable Bonds (FCEB) Scheme, 2008", notified by the Government of India, Ministry of Finance, Department of Economic Affairs vide Notification G.S.R.89(E) dated February 15, 2008. The guidelines, rules, etc. governing ECBs are also applicable to FCEBs.

ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.

The master circular on External Commercial Borrowings and Trade Credits was issued on July 1st 2013 which is available at www.rbi.org.

**External Commercial Borrowing**

**Automatic Route**

1. Check the Eligibility of borrower; whether the borrower obtained Loan Registration Number by submitting form 83 to RBI.

2. Check the recognition of lender.

3. Check whether the maximum amount of ECB by a corporate other than those in the hotel, hospital and software sectors is within USD 750 million or its equivalent during a financial year.

4. Check whether ECB by Corporates in the services sector viz. hotels, hospitals and software sector is not more than USD 200 million or its equivalent in a financial year.
5 Check whether NGOs engaged in micro finance activities and Micro Finance Institutions (MFIs) raises ECB not more than USD 10 million or its equivalent during a financial year.

6 Check whether NBFC-Infrastructure Finance Companies avail of ECB up to 75 per cent of their owned funds (ECB including outstanding ECBs) and hedge 75 per cent of their currency risk exposure.

7 Check whether NBFC Asset Finance Companies avail of ECBs up to 75 per cent of their owned funds (ECB including outstanding ECBs) subject to a maximum of USD 200 million or its equivalent per financial year with a minimum maturity of 5 years and must hedge the currency risk exposure in full.

8 Check whether SIDBI avail of ECB to the extent of 50 per cent of their owned funds including the outstanding ECB, subject to a ceiling of USD 500 million per financial year.

9 Check whether ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.

10 Check whether ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.

11 Check whether ECB up to USD 20 million or equivalent having call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.

12 Check the permitted End use requirements.

13 Check ECB proceeds parked overseas is invested in the permitted liquid assets.

14 Check the Prepayment of ECB is up to USD 500 million and in compliance with the stipulated minimum average maturity period as applicable to the loan.

15 Check whether the existing ECB is refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

16 Check All in Cost Ceiling prescribed.

**External Commercial Borrowing under Approval route**

1 Check the Eligibility of borrower

2 Check the recognition of lender.

3 Check whether total outstanding stock of ECBs (including the proposed ECBs) from a foreign equity lender should not exceed seven times the equity holding, either directly or indirectly of the lender (in case of lending by a group company, equity holdings by the common parent would be reckoned)

4 Check the All in cost Ceiling.

5 Check the permitted end use requirements.

6 Check whether the parking of ECB funds is as per the norms.

7 Check whether RBI permission is obtained for Pre-payment of ECB for amounts exceeding USD 500 million.

8 Check the provisions regarding refinancing/rescheduling of ECB if any.

**Issue of FCCBs**

1 Check whether the fresh ECBs/ FCCBs is raised with the stipulated average maturity period and
applicable all-in-cost being as per the extant ECB guidelines

2 The amount of fresh ECB/FCCB shall not exceed the outstanding redemption value at maturity of the outstanding FCCBs.

3 The fresh ECB/FCCB shall not be raised six months prior to the maturity date of the outstanding FCCBs.

4 ECB / FCCB beyond USD 500 million for the purpose of redemption of the existing FCCB will be considered under the approval route.

5 The proposal of Buyback / prepayment of FCCBs from Indian Companies may be considered subject to condition that the buyback value of the FCCBs shall be at a minimum discount of five per cent on the accreted value.

### Issue of FCEBs

1 Check whether the Issuing Company is a part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of FCEB.

2 Check whether the Offered Company is a listed company, which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond (FCCB) or External Commercial Borrowings (ECB).

3 Check whether the Indian company, which is eligible to raise funds from the Indian securities market, including a company which has not been restrained from accessing the securities market by the SEBI.

4 Check the Entities complying with the Foreign Direct Investment policy and adhering to the sectoral caps at the time of issue of FCEB and Prior approval of the Foreign Investment Promotion Board, wherever required under the Foreign Direct Investment policy, has been obtained.

5 Check whether the Entities are not prohibited to buy, sell or deal in securities by the SEBI.

6 Check the End-use of FCEB proceeds prescribed.

7 Check whether Minimum maturity of FCEB is five years.

8 Check the conditions for Parking of FCEB proceeds abroad.

9 Check the Pricing of norms of FCEB.

### LESSON ROUNDUP

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

- The purpose of a company, formed as a commercial enterprise, is mainly to make profits by carrying on its business and maximize its wealth. While doing so, a company is directed by the Board of Directors, which is assisted by officers and professionals.

- General Compliance required that whether the company has kept and maintained all the statutory registers, filed all forms, returns and notices to the prescribed authorities as per the provisions of the Companies Act, 2013 and mention the name of each register, return, form or notice together with date of filing of the return, form or notice.
• The objective of FEMA and the rules and regulations made thereunder is to facilitate economic development and at the same time open up the markets to remove the geographical barriers so that opportunities are available to be capitalised by those who seek to do so. The enactment of FEMA has also signalled a new era of liberalization and the continued removal of restrictions by means of notifications issued under various rules and regulations falling under FEMA.

SELF TEST QUESTIONS

1. Today adoption of good governance practices has emerged as an integral element for doing business. Compliances are being regarded as value addition measures to Corporate Governance. Comment.

2. Prepare a check list on Buy-back of shares by your Company, where you are the Company Secretary.

3. Prepare a check list on Company’s Inter-corporate loan and investments under Companies Act, 2013.

4. Briefly discuss about reporting requirement under Foreign Direct Investment.

5. Indian party desired to invest in outside India. Advise as a PCS.
Lesson 4
Issue of Securities

LESSON OUTLINE

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

LEARNING OBJECTIVES

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

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

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

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

Public         Rights     Private placement

- Public Placement (For unlisted companies)
- Further Public Offering (For listed companies)
- Fresh Issue
- Offer for sale
- Preferential Issue (For listed companies)
- Qualified Institutional Placement (For listed companies)
- Initial Public Offering (For unlisted companies)
- Fresh Issue
- Offer for sale

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)**

When an issue of shares or convertible securities is made by an issuer to its existing shareholders as on a particular date fixed by the issuer (i.e. record date), it is called a rights issue. The rights are offered in a particular ratio to the number of shares or convertible securities held as on the record date.

**Bonus issue**

When an issuer makes an issue of shares to its existing shareholders without any consideration based on the number of shares already held by them as on a record date 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.
Private Placement

When an issuer makes an issue of shares or convertible securities to a select person or group of persons not exceeding 200 in a financial year, and which is neither a rights issue nor a public issue or bonus issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of three types:

Preferential Issue

When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter VII of SEBI (ICDR) Regulations, 2009, it is called a preferential issue. The issuer is required to comply with various provisions which inter-alia include pricing, disclosures in the notice, lock-in etc, in addition to the requirements specified in the Companies Act.

Qualified institutions placement (QIP)

When a listed issuer issues equity shares or non-convertible debt instruments along with warrants and convertible securities other than warrants to Qualified Institutions Buyers only, in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, 2009, it is called a QIP.

Institutional Placement Programme (IPP)

When a listed issuer makes a further public offer of equity shares, or offer for sale of shares by promoter / promoter group of listed issuer in which, the offer allocation and allotment of such shares is made only to QIBs in terms of chapter VIII A of SEBI (ICDR) Regulations, 2009 for the purpose of achieving minimum public shareholding it is called an IPP.

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

The SEBI (ICDR) Regulations, 2009 is applicable to listed companies. The various types of issues include:

(i) a public issue;
(ii) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;
(iii) a preferential issue;
(iv) an issue of bonus shares by a listed issuer;
(v) a qualified institutions placement by a listed issuer;
(vi) an Institutional Placement Programme;
(vii) an issue of Indian Depository Receipts.

Primarily, issues made by an Indian company can be classified as Public, Rights, Bonus and Private Placement. While rights issues by a listed company and public issues involve a detailed procedure, bonus issues and private placements are relatively simpler.

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.
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.

Checklist for compliances under SEBI (ICDR) Regulations, 2009

**GENERAL COMPLIANCES**

1. Check the refund orders / certificate of posting in the event of non-receipt of minimum subscription all application moneys received has been refunded to the applicants within:
   - i. fifteen days of the closure of the issue, in case of a non-underwritten issue; and
   - ii. seventy days of the closure of the issue, in the case of an underwritten issue where minimum subscription including devolvement obligations paid by the underwriters is not received within sixty days of the closure of the issue.

2. Check whether the monitoring agency appointed in case where the issue size exceeds five hundred crore rupees has submitted its report to the issuer on half yearly basis, till the proceeds of the issue have been fully utilised.

3. Check the refund orders / certificate of posting to ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue and interest undertaken in the offer document paid in case of delayed payments.

4. Whether the issuer has altered the terms (including the terms of issue) of specified securities which and the same may adversely affect the interests of the holders of that specified securities, if so, the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class has been obtained. Check compliance with Section 27(2) of the Companies Act, 2013, if any.

5. Whether the specified securities held by promoters and locked-in are pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution, if so the provision in the regulations are complied with.

6. Whether the application money received has been utilised in accordance with the section 40 of Companies Act, 2013.

7. Whether the disclosures made in the red herring prospectus while making an initial public offer are updated on an annual basis by the issuer and made publicly accessible.

8. Check whether the outstanding subscription money is called within twelve months from the date of allotment in the issue and where the applicant has failed to pay the call money within the twelve months, such shares have been forfeited.

9. Check the copy of compliance certificate filed by the merchant banker, for the compliances with regard to news reports for the period between the date of filing the draft offer document with SEBI and the date of closure of the issue.
Conditions for making initial public offer (Regulation 26)

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

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

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

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

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

The issuer may obtain grading for the initial public offer from at least one credit rating agency registered with SEBI.

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

Warrants may be issued along with public issue or rights issue of specified securities subject to the following: (a) the tenure of such warrants shall not exceed twelve months from their date of allotment in the public/rights issue; (b) not more than one warrant shall be attached to one specified security.

* Companies Act, 2013 is notified.
Limit regarding money proposed to be spent on General Corporate Purposes (Regulation 4(4))

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

Who is not eligible for making Public Offer?

(a) The issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by SEBI;

(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 SEBI;

(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, 2013
- Securities Contracts (Regulation) Act, 1956
- Foreign Exchange Management Act, 1999
- Securities Contracts Regulation (Rules) 1957
- SEBI (ICDR) Regulations 2009
- Listing Agreement

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

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

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

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

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

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

Key areas to be focused:

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

Illustrative list of documents/information to be examined:

**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.

**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.

**Financials**

1. Projections of combined operations (existing + proposed) for 5 years including the following:
   - Income details including prices
   - Cash flow and Balance Sheet
   - Capacity utilization details
   - Interest calculation – Assessment of rate/Repayment schedule
   - Depreciation
   - Tax
   - Assumptions w.r.t. cost items
   - Commencement of commercial production (Year to be mentioned)
   - IT depreciation table for past (in case projections have to be prepared)
   - Latest provisional accounts with all schedules
   - Latest income Tax Depreciation calculation
   - Input-Output ration (consumption norms) for each segment alongwith prices and input prices
— Services-wise capacity & Capacity utilization projects for the next 5 years
— Working Capital norms
— Basis for working out various expenses
— Month from which the commercial production will commence for the new project
— IT depreciation table for past.

2. Bankers to the Company – name & addresses.

3. Details of Banks Loan, Term Loan, Promissory notes, Hundis, Credit Agreements, Lease, Hire Purchase, Guarantees or any other evidences of indebtedness, Copies of Sanction letters, Original amount, Interest rate, Amount outstanding, Repayment schedule.

4. Details of default/reschedulings, 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


(iv) Project Information

1. Project Feasibility report

2. Reports/documents prepared by independent research agencies in respect of the state of the industry and demand and supply for the company’s products

3. Break-up of Cost of Project:
   — Land – Locational site & map, area, copy of documents i.e. Sale/lease Deed for land, Soil Test Report, Order for converting land into Industrial land etc.
   — Building – Details break-up from Architect, Approval details from Municipality etc. and Valuation Report from a chartered engg. (for existing building and suitability of site)
   — Equipments – Invoices/Quotations of main items. (Indicate Imported mach. Separately)
   — 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
   (a) Manpower
      (i) Break-up of employees – whether any agreements are entered into with employee – If so, copy of agreement
      (ii) Details of Pay scales/bonus (including performance bonus)/PF/ Gratuity etc.
      (iii) Employment of contract labour – no. of workers, copy of contract.
   (b) Quality Control facilities, Research & Development.
10. Market (Demand/supply with sources alongwith copies),
11. Marketing & Distribution (network etc.) & relevant documents wherever applicable.
12. Arrangements and strategy of the company for marketing its products
13. Discussions with important customers, suppliers, Joint Venture partners, collaborators of the company.

(v) General Information
1. Details on Litigation, Disputes, overdue, statutory dues, other Material development and tax status of Company & promoters.
2. Copies of IT returns of the Company along with copies of Assessment orders for last three years.
3. Copies of IT/Wealth tax returns of the promoter 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.
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
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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.


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

1. Appointments

   • Check whether the issuer has appointed one/more merchant bankers atleast one of whom shall the lead merchant banker, to carry out the obligations relating the issue.

   • If the merchant banker is an associate of an issuer it shall declare itself as marketing lead merchant banker and its role shall be limited to the marketing of the issue.

   • Check whether the issuer has appointed SEBI registered intermediaries in consultation with lead merchant banker.

   • Check whether the issuer has appointed syndicate member in respect of issue through book building.

   • Check whether the issuer appointed registrars who has connectivity with both depositories.(ie NSDL/CDSL)

   • Ensure that the lead merchant banker is not acting as registrar to the issue in which it is also handling post issue obligations.

   • Ensure that in case of book built issue lead merchant banker and lead book runner are not different persons.

2. Filings/approvals/submissions

   • Check whether the draft offer document is filed with SEBI at least thirty days prior to registering a prospectus, red herring prospectus or shelf prospectus with ROC or filing the letter offer with the registrar of companies.

   • Check whether the draft offer document is made available to the public for atleast 21 days from the date of such filing with SEBI.

   • Check whether a statement on the comments received from public on draft offer document is filed with SEBI.

   • 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.

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### Filing of Offer Document is

**Mandatory for:**

1. **All Public Issues**
2. **Rights Issue in excess of ₹50 lakhs or more**

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### 3. Pre issue-Due Diligence Certificates

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

- filing of draft offer document with SEBI.
- At the time of Registering prospectus with ROC.
- Immediately before opening of the issue.
- After the opening of the issue and before its closure before it closes for subscription.

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### 4. Time limitation in opening of issue

Ensure that subject to compliance with the Companies Act, 2013, public/rights issue is opened within:

- Twelve months from the date of issuance of observations from the SEBI on draft offer document or
- 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.

- In case of Fast Track issues the issue shall be opened within 90 days from the registration of prospectus with ROC.
(ii) In case of shelf prospectus, the first issue may be opened within 3 months from the date of observation of SEBI.

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

5. Dispatch of offer documents and other materials

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

6. Underwriting for issue through book building

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

7. Minimum Subscription

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

8. Minimum allottees

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

9. Monitoring agency

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

10. Time limitation for receiving the call money

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

11. Time limit for allotment or refund of Subscription money

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

12. Pricing

- Ensure the norms relating to price/price band, cap on price 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

- Ensure that the promoters’ contribution is:
  
  (a) in case of an initial public offer, not less than twenty per cent. of the post issue capital; In case the post issue shareholding of the promoters is less than twenty per cent., alternative
investment funds may contribute for the purpose of meeting the shortfall in minimum contribution as specified for promoters, subject to a maximum of ten per cent of the post issue capital.

(b) in case of a further public offer, either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital;

(c) in case of a composite issue, either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital excluding the rights issue component.

- Ensure that the promoters’ contribution is kept in an escrow account with a scheduled bank and shall be released to the issuer along with the release of issue proceeds.
- Ensure that the securities ineligible for promoters’ contribution is not included while calculating the above limits.
- Ensure that the minimum promoters contribution and excess promoters contribution is locked in for 3 years and one year respectively.

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

(a) specified securities acquired during the preceding three years, if they are:
   (i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or
   (ii) resulting from a bonus issue by utilisation of revaluation reserves or unrealized profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters’ contribution;

(b) Specified securities acquired by promoters and alternative investment funds during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer subject to certain specified exemptions.

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

(d) Specified securities pledged with any creditor.

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

14. Lock in requirements

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

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

(a) minimum promoters’ contribution including contribution made by alternative investment funds,
referred to in proviso to clause (a) of sub-regulation (1) of regulation 32, shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later;

(b) promoters’ holding in excess of minimum promoters’ contribution shall be locked-in for a period of one year: Provided that excess promoters’ contribution as provided in proviso to clause (b) of regulation 34 (in those cases where the minimum promoters’ contribution is not applicable) shall not be subject to lock-in. It may be noted that "date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

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

It does not apply to:

(a) equity shares allotted to employees under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with Part A of Schedule VIII;

(b) equity shares held by a venture capital fund or alternative investment fund of category I or a foreign venture capital investor. However, such equity shares shall be locked in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

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

The lock-in provisions of Chapter III Part IV shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation 45. The specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

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

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 2011 the specified securities held by promoters and locked-in as per regulation 36 may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and the specified securities held by persons other than promoters and locked-in as per regulation 37 may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred. The lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.
Minimum offer to the Public

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

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

(b) in case of a further public offer, is at least ten per cent or twenty five per cent of the issue size, as the case may be.

16. Reservation on Competitive Basis

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

  (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies

  (b) shareholders (other than promoters) of:
      
      (i) listed promoting companies, in case of a new issuer; and
      
      (ii) listed group companies, in case of an existing issuer

  (c) persons who, as on the date of filing the draft offer document with SEBI, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer.

- **For issue made other than through the book building process:**

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

  (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies

  (b) shareholders (other than promoters) of:
      
      (i) listed promoting companies, in the case of a new issuer; and
      
      (ii) listed group companies, in the case of an existing issuer.

- Ensure that reservations have not been made in respect of the following persons who are not eligible.

  (a) In case of promoting companies being financial institutions or state and central financial institutions, the shareholders of such promoting companies

  (b) In case of issue made through book building process, the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees;

- In case of a further public offer (not being a composite issue), the issuer may make reservation on
competitive basis out of the issue size excluding promoters’ contribution and net offer to public in favour of retail individual shareholders of the issuer.

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

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

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

17. Allocation in net offer to public

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

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

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

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

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

18. Period of subscription

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

<table>
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<tr>
<th>What is the Minimum and Maximum period of Subscription?</th>
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<tr>
<td>Minimum Period – 3 working days</td>
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<td>Maximum Period – 10 working days</td>
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19. Advertisements

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

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

- **Advertisement**
  
  Ensure that advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of dispatch of refund orders or instructions to Self Certified Syndicate Banks by the Registrar, date of dispatch of certificates and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

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

- Ensure that issuer, advisors, brokers or any other entity connected with the issue do not publish any advertisement stating that issue has been oversubscribed or indicating investors’ response to the issue, during the period when the public issue is still open for subscription by the public.

- Ensure that all public communications and publicity material issued or published in any media during the period commencing from the date of the meeting of the board of directors of the issuer in which the public issue or rights issue is approved till the date of filing draft offer document with SEBI 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 an IPO advertisement use models?*

*Can a product advertisement refer to the performance of the issues during subscription period?*

### 20. Minimum Application Value

Ensure that Minimum application Value is kept between ten thousand rupees to fifteen thousand rupees.

### 21. Allotment procedure and basis of allotment

The allotment of specified securities to applicants other than retain individual investors and anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer.
Provided that value of specified securities allotted to any person in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 42, shall not exceed two lakhs rupees.

The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

The executive director or managing director of the designated stock exchange along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified.

22. Appointment of Compliance officer

The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors’ grievances.

23. Redressal of investor grievances

The post-issue lead merchant bankers shall actively associate himself with post-issue activities such as allotment, refund, despatch and giving instructions to syndicate members, Self Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

24. Post issue diligence

(1) The lead merchant bankers shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.

(2) The lead merchant bankers shall call upon the issuer, its promoters or directors or in case of an offer for sale, the selling shareholders, to fulfil their obligations as disclosed by them in the offer document and as required in terms of these Regulations.

(3) The post-issue merchant banker shall continue to be responsible for post-issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application moneys and the listing agreement is entered into by the issuer with the stock exchange and listing/trading permission is obtained.

(4) The responsibility of the lead merchant banker shall continue even after the completion of issue process.

25. Post issue Reports

The lead merchant banker shall submit post-issue reports as follows:

(a) initial post issue report in specified form within three days of closure of the issue

(b) final post issue report in specified format within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue. The lead merchant banker shall also submit a due diligence certificate in the specified format along with the final post issue report.

The initial post issue monitoring report is to be sent within 3 days of closure of the issue and the final post issue report is to be sent within 15 days from the date of finalization of basis of allotment.
Annual Updation of Offer Document

The disclosures made in the red herring prospectus while making an initial public offer, shall be updated on an annual basis by the issuer and shall be made publicly accessible in the manner specified by SEBI.

ROLE OF COMPANY SECRETARY IN AN IPO

The plethora of services, which a Practising Company Secretary can render in IPOs can be listed as under:

1. Planning Stage
   (a) Deciding the time line
   (b) Compliance related issues
   (c) Importance of Corporate Governance
   (d) Structure of Board
   (e) Promoters consent
   (f) Method of issuance of shares (Demat/Physical/Both) - Compliance

2. Due diligence
   (a) Company Contract and Leases
   (b) Legal and Tax Issues
   (c) Corporate issues
   (d) Financial Assets
   (e) Financial Statement
   (f) Creditors & Debtors
   (g) Legal Cases against the company

3. Appointing Advisors and other intermediaries such as:
   (a) Investment Bankers
   (b) Book Running Lead Managers
   (c) Issues with Depository
   (d) Legal Advisor
   (e) Bankers

4. Offer Document
   (a) Drafting the offer document
   (b) Filing with SEBI
   (c) In-principle approval of Stock Exchange
   (d) Filing with Designated Stock Exchanges
   (e) Complying with Comments received from SEBI
   (f) Filing with ROC

5. Issue Period
   (a) Adhering to Issue Opening/Closing Date
   (b) Compiling Field Reports on subscription status
   (c) Coordinating with Registrar/Bankers to the issue
6. Allotment of shares
   (a) Basis of allotment
   (b) Board meeting for allotment
   (c) Crediting shares in beneficiary account/dispatch of share certificates
   (d) Despatch of refund orders
   (e) Payment of stamp duty

7. Listing
   (a) Filing for Listing with Designated Stock Exchange
   (b) Finalisation of Listing Process

8. Post issue compliances
   (a) To ensure proper compliance with Listing Agreement
   (b) Redressal of shareholder complaints
   (c) Timely filing of required reports with ROC/SEBI/Stock Exchange

As can be seen from the above, a Company Secretary is a key member in an IPO team. Apart from checking the applicability and eligibility norms or exemption from eligibility norms and the pre-listing requirements of Stock Exchange, he is responsible for ensuring that the company has complied with the pre-issue, issue and post-issue obligations of the company and corporate governance requirements including disclosures with respect to, inter alia, material contracts, statutory approvals, subsidiaries and promoter holding and litigations.

Compliance of SEBI (ICDR) Regulation 2009 and other applicable Acts and guidelines is a primary responsibility of the Company Secretary in case the company proposes to list its securities abroad, he is also required to comply with conditions for listing abroad.

### Activities to do

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<tr>
<td>1.</td>
<td>Reading and analyzing various offer documents published in newspaper</td>
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<td>2.</td>
<td>Reading various pre-issue and post issue advertisement</td>
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<tr>
<td>3.</td>
<td>Reading offer documents filed with SEBI</td>
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### 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 diligence of preferential issues by listed companies.

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

(a) Due Diligence Preferential issue of listed Companies- a Check list under Chapter VII of SEBI(ICDR) Regulations 2009

Non Applicability

(1) The provisions of this Chapter shall not apply where the preferential issue of equity shares is made:

(a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956*;

(b) pursuant to a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956*;

(c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985:

Provided that the lock-in provisions of this Chapter shall apply to such preferential issue of equity shares.

(2) The provisions of this Chapter relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993.

Section 2(h) of Recovery of Debts due to Banks and Financial Institutions Act, 1993, defines Financial Institutions as follows

“financial institution” means –

(i) a public financial institution within the meaning of section 4A of the Companies Act, 1956*;

(ia) the securitization company or reconstruction company which has obtained a certificate of registration under sub-section (4) of section 3 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(ii) such other institution as the Central Government may, having regard to its business activity and the area of its operation in India, by notification, specify.”

(3) The provisions of regulation 73 (Disclosures)and regulation 76(Pricing) shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where SEBI has granted relaxation to the issuer in terms of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.

(4) The provisions of sub-regulation (2) of regulation 72 and sub-regulation (6) of regulation 78 shall not apply to a preferential issue of specified securities where the proposed allottee is a Mutual Fund registered with SEBI or Insurance Company registered with Insurance Regulatory and Development Authority.

* Sub-section (3) and (4) of section 81 of the Companies Act, 1956 corresponding to section 62 of the Companies Act, 2013 is notified and section 391 to 394 of the Companies Act, 1956 corresponding to section 230 to 232, is yet to be notified.

* Section 4A of the Companies Act, 1956 corresponding to section 2 (72) of the Companies Act, 2013, is notified.
Check list for Preferential Issue

1. Check the Certified copy of the resolution passed by the Board of Directors of the company for the proposed preferential and the true copy of form MGT 14 and form SH 7 filed with the ROC.

2. Check whether the additional disclosures as specified in the regulations were also made in the explanatory statement o the notice for the general meeting proposed for passing special resolution.

3. Check whether the allotment pursuant to the special resolution in case of preferential issue has been completed within a period of fifteen days from the date of passing of such resolution.

4. Where allotment is:
   I) for consideration other than cash check the following documents:
      • Certified copy of valuation report
      • Certified copy of Shareholders Agreements.
      • Certified copy of approval letters from FIPB and RBI if applicable.
   II) pursuant to CDR Scheme/ Order of High Court/ BIFR check the following document:
      • Certified copy of relevant scheme/ order
   III) pursuant to conversion of loan of financial institutions check the following document:
      • Certified copy of the Loan Agreement executed by the company.

Check if the consideration is paid in cash, it was received from the respective allottee’s bank account.

5. Check whether the issuer company has complied with clause 35 of Listing Agreement w.r.t pledging of shares.

6. Check the copy of the confirmation submitted by the Managing Director/ Company Secretary of the issuer company w.r.t. compliance with the regulations.

7. Check whether the allotment has been made in dematerialised form.

1. Special Resolution
   • Check whether a special resolution has been passed by its shareholders;
   • The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

"Relevant date" means:

(a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date. Where the relevant date falls on a Weekend/Holiday, the day preceding the Weekend/Holiday will be reckoned to be the relevant date.
(b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

- The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956* or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:

  (a) the objects of the preferential issue;

  (b) the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;

  (c) the shareholding pattern of the issuer before and after the preferential issue;

  (d) the time within which the preferential issue shall be completed;

  (e) the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;

  (f) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;

  (g) an undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked-in till the time such amount is paid by the allottees.

2. Compulsory Dematerialisation

Check whether all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form.

3. Condition for continued listing

Check the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement.

4. Permanent Account Number of allottees

Check whether the issuer has obtained the Permanent Account Number of the proposed allottees.

5. Shares not to be allotted to persons who has sold any equity shares of the issuer in preceding six months

Ensure that the issuer has not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date: However, in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, SEBI may grant relaxation from the requirements of this sub-regulation, if SEBI has granted relaxation in terms of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, to such preferential allotment.

* Section 173 of the Companies Act, 1956 corresponding to section 102 of the Companies Act, 2013, is notified.
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, 2011, 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 SEBI has granted relaxation to the issuer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by SEBI 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.


The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.


(a) If listed for more than Twenty six weeks

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of six months or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:
(a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the Twenty six weeks preceding the relevant date; or

(b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(b) If listed for less than Twenty six weeks

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than Twenty six weeks as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:

(a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956∗, pursuant to which the equity shares of the issuer were listed, as the case may be;

or

(b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or

(c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

This price shall be recomputed by the issuer on completion of Twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these Twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

c. Preferential issue to qualified institutional buyer

Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

‘Stock exchange’ means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding six months prior to the relevant date.

11. Payment of consideration.

Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities:

Exceptions/Conditions

In case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

∗ Section 391 to 394 of the Companies Act, 1956 corresponding to section 230 to 232, is yet to be notified.
An amount equivalent to at least twenty five per cent. of the consideration shall be paid against each warrant on the date of allotment of warrants. The balance seventy five per cent. of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such shall be forfeited by the issuer.

12. Lock-in of specified securities.

The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be.

Exceptions/Conditions

Not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment:

Equity shares allotted in excess of the twenty per cent. shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be.

- The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of their allotment.
- The lock-in of equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.
- The equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment: However partly paid up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid up.

If the amount payable by the allottee, in case of re-calculation of price after completion of Twenty six weeks from the date of listing, is not paid till the expiry of lock-in period, the equity shares shall continue to be locked in till such amount is paid by the allottee.

- The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date upto a period of six months from the date of preferential allotment.

13. Transferability of locked-in specified securities and warrants issued on preferential basis.

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 2011, specified securities held by promoters and locked-in may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer:

However, that lock-in on such specified securities shall continue for the remaining period with the transferee.

**Test your Knowledge**

(i) Can locked in shares issued to promoters pursuant to preferential issue be transferred to other promoters?
Due diligence – Preferential issues of unlisted companies

On 01 April, 2014 the Ministry of Corporate Affairs (MCA) notified Companies (Share Capital and Debentures) Rules, 2014. According to rule 13 of the said rule, ‘Preferential Offer’ means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities.

**Key Highlights of Rule 13 of Companies (Share Capital and Debentures) Rules, 2014**

1. For the purposes of clause (c) of sub-section (1) of section 62, If authorized by a special resolution passed in a general meeting, shares may be issued by any company in any manner whatsoever including by way of a preferential offer, to any persons whether or not those persons include the persons referred to in clause (a) or clause (b) of sub-section (1) of section 62 and such issue on preferential basis should also comply with conditions laid down in section 42 of the Act.

However, the price of shares to be issued on a preferential basis by a listed company shall not be required to be determined by the valuation report of a registered valuer.

2. Where the preferential offer of shares or other securities is made by a company whose share or other securities are listed on a recognized stock exchange, such preferential offer shall be made in accordance with the provisions of the Act and regulations made by the Securities and Exchange Board, and if they are not listed, the preferential offer shall be made in accordance with the provisions of the Act and rules made hereunder and subject to compliance with the following requirements, namely:-

(a) the issue is authorized by its articles of association;

(b) the issue has been authorized by a special resolution of the members;

(c) the securities allotted by way of preferential offer shall be made fully paid up at the time of their allotment.

(d) The company shall make the disclosures prescribed in this rule in the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 of the Act.

(e) the allotment of securities on a preferential basis made pursuant to the special resolution passed pursuant to sub-rule (2)(b) shall be completed within a period of twelve months from the date of passing of the special resolution.

(f) if the allotment of securities is not completed within twelve months from the date of passing of the special resolution, another special resolution shall be passed for the company to complete such allotment thereafter.

(g) the price of the shares or other securities to be issued on a preferential basis, either for cash or for consideration other than cash, shall be determined on the basis of valuation report of a registered valuer.

(h) where convertible securities are offered on a preferential basis with an option to apply for and get equity shares allotted, the price of the resultant shares shall be determined beforehand on the basis of a valuation report of a registered valuer and also complied with the provisions of section 62 of the Act.

(i) where shares or other securities are to be allotted for consideration other than cash, the valuation of such consideration shall be done by a registered valuer who shall submit a valuation report to the company giving justification for the valuation.
(j) where the preferential offer of shares is made for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company-

(i) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

(ii) where clause (i) is not applicable, it shall be expensed as provided in the accounting standards.

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.

Checklist for compliances under SEBI (ESOS & ESPS) Guidelines

For listed companies

1. Whether the company has used the direct route or trust route for issue of ESOP?

2. If the company is using the direct route, then check the terms and conditions of ESOP formulated by the compensation committee.


4. Check the copy of certificate issued by registered Merchant Banker as per Schedule V of the SEBI (ESOS & ESPS) Guidelines, 1999 for applying for In Principle approval from the Stock Exchanges and whether the same has been submitted to Stock Exchanges.

5. Check certified true copy of the Certificate given by the Statutory Auditor that the scheme has been implemented in accordance with these guidelines and in accordance with the special resolution passed in the general meeting.

6. Before exercise of option, the company has filed a statement as per Schedule V with the concerned stock exchanges.

7. The company has obtained In-Principle approval from the stock exchange.

8. As and when ESOS/ESPS are exercised, the company has notified the concerned stock exchanges as per Schedule VI of the guidelines.

9. Form No. PAS. 3 as per Companies Prospectus and Allotment of Securities) Rules, 2014, Form No. SH.7 as per Companies (Share Capital and Debentures) Rules, 2014 and Form No. MGT.14 as per Companies (Management and Administration) Rules, 2014, as applicable, has been filed with ROC.

10. Check the copy of Stock Option Scheme Amended Stock Option Scheme.

11. Check the notice of AGM/EGM for approving the Scheme/ for amending the scheme under Clause 6.3(a) or (b) of the SEBI (ESOS & ESPS) Guidelines.

12. Check the copy of special resolution of shareholders for approving the scheme/for amending the grants.
13. Check the list of promoters as defined under the SEBI (ESOS & ESPS) Guidelines, 1999.

14. Check the copy of latest annual report.

15. Check if listing approval by stock exchange (s) was granted for shares arising after IPO out of options granted under a scheme prior to the IPO, upon exercise subject to compliance with SEBI (ICDR) Regulations, 2009.

16. Check the copy of the in principle approval granted by the stock exchange under clause 24 (a) of the listing agreement.

17. Check compliance with the following clauses of the listing agreement –
   (i) Clause 22 regarding intimation to stock exchange for any increase in share capital by whatever mode.
   (ii) Clause 25 regarding notification to stock exchange in the event of the Issuer granting any options to purchase any shares of the Issuer:
        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.

18. Check the copy of the resolution passed by the Board of Directors in which the company has allotted these shares.

19. The statement of the compliance officer Company Secretary/authorised signatory showing number of shares for which the in-principle approval was taken and no. of shares allotted, date of allotment and the balance outstanding.

20. The quarterly certificate received from the Statutory Auditors/Practicing Company Secretary/Practicing Chartered Accountant, submitted to the stock exchange specifically certifying that the company has received the application/allotment monies from the applicants of these shares.

(a) Employee Stock Option

1. Eligibility to Participate
   (i) An employee is eligible to participate in Employee Stock Option Scheme (ESOS) of the company.

Who is an employee?

Employee means:

(a) a permanent employee of the company working in India or out of India or
(b) a director of the company whether whole time director or not, or
(c) an employee as defined in sub-clauses (a) or (b) of a Subsidiary, in India or out of India, or of a holding company of the company.

It may be noted that where such employee is a director nominated by an institution as its representative on the Board of Directors of the company—

(i) the contract/agreement entered into between the institution nominating its employee as the director of a company and the director so appointed shall, inter alia, specify the following:

   (a) whether options granted by the company under its ESOS can be accepted by the said
employee in his capacity as director of the company;

(b) that options, if granted to the director, shall not be renounced in favour of the nominating institution; and

(c) the conditions subject to which fees, commissions, ESOSs, other incentives, etc. can be accepted by the director from the company.

(ii) the institution nominating its employee as a director of a company shall file a copy of the contract/agreement with the said company, which shall, in turn, file the copy with all the stock exchanges on which its shares are listed.

(iii) the director so appointed shall furnish a copy of the contract/agreement at the first Board meeting of the company attended by him after his nomination.

(ii) Check that employee is not a promoter nor belongs to the promoter group.

(ii) Check that a director who either himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating as he is not eligible to participate in the scheme.

2. Compensation Committee

(i) Check that the disclosures, as specified in Schedule IV are made by the company to the prospective option 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


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...
(ii) However, if such variation is not prejudicial to the interests of the option holders, Check that the company has passed a special resolution in a general meeting to vary the terms of scheme.

(iii) the provisions of clause 6.3 of the guidelines, 1999 as above shall apply to such variation of terms as they apply to the original grant of option.

(iv) Check that the notice for passing special resolution for variation of terms of ESOS has been sent.

(v) Check that the notice discloses full details of the variation, the rationale therefor and the details of the employees who are beneficiary of such variation.

(vi) The companies have been given an option to reprice the options which are not exercised if ESOSs were rendered unattractive due to fall in the price of shares in the market. The company must ensure that such re-pricing should not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such pricing.

5. Pricing

The companies granting option to its employees pursuant to the scheme have the freedom to determine the exercise price subject to adherence to the accounting policies. In case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, is required to be disclosed in the Director’s Report and also the impact of this difference on profits and on Earnings per Share of the company shall also be disclosed in the Director’s Report.

6. Lock-in-Period and Rights of the Option-holder

(i) Check that there exists a minimum period of one year between the grant of options and vesting of option.

Also ensure that, in the case where options are granted by a company under an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required under this clause.

(ii) The company has the freedom to specify the lock-in-period for the shares issued pursuant to exercise of option.

(iii) Check that the employee does not have the right to receive any dividend or to vote or in any manner enjoys the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

7. Consequence of Failure to Exercise Option

(i) Check that amount payable by the employee, if any, at the time of grant of option has been forfeited by the company if the option is not exercised by the employee within the exercise period; or

(ii) Check that the amount has been refunded to the employee if the option is not vested due to non-fulfilment of condition relating to vesting of option as per the Scheme.

8. Non-Transferability of Option

(i) Check that option granted to an employee is not transferable to any person.
(ii) (a) No person other than the employee to whom the option is granted shall be entitled to exercise the option.

(b) under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act, 1956.

(iii) Check that the option granted to the employee is not pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

(iv) Check that in the event of the death of employee while in employment, all the options granted to him till such date are vested in the legal heirs or nominees of the deceased employee.

(v) Check that in case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.

(vi) Check that if an employee resigns or is terminated, all options not vested as on that day expire. However, the employee shall, subject to the terms and conditions formulated by compensation committee, be entitled to retain all the vested options.

(vii) Check that, the options granted to a director, who is an employee of an institution and has been nominated by the said institution, has not been renounced in favour of institution nominating him.


1. Check that the Board of Directors disclose either in the Directors Report or in the Annexure to the Director’s Report, the following details of the Scheme:

(a) options granted;

(b) the pricing formula;

(c) options vested;

(d) options exercised;

(e) the total number of shares arising as a result of exercise of option;

(f) options lapsed;

(g) variation of terms of options;

(h) money realized by exercise of options;

(i) total number of options in force;

(j) employee-wise details of options granted to—

   (i) senior managerial personnel;

   (ii) any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;

   (iii) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

(k) diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with Accounting Standard (AS) 20, Earning Per Share.

(l) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and
the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.

(m) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.

(n) A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted average information:

1. risk-free interest rate,
2. expected life,
3. expected volatility,
4. expected dividends, and
5. the price of the underlying share in market at the time of option grant.

2. Ensure that until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosures are made either in the Directors’ Report or in an Annexure thereto of the information specified above in respect of such options also.

3. Ensure that until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosure are made either in the Directors’ Report or in an Annexure thereto of the impact on the profits and on the EPS of the company if the company had followed the accounting policies specified under clause 13 of these guidelines in respect of such options.

10. Accounting Policies

Check that the company which has passed a resolution for the scheme complies with the accounting policies specified by SEBI in regard to the Scheme under Schedule I of the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

11. Certificate from Auditors

Check that the Board of Directors of company present before the shareholders at each AGM, a certificate from the auditors of the company that the Scheme has been implemented in conformity with these guidelines and in accordance with the resolution of the company in the general meeting.

Test Your Knowledge

1. Can a director participate in an employee Stock Option Scheme?
2. What is the consequence of non-exercise of option?

(b) Employees Stock Purchase Scheme (ESPS)

1. Eligibility to Participate in the Scheme

(i) An employee eligible to participate in the scheme should be:
   (a) a permanent employee of the company working in India or out of India; or
   (b) a director of the company, whether a whole time director or not;
   (c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.
(ii) Check that the employee is not a promoter nor belongs to the promoter group.

(iii) Ensure that a director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating, as he is not eligible to participate in the scheme.

2. Shareholder Approval

(i) Check that the Scheme has been approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.

(ii) Check that the explanatory statement to the notice has been sent to the shareholders and it specifies—
(a) the price of the shares and also the number of shares to be offered to each employee;
(b) the appraisal for determining the eligibility of employee for the scheme;
(c) total number of shares to be issued.

(iii) The number of shares offered may be different for different categories of employees.

(iv) Check that special resolution states that the company shall conform to the accounting policies as specified in Schedule II of the SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.

(v) Check that approval of shareholders have been obtained by way of separate resolution in the general meeting in case of—
(a) allotment of shares to employees of subsidiary or holding company and;
(b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

3. Pricing and Lock-in-period

(i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.

(ii) Check that the shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.

Also ensure that in a case where shares are allotted by a company under a ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in-period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in required under this clause.

(iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

4. Disclosure and Accounting Policies

(i) Check that the Director’s Report or Annexure thereto shall contain, inter alia, the following disclosures:

(a) the details of the number of shares issued in the scheme;
(b) the price at which such shares are issued;
(c) employee-wise details of the shares issued to:

(i) senior managerial personnel;

(ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;

(iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;

(d) diluted Earning Per Share (EPS) pursuant to issuance of shares under the scheme; and

(e) consideration received against the issuance of shares.

(ii) Check that every company that has passed a resolution for the scheme complies with the accounting policies as specified in Schedule II to the SEBI (Employee Stock Option Scheme and Employee Stock Purchase) Guidelines, 1999.

5. Preferential Allotment

Nothing in these guidelines shall apply to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

6. Listing

(i) The shares arising pursuant to an ESOS and shares issued under an ESPS are required to be listed immediately upon exercise in any recognized stock exchange where the securities of the company are listed subject to compliance of the following:

(a) The ESOS/ESPS is in accordance with these Guidelines.

(b) In case of an ESOS the company has also filed with the concerned stock exchanges, before the exercise of option, a statement as per Schedule V and has obtained in-principle approval from such Stock Exchanges.

(c) As and when ESOS/ESPS are exercised the company has notified the concerned Stock Exchanges as per the statement as per Schedule VI.

(ii) (a) Ensure that the shares arising after the IPO, out of options granted under any ESOS framed prior to its IPO is being listed immediately upon exercise in all the recognised stock exchanges where the equity shares of the company are listed subject to compliance with clause 15.3 (i.e. options outstanding at IPO) and, where applicable, clause 22.2A (conditions for fresh grant of options prior to IPO).

(b) Ensure that any fresh grant of options under any ESOS framed prior to its IPO and prior to the listing of its equity shares is—

(i) in conformity with these guidelines; and

(ii) such pre-IPO scheme is ratified by its shareholders in general meeting subsequent to the IPO. However such ratification may be done any time prior to grant of new options under such pre-IPO scheme.

(c) Ensure that no change shall be made in the terms of options issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise, unless prior approval of the shareholders is taken for such change. However, nothing in this sub-clause shall
apply to any adjustments for corporate actions made in accordance with these guidelines.

(iii) For listing of shares issued pursuant to ESOS or ESPS the company is required obtain the in-principle approval from Stock Exchanges where it proposes to list the said shares.

(iv) The listed companies is required to file the ESOS or ESPS Schemes through EDIFAR filing.

(vii) When holding company issues ESOS/ESPS to the employee of its subsidiary, the cost incurred by the holding company for issuing such options/shares is required to be disclosed in the ‘notes to accounts’ of the financial statements of the subsidiary company.

In a case falling under above clause, if the subsidiary reimburses the cost incurred by the holding company in granting options to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the ‘notes to accounts’ to their financial statements.

(viii) The company shall appoint a registered Merchant Banker for the implementation of ESOS and ESPS as per these guidelines till the stage of framing the ESOS/ESPS and obtaining in-principal approval from the stock exchanges in accordance with these Guidelines.

7. ESOS/ESPS through Trust Route

In case of ESOS/ESPS administered through a Trust, the accounts of the company shall be prepared as if the company itself is administering the ESOS/ESPS.

8. Prohibition of acquisition of securities from secondary market

NO ESOS/ ESPS shall involve in acquisition of securities from the secondary market.

III-C. DUE DILIGENCE- BONUS ISSUE

Checklist for issue of Bonus shares

1. Whether the issuer company is authorised by its articles of association for issue of bonus shares, if not special resolution has been passed and a certified true copy of the Resolution passed in the EGM/AGM has been filed with the Registrar in Form MGT 14.

2. In case the issuer company is authorised by its articles check the certified true copy of the Resolution passed by the Board of Directors in which the company has proposed to issue Bonus Shares to the shareholders of the company.

3. A certificate that the proposed bonus shares would be ranking pari-passu in all respect including dividend with the existing equity shares of the company should be checked.

4. A confirmation that all the existing securities of the company are fully paid-up and are listed on the Exchange.

5. The names of the Stock Exchanges where the securities of the company are listed.


7. Check whether an issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders’ approval was implemented within fifteen days from the date of approval of the issue by its board of directors.
Check whether the bonus issue was 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.

8. In case on unlisted company the issuer company shall comply with section 63 of the Companies Act, 2013.

9. Whether the issuer company has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof, and whether the equity shares so reserved have been issued at the time of conversion of such convertible debt instruments.

**III-D. DUE DILIGENCE — RIGHTS ISSUE**

**Checklist for Rights Issue**

1. Certified true copy of the resolution passed by the Board of Directors for issue of securities under proposed rights issue/approving the proposed fast track rights issue.

2. Certified true copy of the resolution passed by the Shareholders, if any;
   - for issue of securities under proposed rights issue/fast track rights issue
   - increase in the authorised share capital (if required)
   - Check the copy of form SH 7, MGT14 filed with ROC.

3. Undertaking from the Company that the entire issued capital of the Company is listed with Exchange and are fully paid up.

4. Certificate from all Lead Manager/Merchant Banker and Company with respect to compliances in case of fast track rights issue.

5. Whether the issuer company has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof, while opening a rights issue of equity shares.

6. Check whether the equity shares so reserved were issued at the time of conversion of convertible debt instruments on the same terms at which equity shares offered in rights issues.

6. Whether the issuer company has made reservation for employees along with rights issue subject to the condition that value of allotment to any employee shall not exceed rupees, two Lakh.

7. Check whether the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed.

**1. Record Date**

- Ensure that the record date has been announced for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue. It may be noted that the issuer shall not withdraw rights issue after announcement of the record date.

- If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date announced. However, the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.
2. Restriction on rights issue.

No issuer shall make a rights issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.

The equity shares so reserved for the holders of fully or partially compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments at the same terms at which the equity shares offered in the rights issue were issued.


The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue. The letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard. The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money. The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently. If any shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.

4. Pricing

The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

5. Period of subscription

A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

6. Payment Option

The issuer shall give only one payment option out of the following:

(a) part payment on application and balance money paid in calls.

(b) full payment on application

In case of part payment option necessary regulatory approvals are required.

7. Pre-Issue Advertisement for rights issue.

The issuer shall issue an advertisement for rights issue disclosing the following:

(a) the date of completion of despatch of abridged letter of offer and the application form;

(b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

8. Obligation of issuer/intermediaries

The obligation of issuer/intermediaries for a rights issuer, with respect to advertisement, appointment of compliance officer, redressal of investor grievances, due diligence, post issue reports, post issue advertisements etc is same as the public issue.
IV. DUE DILIGENCE: QUALIFIED INSTITUTIONS PLACEMENT

1. Conditions for qualified institutions placement.

1. Check the copy of a special resolution approving the qualified institutions placement passed by its shareholders and Form MGT 14 filed with ROC.

2. Check that the minimum number of allottees for each placement of eligible securities made under qualified institutions placement is not be less than:
   • two, where the issue size is less than or equal to two hundred and fifty crore rupees;
   • five, where the issue size is greater than two hundred and fifty crore rupees:

3. Ensure that no single allottee has been allotted more than fifty per cent. of the issue size.

4. Check the copy of board resolution for allotment with respect to completion of allotment within a period of twelve months from the date of passing of the resolution.

5. Check whether the issuer company has complied with clause 35 of Listing Agreement w.r.t shareholding pattern.

2. Appointment of merchant banker.

A qualified institutions placement shall be managed by merchant banker(s) registered with SEBI 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, 2009.

4. Placement Document

The qualified institutions placement shall be made on the basis of a placement document which shall contain all specified material information.

The placement document shall be serially numbered and copies shall be circulated only to select investors.

The issuer shall, while seeking in-principle approval from the recognised stock exchange, furnish a copy of the placement document, a certificate confirming compliance with the provisions of this Chapter along with any other documents required by the stock exchange.

The placement document shall also be placed on the website of the concerned stock exchange and of the issuer with a disclaimer to the effect that it is in connection with a qualified institutions placement and that no offer is being made to the public or to any other category of investors.

5. Pricing

The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date.
If eligible securities are convertible into or exchangeable with equity shares of the issuer, the issuer shall determine the price of such equity shares allotted pursuant to such conversion or exchange taking the relevant date as decided and disclosed by it while passing the special resolution.

The issuer shall not allot partly paid up eligible securities. However, in case of allotment of non-convertible debt instruments along with warrants, the allottees may pay the full consideration or part thereof payable with respect to warrants, at the time of allotment of such warrants. In case of allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid up.

The prices determined for qualified institutions placement shall be subject to appropriate adjustments if the issuer:

(a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;
(b) makes a rights issue of equity shares;
(c) consolidates its outstanding equity shares into a smaller number of shares;
(d) divides its outstanding equity shares including by way of stock split;
(e) re-classifies any of its equity shares into other securities of the issuer;
(f) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

6. Restrictions on allotment

- Allotment under the qualified institutions placement shall be made subject to the following conditions:
  (a) Minimum of ten per cent. of eligible securities shall be allotted to mutual funds:
      If the mutual funds do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
  (b) No allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer:
      If a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the said rights in the capacity of a lender shall not be deemed to be a person related to promoters.

- In a qualified institutions placement of non-convertible debt instrument along with warrants, an investor can subscribe to the combined offering of non-convertible debt instruments with warrants or to the individual securities, that is, either non-convertible debt instruments or warrants.

- The applicants in qualified institutions placement shall not withdraw their bids after the closure of the issue.

7. Minimum number of allottees

The minimum number of allottees for each placement of eligible securities made under qualified institutions placement shall not be less than:

(a) two, where the issue size is less than or equal to two hundred and fifty crore rupees;
(b) five, where the issue size is greater than two hundred and fifty crore rupees:

Provided that no single allottee shall be allotted more than fifty per cent. of the issue size.
(2) The qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

8. Validity of the special resolution

Allotment pursuant to the special resolution shall be completed within a period of twelve months from the date of passing of the resolution.

The issuer shall not make subsequent qualified institutions placement until expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

9. Restrictions on amount raised.

The aggregate of the proposed qualified institutions placement and all previous qualified institutions placements made by the issuer in the same financial year shall not exceed five times the net worth of the issuer as per the audited balance sheet of the previous financial year.

10. Tenure.

The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement shall not exceed sixty months from the date of allotment.

11. Transferability of eligible securities.

The eligible securities allotted under qualified institutions placement shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

V. DUE DILLIGENCE: INSTITUTIONAL PLACEMENT PROGRAMME

SEBI vide its notification dated January 30, 2012 has amended the Issue of Capital and Disclosure Requirements Regulations, 2009 whereby Chapter VIII-A - Institutional Placement Programme (IPP) has been inserted. The provisions of this Chapter shall apply to issuance of fresh shares and or offer for sale of shares in a listed issuer for the purpose of achieving minimum public shareholding in terms of Rule 19(2)(b) and 19A of the Securities Contracts (Regulation) Rules, 1957.

“Institutional Placement Programme” means a further public offer of eligible securities by an eligible seller, in which the offer, allocation and allotment of such securities is made only to qualified institutional buyers in terms of this Chapter. Eligible seller includes listed issuer, promoters group of listed issuer.

Conditions for Institutional Placement Programme

– An institutional placement programme may be made only after a special resolution approving the institutional placement programme has been passed by the shareholders of the issuer in terms of section 81(1A) of the Companies Act, 1956*.

– No partly paid-up securities shall be offered.

– The issuer shall obtain an in-principle approval from the stock exchange(s).

Appointment of Merchant Banker

An institutional placement programme shall be managed by merchant banker(s) registered with SEBI who shall exercise due diligence.

* Section 81 (1A) of the Companies Act, 1956 corresponding to section 62 of the Companies Act, 2013 is notified.
Offer Document

– The institutional placement programme shall be made on the basis of the offer document which shall contain all material information.

– The issuer shall, simultaneously while registering the offer document with the Registrar of Companies, file a copy thereof with SEBI and with the stock exchange(s) through the lead merchant banker.

– The issuer shall file the soft copy of the offer document with SEBI, along with the fee.

– The offer document shall also be placed on the website of the concerned stock exchange and of the issuer clearly stating that it is in connection with institutional placement programme and that the offer is being made only to the qualified institutional buyers.

– The merchant banker shall submit to SEBI a due diligence certificate, stating that the eligible securities are being issued under institutional placement programme and that the issuer complies with requirements of this Chapter.

Pricing and Allocation/allotment

– The eligible seller shall announce a floor price or price band at least one day prior to the opening of institutional placement programme.

– The eligible seller shall have the option to make allocation/allotment as per any of the following methods -
  
  • proportionate basis
  • price priority basis; or

– criteria as mentioned in the offer document.

– The method chosen shall be disclosed in the offer document.

– Allocation/allotment shall be overseen by stock exchange before final allotment.

Restrictions

– The promoter or promoter group who are offering their eligible securities should not have purchased and/or sold the eligible securities of the company in the twelve weeks period prior to the offer and they should undertake not to purchase and/or sell eligible securities of the company in the twelve weeks period after the offer. However, such promoter or promoter group may, within the twelve weeks period offer eligible securities held by them through institutional placement programme or offer for sale through stock exchange mechanism subject to the condition that there shall be a gap of minimum two weeks between the two successive offer(s) and/or programme(s);

– Allocation/allotment under the institutional placement programme shall be made subject to the following conditions:

  (a) Minimum of twenty five per cent of eligible securities shall be allotted to mutual funds and insurance companies. However, if the mutual funds and insurance companies do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;

  (b) No allocation/allotment shall be made, either directly or indirectly, to any qualified institutional
buyer who is a promoter or any person related to promoters of the issuer. However, a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the rights in the capacity of a lender shall not be deemed to be a person related to promoters.

- The issuer shall accept bids using ASBA facility only.
- The bids made by the applicants in institutional placement programme shall not be revised downwards or withdrawn.

Restrictions on size of the offer

- The aggregate of all the tranches of institutional placement programme made by the eligible seller shall not result in increase in public shareholding by more than ten per cent or such lesser per cent as is required to reach minimum public shareholding.
- Where the issue has been oversubscribed, an allotment of not more than ten percent of the offer size shall be made by the eligible seller.

Period of Subscription and display of demand

- The issue shall be kept open for a minimum of one day or maximum of two days.
- The aggregate demand schedule shall be displayed by stock exchange(s) without disclosing the price.

Withdrawal of offer

The eligible seller shall have the right to withdraw the offer in case it is not fully subscribed.

Transferability of eligible securities

The eligible securities allotted under institutional placement programme shall not be sold by the allottee for a period of one year from the date of allocation/allotment, except on a recognised stock exchange.

Check list for compliances under Institutional Placement Programme (IPP)

1. Check the certified copy of special resolution passed in the general meeting approving the Institutional Placement Programme and form MGT 14 filed with ROC.

2. Check the issuer has obtained in-principle approval from the stock exchange(s).

3. The issuer has appointed a SEBI registered merchant banker to manage the IPP.

4. Check the copy of the due diligence certificate submitted to SEBI with respect to the IPP.

5. Check that in case of oversubscription up to ten percent of the offer size has been made by the eligible seller.

ISSUE OF SECURITIES BY SMALL AND MEDIUM ENTERPRISES

Going for a public issue of capital would provide the SMEs with equity financing opportunities to grow their business - from expansion of operations to acquisitions. In addition, equity financing lowers the debt burden leading to lower financing costs and healthier balance sheets for the firms. The continuing requirement for adhering to the stock market rules for the issuers lower the on-going information and monitoring costs for the banks.
In view of the aforesaid concerns raised by the market participants/industry representatives, there was a felt need for developing a dedicated stock exchange for the SME sector so that SMEs can access capital markets easily, quickly and at lower costs. Such dedicated SME exchange is expected to provide better, focused and cost effective service to the SME sector. The need for having a separate exchange/platform for SMEs was also discussed during the 32nd Annual Conference of IOSCO held in April 2007 in Mumbai and it was felt that the same would be necessary for the focused development of the SME sector.

Internationally also countries have provided for a separate exchange/platform to facilitate listing of securities of growth companies/new economy companies/small and medium companies. Some of the cases in point are the Alternative Investment Market (AIM), London, the Growth Enterprises Market (GEM), Hong Kong and MOTHERS (Market of High Growth Emerging Stocks), JAPAN.

SME EXCHANGES IN INDIA

In India BSE and NSE have created SME exchanges BSE SME and EMERGE respectively. BCB Finance Ltd – the first Indian SME to get listed on BSE SME. The vision of BSE SME is ‘Wealth creation by the SMEs through inclusive economic growth’ and the mission is ‘Provide the world class Platform for SMEs and Investors to come together and raise equity capital’. The term ‘EMERGE’ stands for investment opportunities in emerging companies.

REGULATORY FRAMEWORK FOR LISTED SMES

In recognition of the need for making finance available to small and medium enterprises, SEBI has decided to encourage promotion of dedicated exchanges and/or dedicated platforms of the exchanges for listing and trading of securities issued by Small and Medium Enterprises (“SME”). Consequently, SEBI amended SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“SEBI (ICDR) Regulations”) by inserting a Chapter on “Issue of specified securities by small and medium enterprises”, through notification dated April 13, 2010.

Accordingly

1. SMEs having a post issue face value capital of upto ₹10 crores can get its shares listed on SME exchanges.
2. SMEs having a post issue face value capital of more than ₹10 crores upto ₹25 crores have the option to get its shares listed either on the main board of the exchange or on SME exchanges.
3. SMEs having post issue face value capital of more than ₹25 crores have to listed on or migrate to Main Board of the exchanges.
4. The minimum application and trading lot size shall not be less than ₹1,00,000/-
5. The existing members would be eligible to participate in SME exchange.
6. The issues shall be 100% underwritten and merchant bankers shall underwrite 15% in their own account.

“SME Exchange” means a trading platform of a recognized stock exchange having nation wide trading terminals by SEBI to list the specified securities issued and includes a stock exchange granted recognition for this purpose but does not include the Main Board.

‘Main board’ means a recognized stock exchange having nation wide trading terminals other than SME exchange.
Exemptions available for securities listed at SME exchange

- Filing of draft offer document. [Regulation 6(1)(2) and (3)]
- In-principle approval from the recognized exchanges (Regulation 7)
- Submission of certain documents before opening of an issue. (Regulation 8)
- Draft offer document to be made to the public. (Regulation 9)
- Fast Track Issues. (Regulation 10)
- Conditions of initial public offer. (Regulation 26)
- Conditions for further public offer. (Regulation 27)
- Minimum application Value related provisions. (Regulation 49(1))

Market making compulsory for listed SMEs

Market making is compulsory for a period of minimum 3 years from the date of listing of securities on SME exchange or from the date of migration to main Board as the case may be and the merchant banker would ensure market making through the stock brokers of SME Exchange.

Model listing agreement for SMEs

To facilitate listing of specified securities in the SME exchange, “Model Equity Listing Agreement” to be executed between the issuer and the Stock Exchange, to list/migrate the specified securities on SME Exchange. The listing agreement covers routine listing compliances such as intimation to exchange, publication requirements, Corporate Governance compliances etc., All listed SMEs on SME platform are also required to appoint the Company Secretary of the Issuer as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Issuer’s board in each meeting. The Compliance Officer will directly liaise with the authorities such as SEBI, Stock Exchanges, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter. Further Registrar & Transfer Agents of listed SMEs are required to produce a certificate from a practicing company secretary that all transfers have been completed within the stipulated time.

DEBT SECURITIES

REGULATORY FRAMEWORK FOR DEBT SECURITIES

(a) SEBI(ICDR) Regulations 2009
(b) Listing Agreement for Debentures issued through public issue/Rights issue.
(c) Listing agreement for privately placed Debentures
(d) SEBI (Issue and Listing of Debt Securities) Regulations, 2008
(e) SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008
(f) The Companies Act, 2013

A. Checklist for compliances under SEBI (ICDR) Regulations, 2009

GENERAL COMPLIANCES

1. Check the refund orders/certificate of posting in the event of non-receipt of minimum subscription all application moneys received has been refunded to the applicants within:
i. fifteen days of the closure of the issue, in case of a non-underwritten issue; and

ii. seventy days of the closure of the issue, in the case of an underwritten issue where minimum subscription including devolvement obligations paid by the underwriters is not received within sixty days of the closure of the issue.

2 Check whether the monitoring agency appointed in case where the issue size exceeds five hundred crore rupees has submitted its report to the issuer on half yearly basis, till the proceeds of the issue have been fully utilised.

3 Check the refund orders/certificate of posting to ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue and interest undertaken in the offer document paid in case of delayed payments.

4 Whether the issuer has altered the terms (including the terms of issue) of specified securities which and the same may adversely affect the interests of the holders of that specified securities, if so, the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class has been obtained. Check compliance with Section 27(2) of the Companies Act, 2013, if any.

5 Whether the specified securities held by promoters and locked-in are pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution, if so the provision in the regulations are complied with.

6 Whether the application money received has been utilised in accordance with the section 40 of Companies Act, 2013.

7 Whether the disclosures made in the red herring prospectus while making an initial public offer are updated on an annual basis by the issuer and made publicly accessible.

8 Check whether the outstanding subscription money is called within twelve months from the date of allotment in the issue and where the applicant has failed to pay the call money within the twelve months, such shares have been forfeited.

9 Check the copy of compliance certificate filed by the merchant banker, for the compliances with regard to news reports for the period between the date of filing the draft offer document with SEBI and the date of closure of the issue

**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;

* Section 117B of the Companies Act, 1956 corresponding to section 71 of the Companies Act, 2013, is notified.
(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 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 SEBI 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.

* Section 117C of the Companies Act, 1956 corresponding to section 71 of the Companies Act, 2013, is notified.
(2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares. However, where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provision stated in sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

**Issue of convertible debt instruments for financing**

No issuer shall issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management. However, an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

- 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**

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.

**Checklist for compliances with respect to Non-Convertible Debt Securities**

1. There is no restraining order against the company or any of its directors by SEBI or any other regulatory authority.
2. Check whether one or more merchant bankers have been appointed.
3. The company has made an application for obtaining in–principle approval from the stock exchange to list its non-convertible debt securities.
4. Check copy of the in–principle approval letter received from the stock exchange.
5. Check the copy of the credit rating certificate of atleast one credit rating agency for the proposed issue.
6. The confirmation letter of the debenture trustee to act as debenture trustee of the debt securities.

7. The Debenture Trust Deed has been executed in Form No. SH.12 as per Companies (Share Capital and Debentures) Rules, 2014, by the company in favour of the debenture trustees within sixty days of allotment of debentures.

8. Creation of debenture redemption reserve as provided in sub-rule 7 of Rule 18 of Companies (Share Capital and Debentures) Rules, 2014.

9. The agreement entered into by the company with the depository registered with SEBI for dematerialization of debt securities.

10. In case of private placement of debt securities, submission of the disclosures in a disclosure document to the Stock Exchanges as specified in Schedule I under Regulation 21 of these regulations.

11. The offer document has been filed with the ROC.

12. If minimum subscription has not been received, the application moneys have been repaid forthwith.

13. Check the compliance with regard to the listing agreement for debt securities.

14. Resolution passed by the Board of Directors for allotment of securities specifically makes a mention of total number of securities allotted/allocated by the issuer.

15. If offer document refers to creation of security, whether charge has been created?

16. Form No. PAS 3 as per Companies (Prospectus and Allotment of Securities) Rules, 2014.

17. Letter from Registrars and lead manager confirming dispatch of share/debenture/warrant certificates, allotment advice, refund orders, underwriting commission, uploading of electronic credit of Securities, uploading of ECS/NEFT/RTGS credits and brokerage warrants.

18. Certificate from the Registrar reconciling the total securities allotted with the total securities credited with the depositories, and securities that have failed to be credited.

19. The basis of allotment has been approved by the designated Stock Exchange.

20. Confirmation letter given by the Lead Manager and Issuer confirming that the issue is in compliance with all requirements of SEBI Regulations, any other applicable law, rules and regulations.

C. SEBI (PUBLIC OFFER AND LISTING OF SECURITISED DEBT INSTRUMENTS) REGULATIONS 2008

Securitization is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitization deals with the conversion of assets which are not marketable into marketable ones.

Securitized Debt Instrument means any certificate or instrument by whatever name called, of the nature referred to in sub-clause (ie) of clause (h) of Section 2 of SCRA.

Section 2(h) (ie) of SCRA reads as follows:

‘Any certificate or instrument(by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.’
Special Purpose Distinct Entity means a trust which acquires debt or receivables not out of funds mobilized by it by issuances of securitized debt instruments through one or more schemes and includes any trust set up by the National Housing Bank under National Housing Bank Act 1987 or by the National Bank for Agricultural and Rural Development Act, 1981.

The amendments in SCRA has enabled SEBI to provide for disclosure based regulation (SEBI (Public Offer And Listing of Securitized Debt Instruments) Regulations 2008) for public issue of or listing of securitized debt instruments on the recognized stock exchanges.

These regulations are principle based and have been made taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction.

The main features of the regulations are as follows:

(a) The special purpose distinct entity (the issuer) will be a trust and the trustees thereof will require registration from SEBI. The instrument issued by the issuer to the investor shall acknowledge the beneficial interest of such investor in underlying debt or receivables assigned to the issuer. The issuer can undertake only the activities permitted by the regulations.

(b) The regulations permit securitization of both existing as well as future receivables.

(c) The regulations provide flexibility in terms of pay through / pass through structures.

(d) In case of public issuances listing will be mandatory. The instruments issued on private placement basis may also be listed subject to the compliance of simplified provisions of the regulations.

(e) Regulations require strict segregation of assets of each scheme.

Some Major compliances

— Ensure that special purpose distinct entity files draft offer document with SEBI atleast 15 days before proposed opening of the issue.

— Ensure that special purpose distinct entity has made arrangements with Registered Depositories for dematerialization of the securitized debt instruments.

— Ensure that special purpose distinct entity has made an application for listing to one or more recognized exchanges in terms of 17A(2) of SCRA.

— Ensure that credit rating is obtained from atleast two registered credit rating agencies and the same is disclosed in the offer document.

— Ensure that the contents of offer document has the required details and does not contain any misleading statements.

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

— Ensure that the special purpose distinct entity complies with its obligation relating to Minimum public offering for listing, continuous listing conditions etc.
LESSON ROUND UP

- The Company shall have a debenture trustee for each debenture issued and listed by it on an exchange on a continuous basis.
- The Company shall create and maintain security ensuring adequate security cover at all times for secured debentures.
- Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.
- Public issue is governed mainly by SEBI (ICDR) Regulations 2009.
- Public issue, whether through normal route or book building route involves various process such as appointment of merchant bankers and other intermediaries, filing of offer documents with SEBI/ROC, listing approvals from stock exchanges, co-ordination with intermediaries etc.
- As regards book building it involves mandatory electronic bidding facility, agreement with stock exchanges for online offer of securities, appointment of book runners, arrangement of collection centers, bidding process for arrival of price etc.
- Issue of stock options to employees by listed companies are governed by SEBI (ESOP & ESPS) Guidelines, 1999.
- Issue of preferential shares by listed companies are governed by SEBI Regulations and Issue of preferential allotments by unlisted companies is mainly governed by Companies (Share Capital and Debentures) Rules, 2014.
- Issue of convertible debt Securities are regulated by SEBI (ICDR) Regulations 2009 and non-convertible debt Securities are regulated by SEBI (Issue and Listing of Debt Securities) Regulations 2008.
- Issue of Securities by SMEs are regulated by chapter XB of SEBI (ICDR) Regulations and listed in SME exchanges of BSE and NSE.

SELF TEST QUESTIONS

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

1. Draft a due diligence plan with respect to IPO through book building scheme?
2. Elaborate the check points while issuing of preferential allotments by listed entities.
3. Describe the role of Company Secretary in an IPO?
4. Draft a check list with respect to issue of rights shares by listed companies.
5. What are the compliances with respect to issue of non-convertible debt instruments?
Lesson 5
Depository Receipts
Due Diligence

LESSON OUTLINE

Global/American Depository Receipts/Foreign Currency Convertible Bonds
- Concept and types of Depository Receipts
- Sponsored Global Depository Receipts/Global Depository Receipts through Fresh issue of shares
- Regulatory framework in and outside India in respect of issue of GDRs
- Parties, documents, approvals and process involved in the issue of GDRs
- Check list for issue of Global Depository Receipts/American Depository Receipts
- Issue of FCCBS

Indian Depository Receipts
- Concept of Indian Depository Receipts
- Regulatory Framework for issue of Indian Depository Receipts
- Procedures for making an issue of Indian Depository Receipts
- Checklist for issue of Indian Depository Receipts (IDRs) under
  (a) Companies (Registration of Foreign Companies) Rules, 2004
  (b) Chapter VIII of SEBI(ICDR) Regulations 2009
  (c) Listing Agreement for IDRs

LEARNING OBJECTIVES

Depository receipts (global and American) are one of the mode through which an Indian company raises money from international market or a foreign company raises money from Indian market. Similarly, foreign companies access Indian market through issue of Indian depository Receipts. Issue of Global/American Depository Receipts exposes Indian investors to international market, whereas issue of Indian Depository Receipts exposes foreign investors to get exposed to Indian market. Issue of global depository receipts are mainly governed by Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme in addition to SEC regulations, EU directive as applicable.

Similarly issue of Indian Depository Receipts are regulated by SEBI(ICDR) Regulations, listing Agreements, Companies (Registration of Foreign Companies) Rules, 2004 etc.

After reading this lesson you should be able to understand the concepts, regulatory framework and procedural aspects as to the issue of Global and Indian Depository Receipts.
GLOBAL DEPOSITORY RECEIPTS

I. INTRODUCTION

The Government has taken a number of policy initiatives to allow Indian companies to raise resources from the International markets. Consequently raising funds through Euro Issues has become popular with Indian companies and investors both. Indian companies found this route very attractive and today more and more companies are trying this avenue to raise funds. International offering made by companies for tapping the international capital markets can be through the following modes.

Foreign Currency Convertible Bond, is an Equity-linked convertible security that can be converted/exchanged for a specific number of shares of the issuer company.

Depository Receipts (DRs) are negotiable securities issued outside India by a Depository Bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian Bank in India. DRs are traded in Stock Exchanges in the US, Singapore, Luxembourg etc. DRs listed and traded in the US markets are known as American Depository Receipts (ADRs) and those listed and traded elsewhere are known as Global Depository Receipts (GDRs). In the Indian context, DRs are treated as FDI. Indian companies can raise foreign currency resources abroad through the issue of ADRs/GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time.

Exchange traded depository receipts from India have been relatively recent phenomenon (i.e. late 90’s) though few companies have issued GDRs through private placement in early 90’s. At present these are several active depository receipts such as Infosys, ITC, Dr. Reddys, L&T etc. that are listed either on American exchanges like the Newyork Stock Exchange or NASDAQ or on European/Asian exchanges such
as London, Dubai, Singapore exchanges. Reliance Industries was the first Indian company to be listed on NYSE and Infosys was the first Indian company to be listed on NASDAQ.

**Why do Investors Invest in GDRs**

- Convenience of holding foreign securities in domestic market.
- Diversification in portfolio.
- No restriction in trading as Depository Receipts are treated as domestic securities.
- Avoid currency risk.

**Why do companies issue GDRs**

- An effective source of finance.
- Global reputation.
- Extension of shareholder base beyond territory.

### II. TYPES OF DEPOSITORY RECEIPTS

#### 1. American Depository Receipts (ADRs)

An American Depository Receipt ("ADR") is a dollar denominated form of equity ownership in the form of Depository receipts in a non-US company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

Following are the types of ADRs:

(a) **Level I ADR (unlisted, OTC traded/Pink Sheets)**

This is the least expensive level to provide for issuance of shares in ADR form in the US. The company issuing ADRs has to comply with the SEC registration requirements but can be exempted from full SEC reporting requirements under certain circumstances. It can only be traded over-the-counter and cannot be listed on a national exchange in the US. The electronic OTC markets are also called pink sheets which is a centralized quotation service that collects and publishes market maker quotes for OTC securities in real time.

(b) **Level II ADRs (US Listed, Non-capital Raising Transaction (i.e. without going for public issue)**

This programme gives more liquidity and marketability as it enables listing of ADRs in one or more of the US exchanges. Under this programme the company has to comply with the registration requirements, reporting requirements of SEC.

(c) **Level III ADRs (US listed Capital Raising Transaction i.e., through fresh issue of shares)** – This type of ADRs which are to comply with SECA Registration, Reporting requirement and after document filing.

(d) **Rule 144A Depository Receipts** (Privately placed for QIBs and cannot be bought on the public exchanges or over the counter.)
2. Global Depository Receipts

Section 2(44) of the Companies Act, 2013 defines “Global Depository Receipt” means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts;

According to section 41, a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed

GDRs have access usually to Euro market and US market.

The US portion of GDRs to be listed on US exchanges to comply with SEC requirements and the European portion are to be complied with EU directive.

(a) Listing of Global Depository Receipts

Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange etc.

International investors are interested in diversifying their portfolio across their national borders either through direct investment or through investment in Depository receipts from the exchanges of their home country. Investment in Depository receipts is an easier route for a small/medium investor. Through listing of Depository 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.

**3. Foreign Currency Convertible Bonds**

Foreign Currency Convertible Bond (FCCB) means a bond issued by an Indian company expressed in foreign currency, the principal and interest of which is payable in foreign currency. FCCBs are issued in accordance with the Foreign Currency Convertible Bonds and ordinary shares (through depository receipt mechanism) Scheme 1993 and subscribed by a non-resident entity in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part.
III. BROAD REGULATORY FRAMEWORK WITHIN AND OUTSIDE INDIA ON ISSUE OF DEPOSITORY RECEIPTS

1. Indian Regulatory Framework in respect of issue of GDR

(a) Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003.

Global Depository Receipts in India are made under Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time. The important features of the amended scheme are as under

— Companies issuing GDRs do not require approval of Ministry of Finance
— GDR issue shall not exceed the sectoral cap of FDI policy. If so FIPB approval is to be obtained.
— Indian companies restrained by SEBI from raising capital, is not eligible to issue GDRs
— Indian companies issuing GDRs has to comply with the specified pricing norms.
— Unlisted companies floating GDRs has to get its shares simultaneously listed in Indian exchange/s.
— The proceeds of the issue cannot be used for investing in the stock market or real estate.
— The issue expenses shall not exceed the specified limit.
— The company has to comply with the reporting requirements of RBI.

(b) Listing Agreement

As FCCB and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003 requires unlisted companies floating GDRs, to get its shares simultaneously listed in Indian exchanges, with respect to underlying shares of the company issuing GDRs, all provisions on listing agreement and other filings with the stock exchanges in India has to be complied with.

(c) 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.

(d) SEBI (SAST) Regulations 2011 (Take over Regulations).

The take over regulations are to be complied with

(i) when the GDR holders become entitled to exercise voting rights, in any manner whatsoever on the underlying shares or

(ii) exchange such depository Receipts with underlying shares carrying voting rights.


2. Regulatory framework outside India

(a) SEC requirements for issue of Global Depository Receipts in America

As discussed earlier, Global Depository Receipts may be listed either at exchanges based at Europe or at America. Accordingly American Depository Receipts and Global Depository Receipts issued/proposed to be listed at US-exchanges are required to comply with SEC requirements.
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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 Depository 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 Depository Receipts.

**Form F-6 – Registration of depository shares evidenced by GDRs/ADRs**

Form F-6 is used for the registration of Depository 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 Depository bank for the GDRs and all fees to be charged to the holders of GDRs.

Part III requires information on any defaults upon securities, and

Part IV requires various financial statements to be submitted.

This reporting requirement is essential when the company desires to list its securities in the US exchange through sponsored program or fresh issue.

**Form F-1 – Filing of information to be included in the prospectus**

Indian Companies planning a public offering in the US and wants to 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.
<table>
<thead>
<tr>
<th>Particulars</th>
<th>Level I ADR</th>
<th>Level II ADR</th>
<th>Level III ADR</th>
<th>Private Placement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listing</td>
<td>Unlisted programme/OTC traded (called Pink Sheets)</td>
<td>Listed on US exchange</td>
<td>Shares offered and listed on US exchange</td>
<td>Issued to QIBs (i.e. Rule 144A)</td>
</tr>
<tr>
<td>SEC compliance</td>
<td>Registration under form F-6 and exempted from reporting requirements</td>
<td>Registration in form 6 and to comply with reporting requirements in form 20-F</td>
<td>Registration under form F-6, Reporting under form 20-F and registration of securities offered in form F-1</td>
<td>None</td>
</tr>
</tbody>
</table>

(b) Compliance under EU directive in respect of issue of Global Depository Receipts

For issue of GDRs being listed in European exchanges has to comply with Prospectus directive, Transparency obligations directive and Market Abuse Directive issued by EU and also country specific laws.

**Prospectus directive**


The Prospectus 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 Depository 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 Depository Bank

It is the bank which is authorised by the issuing company to issue Depository 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 Depository bank. When the shares are issued by a company the same are registered in the name of Depository 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, Depository 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.

(c) Approval of Ministry of Corporate Affairs

(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) Depository Agreement
(iii) Custodian Agreement
(iv) Listing Agreement
(v) Information Memorandum
(vi) 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) Depository Agreement
Depository agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the Depository receipts which are represented by the deposited shares.

(c) Custodian Agreement
Custodian works in co-ordination with the Depository and has to observe all obligations imposed on it
including those mentioned in the Depository agreement. The custodian is responsible solely to the Depository. In the case of the Depository and the custodian being same legal entity, references to them separately in the Depository 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 Depository outside India, where the GDRs are proposed to be issued.

2. Indian custodian would keep these securities in his custody.

3. The investment banker would organize road shows for marketing the issue.

4. The foreign Depository would issue dollar denominated GDRs to foreign investors.

5. Listing of GDRs in American and European Stock Exchanges would take place.

6. Indian company has to comply with various requirements of EU directives and SEC requirements.

The following flowchart explains the issue of GDRs:
In case of sponsored GDRs, the process involved would be as follows.

1. Initiation of the process by company (decision of Board level, drafting of Scheme etc.)
2. Taking the necessary approvals, say, from shareholders, FIPB etc.
3. Record date
4. Tendering of shares by the shareholders
5. Acceptance of share tendered
6. Keeping the shares in Escrow Account (The retention of shares in such escrow account shall not exceed 3 months)
7. Conversion of shares in ADRs/GDRs
8. Sale of ADRs/GDRs to overseas investors
9. Realisation of Proceeds
10. Closure of Issue
11. Within one month
12. Repatriation of proceeds to India
13. Distribution of proceeds (after meeting with the issue expenses) to the shareholders
Issue of shares by Indian Companies under ADR / GDR – Compliance requirements (Based on the Master circular issued by RBI on July 01, 2014).

(i) Indian companies can raise foreign currency resources abroad through the issue of ADRs/GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.

(ii) A company can issue ADRs / GDRs, if it is eligible to issue shares to person resident outside India under the FDI Scheme. However, 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 ADRs/GDRs.

(iii) Unlisted companies incorporated in India are allowed to raise capital abroad, without the requirement of prior or subsequent listing in India, initially for a period of two years, subject to conditions mentioned below. This scheme will be implemented from the date of the Government Notification of the scheme, subject to review after a period of two years. The investment shall be subject to the following conditions:

(a) Unlisted Indian companies shall list abroad only on exchanges in IOSCO/FATF compliant jurisdictions or those jurisdictions with which SEBI has signed bilateral agreements;

(b) The ADRs/ GDRs shall be issued subject to sectoral cap, entry route, minimum capitalisation norms, pricing norms, etc. as applicable as per FDI regulations notified by the Reserve Bank from time to time;

(c) The pricing of such ADRs/GDRs to be issued to a person resident outside India shall be determined in accordance with the captioned scheme as prescribed under paragraph 6 of Schedule 1 of Notification No. FEMA. 20 dated May 3, 2000, as amended from time to time;

(d) The number of underlying equity shares offered for issuance of ADRs/GDRs to be kept with the local custodian shall be determined upfront and ratio of ADRs/GDRs to equity shares shall be decided upfront based on applicable FDI pricing norms of equity shares of unlisted company;

(e) The unlisted Indian company shall comply with the instructions on downstream investment as notified by the Reserve Bank from time to time;

(f) The criteria of eligibility of unlisted company raising funds through ADRs/GDRs shall be as prescribed by Government of India;

(g) The capital raised abroad may be utilised for retiring outstanding overseas debt or for bona fide operations abroad including for acquisitions;

(h) In case the funds raised are not utilised abroad as stipulated above, the company shall repatriate the funds to India within 15 days and such money shall be parked only with AD Category-1 banks.
recognised by RBI and shall be used for eligible purposes;

(i) The unlisted company shall report to the Reserve Bank.

(iv) ADRs / GDRs are issued on the basis of the ratio worked out by the Indian company in consultation with the Lead Manager to the issue. The proceeds so raised have to be kept abroad till actually required in India. Pending repatriation or utilisation of the proceeds, the Indian company can invest the funds in:-

a. Deposits with or Certificate of Deposit or other instruments offered by banks who have been rated by Standard and Poor, Fitch or Moody's, etc. and such rating not being less than the rating stipulated by the Reserve Bank from time to time for the purpose;

b. Deposits with branch/es of Indian Authorised Dealers outside India; and

c. Treasury bills and other monetary instruments with a maturity or unexpired maturity of one year or less.

(v) There are no end-use restrictions except for a ban on deployment / investment of such funds in real estate or the stock market. There is no monetary limit up to which an Indian company can raise ADRs / GDRs.

(vi) The ADR / GDR proceeds can be utilised for first stage acquisition of shares in the disinvestment process of Public Sector Undertakings / Enterprises and also in the mandatory second stage offer to the public in view of their strategic importance.

(vii) Voting rights on shares issued under the Scheme shall be as per the provisions of Companies Act, 1956 and in a manner in which restrictions on voting rights imposed on ADR/GDR issues shall be consistent with the Company Law provisions. Voting rights in the case of banking companies will continue to be in terms of the provisions of the Banking Regulation Act, 1949 and the instructions issued by the Reserve Bank10 from time to time, as applicable to all shareholders exercising voting rights.

(viii) Erstwhile OCBs which are not eligible to invest in India and entities prohibited to buy / sell or deal in securities by SEBI will not be eligible to subscribe to ADRs / GDRs issued by Indian companies.

(ix) The pricing of ADR / GDR issues including sponsored ADRs / GDRs should be made at a price determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

(x) 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.

(xi) **Sponsored ADR/GDR issue**

An Indian company can also sponsor an issue of ADR / GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs / GDRs can be issued abroad. The proceeds of the ADR / GDR issue is remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs / GDRs.
Reporting of ADR/GDR Issues

The Indian company issuing ADRs / GDRs has to furnish to the Reserve Bank, full details of such issue in the prescribed Form, within 30 days from the date of closing of the issue. The company should also furnish a quarterly return in the prescribed Form, 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.


Ensure that

- A company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

- The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.

- The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting:

  Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.

- The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

- The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

- The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts:

  Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

- The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

- The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

- The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

- A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

- Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of
the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

- The proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

**Issue of Foreign Currency Convertible Bonds (FCCBs) ((Automatic Route))**

1. The FCCBs to be issued will have to conform to the Foreign Direct Investment Policy (including Sectoral Cap and Sectors where FDI is permissible) of the Government of India as announced from time to time and the Reserve Bank’s Regulations/directions issued from time to time.

2. The issue of FCCBs shall be subject to a ceiling of US $500 million in any one financial year.

3. Public issue of FCCBs shall be only through reputed lead managers in the international market. In case of private placement, the placement shall be with banks, or with multilateral and bilateral financial institutions, or foreign collaborators, or foreign equity holder having a minimum holding of 5% of the paid-up equity capital of the issuing company. Private placement with unrecognized sources is prohibited.

4. The maturity of the FCCB shall not be less than 5 years. The call and put option, if any, shall not be exercisable prior to 5 years.

5. Issue of FCCBs with attached warrants is not permitted.

6. The “all in cost” will be on par with those prescribed for External Commercial Borrowings (ECB) Schemes specified in the Schedule to Notification No. FEMA 3/2000-RB dated 3rd May, 2000 as amended from time to time. The “all in cost” shall include the issue related expenses such as legal fees, lead managers fees, and out of pocket expenses.

7. The FCCB proceeds shall not be used for investment in Stock Market, and may be used for such purposes for which ECB proceeds are permitted to be utilized under the ECB scheme.

8. FCCBs are allowed for corporate investments in industrial sector especially infrastructure sector. Funds raised through the mechanism may be parked abroad unless actually required.

9. FCCBs for meeting rupee expenditure under automatic route to be hedged unless there is a natural hedge in the form of uncovered foreign exchange receivables, which will be ensured by Authorized Dealers.

10. Financial intermediaries (viz. a bank, DFI or NBFC) shall not be allowed access to FCCBs, except those Banks and financial intermediaries that have participated in the Textile or Steel Sector restructuring package of the Government/RBI subject to the limit of their investment in the package.

11. Banks, FIs, NBFCs shall not provide guarantee/letter of comfort etc. for the FCCB issue.

12. The issue related expenses shall not exceed 4% of issue size and in case of private placement, shall not exceed 2% of the issue size.

13. The issuing entity shall, within 30 days from the date of completion of the issue, furnish a report to the
concerned Regional Office of the Reserve Bank of India through a designated branch of an Authorized Dealer giving the details and documents as under:

(a) The total amount of the FCCBs issued

(b) Names of investors resident outside India and number of FCCBs issued to each of them.

**INDIAN DEPOSITORY RECEIPTS**

Under section 2(48) of the Companies Act, 2013 “Indian Depository Receipt” means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts.

Section 390 read with Companies (Registration of Foreign Companies) Rules, 2014 provides that no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India shall make an issue of Indian Depository Receipts (IDRs) unless such company complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

Investment in Indian Depository Receipts (IDRs) is an interesting opportunity for the Indian Investors who are looking for investing their funds in foreign equity. Just like American Depository Receipts or Global Depository Receipts, which are instruments used by Indian Companies to raise money abroad, IDRs are meant for foreign companies looking to raise capital in India.

Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company which is located outside India. The Indian IDR holders would thus indirectly own the equity shares of overseas issuer company. IDRs are to be listed and denominated in Indian Currency. An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI.

The parties involved in the issue of Indian Depository Receipts are:

(a) Issuing Company (Foreign Company)

(b) Overseas Custodian (custodian located at the same country where issuing company is located).

(c) Domestic Depository (Depository located in India)

(d) Indian Investors who has invested in IDR issue

**Rule 13 of Companies (Registration of Foreign Companies) Rules, 2014 – Indian Depository Receipts**

For the purposes of this rule, the term “Indian Depository Receipt” (hereinafter referred to as ‘IDR’) means any instrument in the form of a depository receipt created by a Domestic Depository in India and authorized by a company incorporated outside India making an issue of such depository receipts.

“Domestic Depository” means custodian of securities registered with the Securities and Exchange Board of India and authorized by the issuing company to issue IDRs.


“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.

(1) For the purposes of section 390, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India (hereinafter in this rule called ‘issuing company’) shall make an issue of Indian Depository Receipts (IDRs) unless such company complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

2. Eligibility

The issuing company shall not issue IDRs unless-

(a) its 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 three years) in its parent country of at least US$ 100 million;

(b) it has been continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years;

(c) it has a track record of distributable profits in terms of section 123 of the Act, for at least three out of immediately preceding five years;

(d) It fulfills such other eligibility criteria as may be laid down by the Securities and Exchange Board of India from time to time in this behalf.

3. Procedure

The issuing company shall follow the following procedure for making an issue of IDRs:

(a) the issuing company shall, where required, obtain the necessary approvals or exemptions from the appropriate authorities from the country of its incorporation under the relevant laws relating to issue of capital and IDRs.

(b) issuing company shall obtain prior written approval from the Securities and Exchange Board of India on an application made in this behalf for issue of IDRs along with the issue size.

(c) an application under clause (b) shall be made to the Securities and Exchange Board of India (along with draft prospectus) at least ninety days prior to the opening date of the IDRs issue, in such form , along with such fee and furnishing such information as may be specified by the Securities and Exchange Board of India from time to time:

Provided that the issuing company shall also file with the Securities and Exchange Board of India, through a Merchant Banker, a due diligence report along with the application under clause (b) in the form specified by the Securities and Exchange Board of India.

(d) the Securities and Exchange Board of India may, within a period of thirty days of receipt of an application under clause (c), call for such further information, and explanations, as it may deem necessary, for disposal of such application and shall dispose the application within a period of thirty days of receipt of further information or explanation:

Provided that if within a period of sixty days from the date of submission of application or draft prospectus, the Securities and Exchange Board of India specifies any changes to be made in the
draft prospectus, the prospectus shall not be filed with the Securities and Exchange Board of India or Registrar of Companies unless such changes have been incorporated therein.

(e) the issuing company shall on approval being granted by the Securities and Exchange Board of India to an application under clause (b), pay to the Securities and Exchange Board of India an issue fee as may be prescribed from time to time by the Securities and Exchange Board of India.

(f) the issuing company shall file a prospectus, certified by two authorized signatories of the issuing company, one of whom shall be a whole-time director and other the Chief Financial Officer, stating the particulars of the resolution of the Board by which it was approved with the Securities and Exchange Board of India and Registrar of Companies, New Delhi before such issue:

Provided that at the time of filing of said prospectus with the Registrar of Companies, New Delhi, a copy of approval granted by the Securities and Exchange Board of India and the statement of fees paid by the Issuing Company to the Securities and Exchange Board of India shall also be attached.

(g) the prospectus to be filed with the Securities and Exchange Board of India and the Registrar of Companies, New Delhi shall contain the particulars as prescribed in sub-rule (8) and shall be signed by all the whole-time directors of the issuing company, and the Chief Financial Officer.

(h) the issuing company shall appoint an overseas custodian bank, a Domestic Depository and a Merchant Banker for the purpose of issue of IDRs.

(i) the issuing company may appoint underwriters registered with the Securities and Exchange Board of India to underwrite the issue of IDRs.

(j) the issuing company shall deliver the underlying equity shares or cause them to be delivered to an Overseas Custodian Bank and the said bank shall authorize the domestic depository to issue IDRs.

(k) the issuing company shall obtain in-principle listing permission from one or more stock exchanges having nationwide trading terminals in India.

4. Merchant Banker to deliver certain documents to SEBI and ROC

The Merchant Banker to the issue of IDRs shall deliver for registration the following documents or information to the Securities and Exchange Board of India and Registrar of Companies at New Delhi, namely:-

(a) instrument constituting or defining the constitution of the issuing company;

(b) 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;

(c) if the issuing company has established place of business in India, address of its principal office in India;

(d) if the issuing company does not establish a 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 key managerial personnel of the Issuing company shall be kept for public inspection;

(e) a certified copy of the certificate of incorporation of the issuing company in the country in which it is incorporated;

(f) the 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;

(g) if any document or any portion thereof required to be filed with the Securities and Exchange Board of India or the Registrar of Companies is not in English language, a translation of that document or portion thereof in English, certified by a key managerial personnel of the company to be correct and attested by an authorized officer of the Embassy or Consulate of that country in India, shall be attached to each copy of the document.

5. (a) No application form for the securities of the issuing company shall be issued unless the form is accompanied by a memorandum containing the salient features of prospectus in the specified form.

(b) An application form can be issued without the memorandum as specified in clause (a), if it is issued in connection with an invitation to enter into an underwriting agreement with respect to the IDRs.

(c) The prospectus for subscription of IDRs of the Issuing company which includes a statement purporting to be made by an expert shall not be circulated, issued or distributed in India or abroad unless a statement that 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 Securities and Exchange Board of India and the Registrar of Companies, New Delhi, appears on the prospectus.

(d) The provisions of the Act shall apply for all liabilities for mis-statements in prospectus or punishment for fraudulently inducing persons to invest money in IDRs.

(e) 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-

(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 or the Securities and Exchange Board of India were not material.

6. (a) A holder of IDRs may transfer the IDRs, may ask the Domestic Depository to redeem them or any person may seek reissuance of IDRs by conversion of underlying equity shares, subject to the provisions of the Foreign Exchange Management Act, 1999, the Securities and Exchange Board of India Act, 1992, or the rules, regulations or guidelines issued under these Acts, or any other law for the time being in force;

(b) In case of redemption, Domestic Depository shall request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of the holder of IDRs for being sold directly on behalf of holder of IDRs, or being transferred in the books of Issuing company in the name of holder of IDRs and a copy of such request shall be sent to the issuing company for information.

(c) A holder of IDRs may, at any time, nominate a person to whom his IDRs shall vest in the event of his death and Form FC-5 may be used for this purpose.

7. (a) The repatriation of the proceeds of issue of IDRs shall be subject to laws for the time being in force relating to export of foreign exchange.

(b) The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed twenty five per cent. of the post issue number of equity shares of the company.

(c) Notwithstanding the denomination of securities of an Issuing company, the IDRs issued by it shall be denominated in Indian Rupees.
(d) The IDRs issued under this Rule shall be listed on the recognized Stock Exchange(s) in India as specified in clause (k) of sub-rule (3) and such IDRs may be purchased, possessed and freely transferred by a person resident in India as defined in section 2(v) of the Foreign Exchange Management Act, 1999, subject to the provisions of the said Act:

Provided that 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 Reserve Bank of India on the subject matter;

(e) Every issuing company shall comply with such continuous disclosure requirements as may be specified by the Securities and Exchange Board of India in this regard.

(f) 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 shall distribute them to the IDR holders in proportion to their holdings of IDRs.

8. Prospectus or letter of offer to contain certain particulars

(a) General information-

(b) Capital Structure of the Company- The authorized, issued, subscribed and paid-up capital of the issuing company;

(c) Terms of the issue-

(d) Particulars of Issue-

(e) Company, Management and Project elsewhere.

(f) Report-

(i) Where the law of a country, in which the Issuing company is incorporated, requires annual statutory audit of the accounts of the Issuing company, a report by the statutory auditor of the Issuing company, in such form as may be specified by the Securities and Exchange Board of India on-

(A) the audited financial statements of the Issuing company in respect of three financial years immediately preceding the date of prospectus;

(B) the interim audited financial statements in respect of the period ending on a date which is less than 180 days prior to the date of opening of the issue, if the gap between the ending date of the latest audited financial statements disclosed under clause (A) and the date of the opening of the issue is more than 180 days:

Provided that if the gap between such date of latest audited financial statements and the date of opening of issue is 180 days or less, the requirement under item (B) shall be deemed to be complied with, if a statement, as may be specified by the Securities and Exchange Board of India, in respect of material changes in the financial position of Issuing company for such gap is disclosed in the Prospectus:

Provided further that in case of an Issuing company which is a foreign bank incorporated outside India and which is regulated by a member of the Bank for International Settlements or a member of the International Organization of Securities Commissions which is a signatory to a Multilateral Memorandum of Understanding, the requirement under this paragraph, in respect of period beginning with last date of period for which the latest
audited financial statements are made and the date of opening of the issue shall be satisfied, if the relevant financial statements are based on limited review report of such statutory auditor;

(ii) Where the law of the country, in which the Issuing company is incorporated, does not require annual statutory audit of the accounts of the Issuing company, a report, in such form as may be specified by the Securities And Exchange Board of India, certified by a Chartered Accountant in practice within the terms and meaning of the Chartered Accountants Act, 1949 on -

(A) the financial statements of the Issuing company, in particular on the profits and losses for each of the three financial years immediately preceding the date of prospectus and upon the assets and liabilities of the Issuing company; and

(B) the interim financial statements in respect of the period ending on a date which is less than one hundred and eighty days prior to the date of opening of the issue, have to be included in report, if the gap between the ending date of the latest financial statements disclosed under item (A) and the date of the opening of the issue is more than one hundred and eighty days:

Provided that if the gap between such date of latest audited financial statements and the date of opening of issue is one hundred and eighty days or less, the requirement under item (B) shall be deemed to be complied with if a statement, as may be specified by the Securities And Exchange Board of India, in respect of changes in the financial position of Issuing company for such gap is disclosed in the Prospectus.

(iii) the gap between date of opening of issue and date of reports specified under sub-clauses (i) and (ii) shall not exceed one hundred and twenty days;

(iv) If the proceeds of the IDR issue are used for investing in other body(ies) corporate, then following details of such body(ies) corporate shall be given-

(A) the Name and address(es) of the bodies corporate;

(B) the reports stated in sub-clauses (i) and (ii), as the case may be, in respect of such body (ies) corporate also.”

(g) Other Information-

(i) the Minimum subscription for the issue;

(ii) the fees and expenses payable to the intermediaries involved in the issue of IDRs;

(iii) the declaration with regard to compliance with the Foreign Exchange Management Act, 1999.

(h) Inspection of Documents-

The Place at which inspection of the offer documents, the financial statements and auditor’s report thereof shall be allowed during the normal business hours; and

(i) any other information as specified by the Securities and Exchange Board of India or the Income-tax Authorities or the Reserve Bank of India or other regulatory authorities from time to time.

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 at least 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 been returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
(b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

For underwritten issues

If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue,
the issuing company shall forthwith refund the entire subscription amount received with interest to the
subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

**Filing of draft prospectus, due diligence certificates, payment of fees and issue advertisement for IDR**

The issuing company making an issue of IDR shall enter into an agreement with a merchant banker on the
lines of format of agreement specified. If the issue is managed by more than one merchant banker, the rights,
obligations and responsibilities, relating inter-alia to disclosures, allotment, refund and underwriting
obligations, if any, of each merchant banker shall be predetermined and disclosed in the prospectus on the
lines of format as specified in the Schedule.

The issuing company shall file a draft prospectus with the Board through a merchant banker along with the
requisite fee, as prescribed in Companies (Issue of Indian Depository Receipts) Rules, 2004.

The prospectus filed with the Board under this regulation shall also be furnished to the Board in a soft copy
on the lines specified in the Schedule.

(5) The lead merchant bankers shall:

(a) Submit a due diligence certificate as per specified format to the Board along with the draft
prospectus.

(b) Certify that all amendments, suggestions or observations made by the Board have been
incorporated in the prospectus.

(c) Submit a fresh due diligence certificate as per format specified, at the time of filing the prospectus
with the Registrar of the Companies.

(d) Furnish a certificate as per specified format, immediately before the opening of the issue, certifying
that no corrective action is required on its part.

(e) Furnish a certificate as per specified format, after the issue has opened but before it closes for
subscription.

(6) The issuing company shall make arrangements for specified mandatory collection centres.

(7) The issuing company shall issue an advertisement in one English national daily newspaper with wide
circulation and one Hindi national daily newspaper with wide circulation, soon after receiving final
observations, if any, on the publicly filed draft prospectus with the Board, which shall be on the lines of the
format and contain the minimum disclosures as required.

**Display of bid data**

The stock exchanges offering online bidding system for the book building process shall display on their
website, the data pertaining to book built IDR issue, in the format specified, from the date of opening of the
bids till at least three days after closure of bids.

**Disclosures in prospectus and abridged prospectus**

The prospectus shall contain all material disclosures which are true, correct and adequate so as to enable
the applicants to take an informed investment decision.

The prospectus shall contain:

(a) the disclosures specified in Schedule to Companies (Issue of Indian Depository Receipts) Rules,
    2004; and
(b) the specified disclosures.

(3) The abridged prospectus for issue of Indian Depository Receipts shall contain the specified disclosures.

Post-issue reports

The merchant banker shall submit post-issue reports to the Board as follows:

(a) initial post issue report, within three days of closure of the issue;

(b) final post issue report, within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue.

Undersubscribed issue

In case of undersubscribed issue of IDR, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board on the lines of the format specified.

Finalisation of basis of allotment

The executive director or managing director of the stock exchange, where the IDR are proposed to be listed, along with the post issue lead merchant bankers and registrars to the issueshall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the specified allotment procedure.

Rights Issue of Indian Depository Receipts-Salient Features

Eligibility.

No issuer shall make a rights issue of IDR:

(a) if at the time of undertaking the rights issue, the issuer is in breach of ongoing material obligations under the IDR Listing Agreement as may be applicable to such issuer or material obligations under the deposit agreement entered into between the domestic depository and the issuer at the time of initial offering of IDR; and

(b) unless it has made an application to all the recognised stock exchanges in India, where its IDRs are already listed, for listing of the IDRs to be issued by way of rights and has chosen one of them as the designated stock exchange.

Record Date

A listed issuer making a rights issue of IDRs shall in accordance with provisions of the listing agreement, announce a record date for the purpose of determining the shareholders eligible to apply for IDRs in the proposed rights issue.

Disclosures in the offer document and the addendum for the rights offering

The offer document for the rights offering shall contain disclosures as required under the home country regulations of the issuer.

Apart from the disclosures as required under the home country regulations, an additional wrap (addendum to offer document) shall be attached to the offer document to be circulated in India containing information as specified in Part A of Schedule XXI and other instructions as to the procedures and process to be followed with respect to rights issue of IDRs in India.
Filing of draft offer document and the addendum for rights offering

(1) The issuer shall appoint one or more merchant bankers, one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.

(2) The issuer shall, through the lead merchant banker, file the draft offer document prepared in accordance with the home country requirements along with an addendum containing disclosures as specified in Part A of Schedule XXI with the SEBI, as a confidential filing accompanied with fees as specified in Part A of Schedule IV.

(3) The Board may specify changes or issue observations, if any, on the draft offer document and the addendum within thirty days or from the following dates, whichever is later:

(a) the date of receipt of the draft offer document prepared in accordance with the home country requirements along with an addendum under sub-regulation (2); or

(b) the date of receipt of satisfactory reply from the lead merchant bankers, where SEBI has sought any clarification or additional information from them; or

(c) the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency; or

(d) the date of receipt of a copy of in-principle approval letter issued by the recognized stock exchanges.

(4) If SEBI specifies changes or issues observations on the draft offer document and the addendum under sub-regulation(3), the issuer and the merchant banker shall file the revised draft offer document and the updated addendum after incorporating the changes suggested or specified by the SEBI.

(5) The issuer shall also submit an undertaking from the Overseas Custodian and Domestic Depository addressed to the issuer, to comply with their obligations with respect to the said rights issue under their respective agreements entered into between them, along with the offer document.

(6) The issuer shall ensure that the Compliance Officer, in charge of ensuring compliance with the obligations under this Chapter, functions from within the territorial limits of India.

(c) Listing Agreement for Indian Depository Receipts (IDRs)

1. Board Meeting

— Check whether the Company has notified stock exchange at least 7 days in advance of the date of the meeting of its Board of Directors at which the recommendation or declaration of a dividend or a rights issue or convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend were considered

— Check whether the Company has within 15 minutes of Board Meeting, intimated to the Stock Exchange, by phone, fax, telegram, e-mail, the details on all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment, short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by issue of rights shares, or in any other manner; short particulars of the reissues of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe thereto; short particulars of any other alterations of capital, including calls; or any other information
necessary to enable the holders of the IDRs to appraise the issuer’s position and to avoid the establishment of a false market.

2. Intimation/filing/submissions to stock exchange/s

— Check whether the Company has notified the stock exchange at least twenty-one days in advance of the date on and from which the dividend on shares will be payable.

— Check whether the Company has submitted to the exchange documents such as Copy of SEBI observation letter on draft prospectus, due diligence report from depository, merchant bankers certificate reporting positive compliance

— Check whether the issuer, in case of granting any options, has notified Stock Exchange number of shares covered by such options, of the terms thereof and of the time within which they may be exercised and any subsequent changes or cancellation or exercise of such options.

— Check whether the company has notified any change in the rights attaching to any class of equity shares into which the IDRs are exchangeable.

— Check whether the company has notified change in the constitution of Board, Managing Director, Auditor, Compliance officer, domestic depository, overseas custodian etc

— Check whether the Company has forwarded to stock exchange promptly the following:
  — copies of the Annual Reports, which shall include the Balance Sheet and Profit & Loss Account, Directors’ Report and the Auditors’ Report and of all periodical and special reports as soon as they are issued;
  — copies of all notices, resolutions and circulars relating to new issue of capital prior to their dispatch to the equity shareholders or IDR holders;
  — copies of all the notices, call letters or any other circulars including notices of meetings at the same time as they are sent to the equity shareholders, IDR holders, debenture holders or creditors or any class of them or as they are advertised in the Press.
  — copy of the proceedings at all Annual and Extraordinary General Meetings of the Issuer;
  — copy of the deposit agreement as soon as it is executed.
  — copies of all notices, circulars, etc., issued or advertised in the press either by the Issuer, or by any other body corporate which the Issuer proposes to absorb or with which the Issuer proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the press in regard to meetings of equity shareholders, IDR holders or any class of them and copies of the proceedings at all such meetings.

— Check whether the company has filed with the Exchange the shareholding pattern on a quarterly basis within 15 days of end of the quarter in the prescribed form

— Check Issuer has intimated to the Stock Exchanges, immediately of events such as strikes, lockouts, closure on account of power cuts, etc. and all events which will have a bearing on the performance/operations of the company as well as price sensitive information both at the time of occurrence of the event and subsequently after the cessation of the event.

— Check whether the company has informed stock exchange about material events such as Change in the general character or nature of business, Disruption of operations due to natural calamity, Commencement of Commercial Production/Commercial Operations, Developments with respect to
pricing/realisation arising out of change in the regulatory framework, Litigation/dispute with a material impact, Revision in Ratings etc.

— Check whether the company has furnished on a quarterly basis a statement to the stock exchange indicating the variations between projected utilisation of funds and/or projected profitability statement made by it in its prospectus or letter of offer and the actual utilisation of funds and/or actual profitability.

— Check whether the company has furnished a copy of agreement or MOU entered into with overseas custodian bank, domestic depository, merchant banker and RTA to the stock exchange.

3. Issuance of further IDRs

— Check whether the company has obtained ‘in-principle’ approval and made application for listing, in respect of further issue of IDRs if any,

— Check whether the Company has complied with all legal and regulatory requirements before issuing any prospectus/offer document/letter of offer for public subscription of any IDRs.

— Check whether the company has made the allotment of IDRs offered to the public within 30 days of the closure of the public issue and has paid interest @ 15% per annum if the allotment has not been made and or refund orders have not been dispatched to the investors within 30 days from the date of the closure of the issue.

— Check whether the underlying shares of IDRs ranks pari passu with the existing shares of the same class and the fact of having different classes of shares based on different criteria, if any, has been disclosed by the company in every offer document issued in India and in the annual report.

4. Corporate Governance

Composition of Board

— Check whether the Board of the company has optimum combination of executive/non-executive director and with prescribed minimum Percentage of Independent Directors

— Check whether all fees/compensation, if any paid to non-executive directors, including independent directors, has been fixed by the Board of Directors and with previous approval of shareholders in general meeting.

— Check whether the Board has met at least four times a year, with a maximum time gap of four months between any two meetings.

— Check whether no director is a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director.

— Check whether the Board periodically reviews compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.

— Check whether the Board has laid down a code of conduct for all Board members and senior management of the company and the same is posted on the website of the company.

— Check whether all Board members and senior management personnel affirms compliance with the code on an annual basis.

— Check whether the Annual Report of the company contains a declaration to this effect signed by the CEO.

Audit Committee

— Check whether a qualified and independent Audit Committee has been set up, with minimum three
directors as members and Two-thirds of them being independent.

— Check whether all members of Audit Committee are financially literate and at least one member has accounting or related financial management expertise.

— Check whether the Chairman of the Audit Committee is an independent director and was present at Annual General Meeting to answer shareholder queries.

— Check whether the Audit Committee has met at least four times in a year and not more than four months elapsed between two meetings.

— Check whether the Audit Committee has reviewed the following information:
  1. Management discussion and analysis of financial condition and results of operations;
  2. Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
  3. Management letters/letters of internal control weaknesses issued by the statutory auditors;
  4. Internal audit reports relating to internal control weaknesses; and
  5. The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee.

Subsidiary Companies

— Check whether at least one independent director on the Board of Directors of the holding company is a director on the Board of Directors of a material non-listed Indian subsidiary company.

— Check whether the Audit Committee of the listed holding company review the financial statements, in particular, the investments made by the unlisted subsidiary company.

— Check whether the minutes of the Board meetings of the unlisted subsidiary company was placed at the Board meeting of the listed holding company.

Disclosures

— Check whether the company has disclosed related party transactions if any to the audit committee.

— Check whether the company has disclosed to the Audit Committee about accounting treatment which is different from prescribed accounting standard.

— Check whether the company has laid down procedures to inform Board members about the risk assessment and minimization procedures.

— Check whether the company has disclosed to the Audit Committee the uses and applications of funds arising out of an IPO.

Remuneration of Directors

— Check whether all pecuniary relationship or transactions of the non-executive directors vis-à-vis the company has been disclosed in the Annual Report.

— Check whether the following disclosures on the remuneration of directors has been made in the section on the corporate governance of the Annual Report:
  
  (a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
  
  (b) Details of fixed component and performance linked incentives, along with the performance criteria.
  
  (c) Service contracts, notice period, severance fees.
(d) Stock option details, if any - and whether issued at a discount as well as the period over which accrued and over which exercisable.

— Check whether the company has published its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company’s website and reference drawn thereto in the annual report.

— Check whether the company has disclosed the number of shares and convertible instruments held by non-executive directors in the annual report.

Management

— Check whether, as part of the directors’ report or as an addition thereto, a Management Discussion and Analysis report is forming part of the Annual Report to the shareholders with specified information.

— Check whether Senior management has made disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.).

Shareholders

— Check, in case of the appointment of a new director or re-appointment of a director the shareholders has been provided with the following information:

   — A brief resume of the director;

   — Nature of his expertise in specific functional areas;

   — Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and

   — Shareholding of non-executive directors as stated in clause 24 (IV)(E)(v) above.

— Check whether Quarterly results and presentations made by the company to analysts has been put on company’s website, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own website.

— Check whether a board committee under the chairmanship of a non-executive director has been formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc.

CEO/CFO certification

Check whether the CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function has certified to the Board that:

(a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

   (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   (ii) these statements together present a true and fair view of the company’s affairs and are in compliance with existing accounting standards, applicable laws and regulations.

(b) There are, to the best of their knowledge and belief, no transactions entered into by the company
during the year which are fraudulent, illegal or violative of the company’s code of conduct.

(c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

(d) They have indicated to the auditors and the Audit Committee

(i) significant changes in internal control over financial reporting during the year;

(ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and

(iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company’s internal control system over financial reporting.

**Report on Corporate Governance**

— Check whether there is a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance.

— Check whether the company has submitted a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the specified format.

**Compliance**

Check whether the company has obtained a certificate from either the auditors or practising company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors’ report, which is sent annually to all the shareholders of the company and has been sent to the Stock Exchanges along with the annual report filed by the company.

5. Actions/investigations initiated

Check whether the issuer has intimated any action/investigations initiated by any statutory/regulatory authority along with the purpose of the same.

6. Information/submissions to IDR holders

Check whether the issuer has sent a copy of Annual Report containing Boards Report, Profit & Loss Account, Balance Sheet, Cash flow statement, Auditors report etc within four months of the end of financial year.

Check whether the company has disclosed the pre and post arrangement capital structure and shareholding pattern to the IDR holders in case of corporate restructuring like mergers/amalgamations and other schemes in advance.

7. Annual Report/publications etc

— Check whether the Issuer has sent to its IDR holders and the stock exchange a copy of the annual report within four months of the end of the financial year. The annual report shall contain the Board’s report, Balance Sheet, Profit and Loss Account, Cash Flow Statement and the auditor’s report thereon.

— Check whether the company has complied either with Indian GAAP (including all Accounting Standards issued by the Institute of Chartered Accountants of India) or with the International
Financial Reporting Standards (IFRS) [including the International Accounting Standards (IAS)] or with US GAAP in the preparation and disclosure of its financial results.

— In case the Company opts to prepare and disclose its financial results as per IFRS/US GAAP, Check whether it has complied with the requirements of clauses 35 and 36 of listing agreement for IDRs.

— In case the Company opts to prepare and disclose its financial results as per Indian GAAP, Check whether the company has complied with, as far as may be, with clauses 37 and 38 of the listing agreement for IDRs and with the provisions of the Companies Act, 1956 relating to authentication and presentation of annual accounts as far as may be practicable.

8. Audit Qualifications

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

9. Appointment of Company Secretary

Check whether the company has appointed the Company Secretary as Compliance Officer who will directly liaise with the authorities such as SEBI, Stock Exchanges, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter.

10. Undertaking of Due diligence

Check whether the company has undertaken a due diligence survey to ascertain whether the RTA is sufficiently equipped with infrastructure facilities such as adequate manpower, computer hardware and software, office space, documents handling facility etc., to serve the IDR holders.

11. Equivalent Information

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

12. Miscellaneous

Check whether any scheme of arrangement/amalgamation/merger/ reconstruction/reduction of capital, etc., presented by the Company to any Court or Tribunal has not violated in any way violate, override or circumscribe the provisions of securities laws or the stock exchange requirements

Check whether the issuer has complied with the rules/regulations/laws of the country of origin.

**PENAL PROVISIONS RELATING TO IDRs UNDER VARIOUS LEGISLATIONS**

**(a) Companies Act, 2013**

Section 391 and 392 of the Act prescribe the penalty for non-compliance of any of the provisions relating to IDR which is reproduced below:

*Section 391: Application of sections 34 to 36 and Chapter XX*

(1) The provisions of sections 34 to 36 (both inclusive) shall apply to—

(i) the issue of a prospectus by a company incorporated outside India under section 389 as they apply to prospectus issued by an Indian company;

(ii) the issue of Indian Depository Receipts by a foreign company.
(2) The provisions of Chapter XX shall apply mutatis mutandis for closure of the place of business of a foreign company in India as if it were a company incorporated in India.

Section 392: Punishment for contravention

Without prejudice to the provisions of section 391, if a foreign company contravenes the provisions of this Chapter, the foreign company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and in the case of a continuing offence, with an additional fine which may extend to fifty thousand rupees for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twentyfive thousand rupees but which may extend to five lakh rupees, or with both.

(b) Securities Contracts Regulation Act, 1956

Apart from the above, non-compliance of the conditions of the listing agreement attracts the provisions of Section 23(2) and 23E of the SCRA which is given hereunder:

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

— Section 23E of SCRA, 1956 – failure to comply with conditions of listing or delisting or committing a breach thereof – ₹25 crores fine.

(c) Foreign Exchange Management Act, 1999

Non-compliance of FEMA provisions attracts the following:

(1) If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorization is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.

(2) Any Adjudicating Authority adjudging any contravention under sub-section (1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

Explanation: For the purposes of this sub-section, “property” in respect of which contravention has taken place, shall include:

(a) deposits in a bank, where the said property is converted into such deposits;

(b) Indian currency, where the said property is converted into that currency; and

(c) any other property which has resulted out of the conversion of that property.
LESSON ROUND UP

- Global Depository Receipts means any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

- Domestic Custodian Bank means a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian Company which are issued by it against global Depository receipts or certificates.

- Overseas Depository Bank means a bank authorised by the issuing company to issue global Depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

- GDR issue can be through sponsored GDR programme or through fresh issue of shares.

- Through Sponsored GDRs the existing holders of shares in Indian Companies can sell their shares in the overseas market. It is a process of disinvestment by Indian shareholders of their holding in overseas market.

- A limited Two-way Fungibility scheme has been put in place by the Government of India for ADRs/GDRs. Under this scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/ GDRs which have been redeemed into underlying shares and sold in the Indian market.

- Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange etc.

- Indian Companies issuing GDRs in America and Europe has to comply with SEC requirements and EU directives.

- Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company.

- Domestic Depository is custodian of securities registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts.

- Overseas Custodian Bank means a banking company which is established in a country outside India and has a place of business in India and acts as custodian for the equity shares of issuing company against which IDRs are proposed to be issued after having obtained permission from Ministry of Finance for doing such business in India.

- Issue of IDRs are regulated by Chapter X of SEBI (ICDR) Regulations, 2009, Section 390 of Companies Act, 2013 read with Rule 13 of Companies (Registration of Foreign Companies) Rules, 2014 and Listing Agreement for IDRs.

- The IDRs issued should be listed on the recognized Stock Exchange(s) in India as specified and such IDRs may be purchased, possessed and freely transferred by a person resident in India.

- Issuer of an IDR has to comply with the listing conditions stated in the listing agreement for IDRs.

SELF TEST QUESTIONS

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

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

4. What are the provisions relating to transfer/redemption of GDRs?
5. Describe the working mechanism of GDRs?
6. What are the check list in respect of due diligence of GDR issue?
7. What do you mean by Indian Depository Receipts. Briefly explain the salient features of Rule 13 of Companies (Registration of Foreign Companies) Rules, 2014.
8. What are the procedures for making an issue of Indian Depository Receipts?
9. Explain the procedure for carrying out due diligence of IDR issue.
Lesson 9
Due Diligence for Banks

LEARNING OBJECTIVES
Reserve Bank of India, with a view to facilitate industry has liberalized rules for consortium lending a little more than a decade back. Multiple banking as a concept had also started gaining ground at that time and many corporates opted for the multiple banking route presumably due to the perceived rigidity of the consortium arrangement. Unfortunately, exchange of information between banks was minimal and resultanty unscrupulous borrowers were able to take advantage of the information asymmetry that prevailed. The Central Vigilance Commission concerned at this development had attributed this phenomena to lack of effective sharing of information amongst banks. A need was felt, all along to have certification of statutory compliances by a Company through a professional such as a Company Secretary/Chartered Accountant/Cost Accountant so that the lending banks get the desired comfort. Accordingly, the Reserve Bank of India advised all the scheduled commercial Banks to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue in the specified format. The Diligence Report broadly covers many critical and relevant matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilisation/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc. The compact structure of the Diligence Report under its twenty-five paragraphs makes it obligatory for a Practicing Company Secretary to prepare the Report after critical examination of all relevant records and documents of the borrowing companies which demands a high degree of care, skill and knowledge. After reading this lesson you will be able to understand the scope, process of due diligence for banks including compliance checklist.
INTRODUCTION

The Reserve Bank of India vide its Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008 advised all the scheduled commercial Banks (excluding RRBs and LABs) to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in the aforesaid notification. Further RBI vide its Circular dated January 21, 2009 also advised all Primary Urban Co-operative Banks to obtain Diligence Report. Subsequently the RBI vide its Circulars dated December 08, 2008 and February 10, 2009 revised the format of Diligence Report for Scheduled Commercial Banks and also for Primary Urban Co-operative Banks vide its Circular dated February 12, 2009.

Background

In October 1996, various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements were withdrawn by Reserve Bank of India with a view to introducing flexibility in the credit delivery system and to facilitate smooth flow of credit. However, Central Vigilance Commission (CVC), Government of India, in the light of frauds involving consortium/multiple banking arrangements which have taken place in the recent past, expressed concerns on the working of Consortium Lending and Multiple Banking Arrangements in the banking system. The CVC attributed the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of the account of the borrowers amongst various banks.

The matter was examined by the Reserve Bank of India (RBI) in consultation with the Indian Banks Association (IBA) who were of the opinion that there is need for improving the sharing/dissemination of information among the banks about the status of the borrowers enjoying credit facilities from more than one bank.

The RBI vide its Circular No. RBI/2008-2009-313/DBOD No. B.P. BC 94/08.12.001/2008-2009 dated December 08, 2008, advised the banks to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks as under:

(i) At the time of granting fresh facilities, banks may obtain declaration from the borrowers about the credit facilities already enjoyed by them from other banks. In the case of existing lenders, all the banks may seek a declaration from their existing borrowers availing sanctioned limits of ₹ 5.00 crore and above or wherever, it is in their knowledge that their borrowers are availing credit facilities from other banks, and introduce a system of exchange of information with other banks as indicated above.

(ii) Subsequently, banks should exchange information about the conduct of the borrowers’ accounts with other banks at least at quarterly intervals.

(iii) Obtain regular certification by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue.

(iv) Make greater use of credit reports available from Credit Information Bureau of India Limited (CIBIL).

(v) The banks should incorporate suitable clauses in the loan agreements in future (at the time of next renewal in the case of existing facilities) regarding exchange of credit information so as to address confidentiality issues.
Need for Diligence Report

In order to streamline consortium/multiple banking arrangements, Reserve Bank of India has been making regulatory prescriptions from time to time regarding conduct of consortium/multiple banking. Banks have also been advised to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks by following specified criteria.

Way back in October 1996, Reserve Bank of India withdrew various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements so as to bring flexibility in the credit delivery system. With the passage of time, however, it was observed that the relaxations meant for providing flexibility to the borrowing community, may also have contributed to various types of frauds, prompting the Central Vigilance Commission to attribute the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of account of the borrowers among various banks.

Accordingly, Reserve Bank of India in consultation with the Indian Banks’ Association, specified the framework to be observed by banks for improving the sharing/dissemination of information amongst the banks about the status of the borrowers enjoying credit facilities from more than one bank. Further, the banks are required to obtain regular certification of Diligence Report from a professional, preferably a Company Secretary about conformity to statutory prescriptions in vogue. Thus, the banking community in general and the Regulatory in particular have reposed enormous trust on professionals.

The Diligence Report covers many critical and relevant matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilization/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc. The compact structure of the Diligence Report under its twenty-five paragraphs makes it obligatory for a Practicing Company Secretary to prepare the Report after critical examination of all relevant records and documents of the borrowing companies which demands a high degree of care, skill and knowledge.

The introduction of diligence reporting by Company Secretary in Practice is expected to lay down a strong foundation for good governance culture among borrowing corporates and correspondingly enhance the comfort level of the banks by reducing the information asymmetry prevailing currently.

Scope of Diligence Report

The Practising Company Secretary (PCS) is required to certify compliance in respect of matters specified in the RBI Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008. Para (2)(iii) of the RBI Circular specifies that the Diligence Report shall be in the format given in Annex III thereto. The format has been subsequently revised and streamlined by RBI.

Format of Diligence Report

DILIGENCE REPORT

To
The Manager,
__________________________ (Name of the Bank)

I/We have examined the registers, records, books and papers of ............ Limited having its registered office

1 (As contained in RBI Circular No. DBOD. No. BP.BC. 110/08.12.001/2008-09 dated February 10, 2009 read with RBI Circular No. UBD.PCB.No. 49/13.05.000/2008-09 dated February 12, 2009)
as required to be maintained under the Companies Act, 1956 (the Act) and the rules made thereunder, the provisions contained in the Memorandum and Articles of Association of the Company, the provisions of various statutes, wherever applicable, as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s for the half year ended on........... . In my/our opinion and to the best of my/our information and according to the examination carried out by me/us and explanations furnished to me/us by the Company, its officers and agents, I/We report that in respect of the aforesaid period:

1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure …., and the Board was duly constituted. During the period under review the following changes that took place in the Board of Directors of the Company are listed in the Annexure …., and such changes were carried out in due compliance with the provisions of the Companies Act, 1956. (Now Companies Act 2013)

2. The shareholding pattern of the company as on ............. was as detailed in Annexure ............ During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure....... .

3. The company has altered the following provisions of
   (i) The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 (Now Companies Act 2013) for this purpose.
   (ii) The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 (Now Companies Act 2013) for this purpose.

4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure............

5. The company has advanced loans, given guarantees and provided securities amounting to ₹ ........ to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section 295 of the Companies Act, 1956. (Now to be in compliance with Section 185 of Companies Act 2013).

6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexure.... and has complied with the provisions of the Companies Act, 1956. (Now to be in compliance with Section 186 of Companies Act 2013).

7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company’s domestic borrowings were as detailed in Annexure ..... . (Now to be in compliance with Section 180 of Companies Act 2013).

8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies. (Section 73-76 of Companies Act 2013)

9. The Company has created, modified or satisfied charges on the assets of the company as detailed in Annexure.... Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure ...... . (Now to be in compliance with Section 77-87 of Companies Act 2013).
10. Principal value of the forex exposure and Overseas Borrowings of the company as on ………… are as detailed in the Annexure under.

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

12. The Company has insured all its secured assets. (Now to be in compliance with Chapter III and IV of Companies Act 2013).

13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institutions at the time of availing any facility and also during the currency of the facility.

14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956. (Now to be in compliance with Chapter VIII of Companies Act 2013).

15. The Company has insured fully all its assets.

16. The name of the Company and or any of its Directors does not appear in the defaulters’ list of Reserve Bank of India.

17. The name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation.

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

19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.

20. The Company has complied with the provisions stipulated in Section 372A of the Companies Act in respect of its Inter Corporate loans and investments. (Now to be in compliance with Section 186 of Companies Act 2013).

21. It has been observed from the Reports of the Directors and the Auditors that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India.

22. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends and other amounts required to be so credited.

23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and /or its directors in such cases are detailed in Annexure…..

24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement.
25. The Company has deposited within the stipulated time both Employees’ and Employer’s contribution to Provident Fund with the prescribed authorities.

*Note*: The qualification, reservation or adverse remarks, if any, are explicitly stated may be stated at the relevant paragraphs above place(s).

<table>
<thead>
<tr>
<th>Place:</th>
<th>Signature:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>Name of Company Secretary/Firm :</td>
</tr>
<tr>
<td>C.P. No.:</td>
<td></td>
</tr>
</tbody>
</table>

**GUIDANCE ON DILIGENCE REPORTING**

The following paragraphs outline the Compliance Inputs that may be relied upon by the PCS for the purpose of issue of Diligence Report. Compliance Inputs and checklist are indicative and PCS shall not exclusively rely upon that, but use that as a guide and apply his own judgement to determine what is to be checked and to what extent.

**Period of Reporting**

Annex. III to the RBI Notification provides that the Diligence Report shall be made on a half yearly basis.

**Secretary in Whole-Time Practice**

Section 2(25) of the Companies Act, 2013 defines “Company Secretary in practice” as a secretary who is deemed to be in practice under sub-section (2) of section 2 of the Company Secretaries Act, 1980. Thus, a member of the Institute of Company Secretaries of India, who is not in full-time employment can become a Secretary in whole-time practice (hereinafter referred to as PCS) after obtaining from the Council of the Institute a Certificate of Practice under section 6 of the Company Secretaries Act, 1980 and the regulations thereunder.

**Right to Access Records and Methodology for Diligence Reporting**

To enable the PCS to issue the Diligence Report, the Company (borrower) should provide the PCS access at all times to the books, papers, minutes books, forms and returns filed under various statutes, documents and records of the company, whether kept in pursuance of the applicable laws or otherwise and whether kept at the registered office of the company or elsewhere which he considers essential for the purposes of Diligence Reporting. The PCS shall be entitled to require from the officers or agents of the company, such information and explanations as the PCS may think necessary for the purpose of such Reporting. However, depending on the facts and circumstances he/she may obtain a letter of representation from the company in respect of matters where verification by PCS may not be practicable, for example matters like —

(i) dis-qualification of directors;  
(ii) show cause notices received;  
(iii) persons and concerns in which directors are interested, etc.

**Reporting with Qualification**

The qualification, reservation or adverse remarks, if any, may be stated by the PCS at the relevant places. It is recommended that the qualifications, reservations or adverse remarks of PCS, if any, should be stated in **thick type** or in **italics** in the Diligence Report.

If the PCS is unable to form any opinion with regard to any specific matter, the PCS shall state clearly the fact that he is unable to form an opinion with regard to that matter and the reasons thereof.
If the scope of work required to be performed, is restricted on account of limitations imposed by the company or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the Report shall indicate such limitation.

If such limitations are so material as to render the PCS incapable of expressing any opinion, the PCS should state that:

“in the absence of necessary information and records, he is unable to report compliance(s) or otherwise by the Company”.

PCS shall have due regard to the circulars and/or clarifications issued by the Reserve Bank of India from time to time. It is recommended that a specific reference of such circulars at the relevant places in the Report shall be made, wherever possible.

Professional Responsibility and Penalty for False Diligence Report

While the RBI Notification has opened up a significant area of practice for Company Secretaries, it equally casts immense responsibility on them and poses a greater challenge whereby they have to justify fully the faith and confidence reposed by the banking industry and measure up to their expectations. Company Secretaries must take adequate care while issuing Diligence Report.

Any failure or lapse on the part of a Practising Company Secretary (PCS) in issuing a Diligence Report may not only attract penalty for false Reporting and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his/her negligence in issuing the Diligence Report. Therefore, it becomes imperative for the PCS that he/she exercises great care and caution while issuing the Diligence Report and also adheres to the highest standards of professional ethics and excellence in providing his/her services.

While preparing the Diligence Report the PCS should ensure that no field in the report is left blank. If there is nothing to be reported or the field is not applicable to the company, then the PCS should write ‘none’ or ‘nil’ or ‘not applicable’ as the case may be.

The PCS should obtain a list of statutes applicable to the Company before proceeding with the assignment for issue of Diligence Report.

Check lists

Students may refer to Lesson 2 for check lists under Companies Act 2013 and FEMA regulations and Lesson 4 for compliances by listed companies.

Other compliances

Principal value of the forex exposure and Overseas Borrowings of the company as on ……………….. are as detailed in the Annexure under”

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Forex Exposure of the Company</th>
<th>Currency (US$ Million)</th>
<th>Equ. Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>A.</td>
<td>Funded Exposure</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Format of Annexure …
1. Foreign Currency Packing Credit
2. Foreign Currency Post Shipment Credit
3. External Commercial Borrowings
4. FCCB
5. ADR/GDR etc.
6. Other Loans, if any – Please specify
   (a) Suppliers Credit
   (b) Buyers Credit
   (c)
   (d)
   Total Funded Exposure

B. Non Fund Based Exposure
   of which :-
   1. Import Letters of credit opened
   2. Import Letters of credit accepted
   3. Guarantees Issued
   4. Standby letters of Credit
   5. Others, if any – Please specify
      (a)
      (b)
      (c)
   Total Non Funded Exposure

C. Derivatives
   (i) Plain Vanilla Contracts
      1 Forex Forward Contracts
      2 Interest Rate Swaps
      3 Foreign Currency Options
      4 Any other Contracts – Please Specify
   (ii) Complex Derivatives
      1 Contracts involving only interest rate derivatives
      
      2 Other Contracts including those involving FC derivatives
      3 Any other derivatives – Please specify
         (a)
         (b)
         (c)
   Total Derivative Exposure
   Grand Total of all Exposures
Unhedged Foreign Currency Exposures of the Company:
Currency wise

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Type of Exposure</th>
<th>Amount (US$ Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Short Terms (viz. &lt; 1 year)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) Long Positions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) Short Positions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(c) Net Short term Exposures (a - b)</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Long Term (viz. &gt; 1 year)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) Long Positions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) Short Positions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(c) Net Short term Exposures (a - b)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Overall Net Positions (1–2)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>for each currency (Please give overall Net Position in this format for each currency)</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Overall Net Position across all Currencies</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Currency</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total Forex Exposure of the Company

Fund Based Exposure

Non-Fund Based Exposure

Total Borrowing Limit of the Company

External Commercial Borrowings of the Company

<table>
<thead>
<tr>
<th>Borrowing limit of the Company</th>
<th>Currency</th>
<th>Amount (`)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Amount borrowed from Overseas Directors

Shri/Ms. …

Shri/Ms. …

Amount borrowed from Overseas Members

Shri/Ms. …

Shri/Ms. …

Amount borrowed from Overseas Public

Shri/Ms. …

Shri/Ms. …

Amount borrowed from Foreign Bank(s) /
financial institution(s)
M/s…
M/s…

Amount borrowed from Foreign banks
M/s…
M/s….

Amount borrowed from others
M/s…

Credit Linked Notes

Grand Total

Whether approval of RBI required for the above : Yes/No
If yes, date when approval was obtained ______ (date) vide Reference No……

<table>
<thead>
<tr>
<th>Illustrative List of Foreign Currency Exposures with</th>
<th>Source for Verification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Exposure</strong></td>
<td><strong>Source for Verification</strong></td>
</tr>
<tr>
<td>1. Packing credit in Foreign currency</td>
<td>a. Packing credit loan ledger supported by Bank Advice for each disbursement.</td>
</tr>
<tr>
<td></td>
<td>b. Internal MIS including Trial Balance.</td>
</tr>
<tr>
<td></td>
<td>b. Bill-wise advise from bank.</td>
</tr>
<tr>
<td></td>
<td>c. Trial Balance/Internal MIS.</td>
</tr>
<tr>
<td></td>
<td>d. Export Collection Bills</td>
</tr>
<tr>
<td></td>
<td>e. Advance against FOBCs</td>
</tr>
<tr>
<td></td>
<td>b. Bank Advise for disbursement of the loan</td>
</tr>
<tr>
<td></td>
<td>c. Loan Ledger</td>
</tr>
<tr>
<td></td>
<td>d. Statement of Account from Lender (Bank)</td>
</tr>
<tr>
<td>4. External Commercial Borrowings</td>
<td>a. Reporting of loan agreement details under FEMA, 1999</td>
</tr>
<tr>
<td></td>
<td>b. Form ECB-2 under FEMA, 1999 (Details of actual transaction of Foreign Currency Loan/ Financial Lease other than short-term Foreign currency Loans)</td>
</tr>
<tr>
<td></td>
<td>c. Last Interest fixation notification from the Lender</td>
</tr>
<tr>
<td></td>
<td>d. Loan Ledger</td>
</tr>
<tr>
<td>5. Foreign Currency Convertible</td>
<td>a. Issuance Approval (if applicable)</td>
</tr>
</tbody>
</table>
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6. American Depository Receipt (ADR)
   a. Board Resolution for issuance of ADR
   b. Copy of listing agreement filed with NYSE or NASDAQ
   c. Statement from RTA

7. Global Depository Receipt (GDR)
   a. Board Resolution for issuance of GDR
   b. Statement from RTA
   c. Copy of listing arrangement with overseas Stock Exchange(s).

8. Loans from Non Residents
   a. J.V. Partner
   b. Promoter/Director
   c. Others (In all cases:)
     a. Copy of loan agreement
     b. Copy of FIRC
     c. Ledger account extract

9. Imports
   (i) Under LC where the Issuing Banks Nostro A/c has already been debited
     a. Copy of LC
     b. Copy of advance documents received directly from overseas seller
     c. Bank Intimation Letter

   (ii) Not under LC but under DA Terms – accepted by the bank or company for payment on a fixed future date.
     a. Copy of Acceptance
     b. Bank Intimation

   (iii) Buyers credit/Suppliers credit arranged directly by the company
     a. Copy of LC
     b. Copy of Invoice
     c. Term sheet of the overseas Lender (overseas Bank)
     d. Import Collection Bills

10. Foreign currency on Hand (maximum equal to USD 2000=00)
    a. Physical counting
    b. Reasons for keeping the foreign currency

11. Balance in EFFC A/c (Exchange Earners’ Foreign Currency Account)
    a. Statement of Account from the Bank
    b. EEFC A/c Reconciliation Statement

<table>
<thead>
<tr>
<th>Type of Exposure</th>
<th>Source for Verification</th>
</tr>
</thead>
</table>
| 12. Balances in Bank Accounts held abroad | a. General Permission or Special Permission copy  
b. Statement of Account from the Overseas Bank  
c. Reconciliation Statement  
d. Ledger extract from Company’s books  |
| 13. Investments made abroad | a. General or Specific approval copy  
b. Copy of document evidencing investment  |
14. Loans extended in Foreign Currency
   a. General or Special Permission copy
   b. Copy of Loan Agreement
   c. Proof of remittance of foreign currency
   d. Ledger extract of Loan Account

15. Advance payments received against exports (exports not taken place)
   a. Copy of Purchase or Sale contract as the case may be
   b. Copy of FIRC
   c. If credited to EEFC A/c cross reference so as to avoid double counting

16. Security Deposits received from Dealers /Distributors abroad
   a. Copy of appointment letter
   b. Copy of FIRC
   c. Copy of Ledger extract

17. Security Deposit paid for overseas officer but parked in Indian Books in respect of
    (i) Premises
    (ii) Other utilities
    (iii) Refundable Regulatory Payment
   a. Copy of relevant agreement
   b. Bank Advice copy for remittance
   c. Ledger extract

18. Capital/Loans/Advances extended to overseas branches or Joint Ventures (JVs) or Wholly Owned Subsidiaries (WOSs).
   a. Copy of agreement for each loan
   b. Proof of disbursement
   c. Ledger extract

19. Forward Contracts Booked [Both Purchases and Sales]
   a. Copy of Contract Note
   b. Verification of underlying (i.e. export bill, export LC, Import bill, Import LC, Purchase Order, Sales Contract etc.)

20. Bid Bonds
    Performance Guarantees
   a. Copy of each Guarantee with supporting documents

<table>
<thead>
<tr>
<th>Type of Exposure</th>
<th>Source for Verification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retention Money Guarantees</td>
<td>b. Bank Advice or Bank Correspondence for each instrument</td>
</tr>
<tr>
<td>Advance Payment Guarantees</td>
<td></td>
</tr>
<tr>
<td>or any other Guarantees issued and</td>
<td></td>
</tr>
<tr>
<td>outstanding</td>
<td></td>
</tr>
<tr>
<td>Derivative Transactions</td>
<td></td>
</tr>
<tr>
<td>— Options</td>
<td>a. Term sheet for each contract</td>
</tr>
<tr>
<td>— Foreign Currency Swaps etc.</td>
<td>b. Board Resolution</td>
</tr>
</tbody>
</table>
— Exchange Traded Currency Futures (Broker/Bank Contract Note for each deal)

22. Interest Rate Swaps and Forward Rate Agreements

If any one leg is a foreign currency interest rate benchmark, then
a. Certified copy of the agreement
b. Term Sheet
c. Last Payment/Receipt details
d. Liability computation for broken period for each Interest Rate Swap/Forward Rate Agreement (IRS/FRA) deals.

23. Advance remittance towards import of merchandise/capital goods

24. Estimated contracts entered into forex future deals.

Compliance Inputs

— Relevant Ledger Accounts
— Bank specific policies/guidelines
— FEMA 1999 – Notifications issued by Reserve Bank & Rules framed by Government of India
— Guidelines issued by Industrial & Export Credit Department (IECD)/Department of Banking Operative & Development (DBOD)/DBOS/Foreign Exchange Department (FED) of the Reserve Bank
— Foreign Trade (Development and Regulation) Act, 1992
— Foreign Trade Policy 2009-2014
— Foreign Contribution Regulation Act, 2010
— The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974
— Uniform Customs and Practice for Documentary Credits (UCPDC ICC 600)
— FEDAI Rules
— SEBI guidelines
— ODA Guidelines

The Company has insured all its secured assets.

Particulars of Insurance cover obtained by the Company are as under:-

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars of Asset Insured</th>
<th>Value of Asset ( ₹ )</th>
<th>Sum Insured ( ₹ )</th>
<th>Risk Covered</th>
<th>Amount of Policy</th>
<th>Insurance Company</th>
<th>Insurance Policy Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>M/s ...</td>
<td></td>
</tr>
</tbody>
</table>
Note: Insert a remark, whether all the assets have been insured and provide a list of assets that haven’t been insured.

Compliance Inputs

- Original insurance policies
- Register of Assets
- Collateral Security offered to the lenders
- Stock Statement
- Premium payment receipts

Checklist for Insurance Policies

(a) Verify the original insurance policies and check carefully the details of assets covered by the policy.
(b) Check that the Company has taken a Policy from a General Insurance Co. registered with IRDA.
(c) Check the period of the policy. Policies are generally issued for a period of one year. Sometimes, short period policies for less than one year are also issued.
(d) Generally, Fire Insurance policies cover immovable properties, stocks etc. Earthquake, Terrorism etc. are given as add on covers. Vehicles should have Valid Comprehensive Insurance Policies.
(e) Check that the sum insured represents the Market value/Replacement value as the case may be (not book value) or else, under insurance will be applicable. Name, address, situation (with Building No. etc.) of the Company should tally with the records.
(f) Verify the name of the mortgagee.
(g) Verify any endorsement during the policy period, noting the changes in the sum insured, situation, risk etc.

Checklist for Compliance of Terms of Insurance

Check the following in regard to compliance of terms of insurance:

(a) the company’s assets have been insured comprehensively. Where a joint insurance on plant and buildings has been taken, the value thereof has been apportioned in the manner prescribed/approved;
(b) the insurance policy has been taken in the joint names of the company and the bank(s)/financial institution(s);
(c) the policy has been kept alive for such full value, as has been determined by the bank(s)/financial institution(s), all premia are being paid on time, and the company has not done any such act as
would render the policy void or voidable;
(d) the policy has been taken from an insurance office of repute, as determined by the bank(s)/financial institution(s); and
(e) all moneys received under the insurance policies are held in trust for better securing to the bank(s)/financial institution(s), the payment of all moneys secured under the indenture agreement.

The Company has complied with the terms and conditions, set forth by the lending bank/financial institution at the time of availing any facility and also during the currency of the facility.

Compliance Inputs
— Copy of the Lending Agreement

Checklist for Compliance with the terms and conditions set forth by the lending Institution at the time of availing the facility.

Check the following points to confirm that:
(a) further funds have not been borrowed from bank(s)/financial institution(s) on hundis, other than from its bankers, without prior consent;
(b) no donations/contributions have been made to the charitable and other funds, which are not directly related to the business of the borrower or to the welfare of its employees, in excess of the indenture (if any), without the consent of the bank; and
(c) no merger/consolidation/re-organisation/arrangement/compromise with the creditors/shareholders has been undertaken/permission without the approval of the bank.

Checklist for Operations of the Company

Check whether the following have been ensured, about the operations of the company:
(a) the company has not ceased to carry on business, even temporarily;
(b) any material changes in the operations, including creation of a subsidiary, implementation of expansion programmes, and undertaking any general trading activities have been approved by the bank(s)/financial institution(s);
(c) the selling/purchasing agency has been given on terms and conditions laid down in the indenture. Where required the existing arrangements have been suitably modified. Specific permission has been taken where agreement is being entered into with the associate concerns of the promoter(s)/director(s) of the company; and
(d) any arrangements required to be entered into, as per the provisions of the indenture, have been duly made.

Checklist for Security Offered on the Term Loan

Verify the following as regards security offered on the term loan, and subsequent acquisition of assets:
(a) Assets acquired pursuant to the loan agreement are in line with the terms of the sanction;
(b) Assets purchased from the money advanced/to be advanced, if not brought upon/fixed to the factory premises, have been hypothecated with the bank(s)/financial institution(s)/commercial bank;
(c) The company has not entered into any arrangement with the creditors, nor has any act or default been committed, as would render the company liable to be taken into liquidation;
(d) Where guarantees have been furnished, in the event of death of a guarantor, his heirs have not given notice of revocation; and

(e) In the opinion of the assessors/valuers appointed by the company the value of the security has not become insufficient or depreciated beyond norms prescribed in the indenture.

Checklist for Default in Payment of Interest/Principal Instalments

Confirm that in the event of default:

(a) the consent of the bank(s)/financial institution(s) has been taken, where required, prior to distributing dividends and making interest payment on unsecured loans and deposits; and

(b) sales tax refunds/sum received from incentive schemes, etc., have been applied towards payment of overdue amounts.

Checklist for Information submitted to Bank(s)/Financial Institutions

Verify that the periodical statements required to be submitted to the bank(s)/financial institution(s), are being furnished on time. The statements may be on the operations of the company/implementation of the project undertaken.

Checklist for Utilisation of Moneys Advanced

Ensure that consistency has been maintained in utilisation of moneys advanced to the mortgagor. The following aspects may be specifically examined:

(a) funds have been utilised for the purposes laid down in the indenture. Where funds have not been so utilised, the requisite permission has been taken;

(b) requisite conditions laid down to qualify for the outstanding balance of the loan have been fulfilled;

(c) the drawings from the loan are being kept in a separate Scheduled Bank Account, payments therefrom are being made in the manner laid down in the indenture, the said scheduled bank has foregone its right to set-off or lien, in respect of the said account, and the mortgagor is maintaining the records pertaining to the said account, as provided in the indenture;

(d) no part of the loan moneys has been transferred to call, short term, fixed or any other deposits, without prior consent. Where such consent has been obtained, the scheduled bank has foregone its right to set off any amount due from the company, against the deposits, the deposits have been realised on their due dates and the proceeds thereof re-deposited in the special account;

(e) the expenditure has been financed in the manner provided for in the indenture; and

(f) any changes/deviations in the time schedule for completion of the project have been made in consultation with the bank(s)/financial institution(s).

Checklist for Payment of Liabilities/Dues

Ensure as regards payment of liabilities/dues that:

(a) the company has been paying all the ground rents, rates, taxes, dues, duties and outgoings immediately on their becoming due and there is no penalty imposed/adverse remarks by the Regulatory Authorities against the company during the period under review;

(b) where the company has any account(s) with bank(s)/financial institution(s), guaranteed by Reserve Bank of India, no default has been committed on its maintenance, as would render Reserve Bank of
India liable to reimburse the guaranteed amount;

(c) any prepayments, of any amount other than the term loan and the bank borrowings in the ordinary course of business, have been made with the prior approval, in writing, of the bank(s)/financial institution(s). Any other conditions stipulated under the indenture, have also been complied with; and

(d) no other bank(s)/financial institution(s) with whom the company has entered into agreements for financial assistance have refused to disburse the loan(s) or any part thereof, nor have they recalled the sums disbursed under their respective loan agreements entered into with it.

Checklist for Books of Accounts

Scrutinise the books of accounts to check that:

(a) proper books of accounts have been maintained by the company, in consonance with the requirements laid down in the Companies Act, 2013;

(b) books of accounts have been properly posted up at all times; and

(c) annual audit of the books of accounts has been conducted in the manner provided for under the Companies Act, 2013, and copies of audited accounts have been submitted to the bank(s)/financial institution(s) within six months from the date of closing of the accounts.

Checklist for Memorandum/Articles of Association

Verify that any alteration in the Memorandum/Articles of Association has been made with the prior consent, in writing, of the bank(s)/financial institution(s).

Checklist for Directors/Promoters

Scrutinise the records to ascertain that:

(a) the shareholdings of the directors have not been substantially varied, nor have the deposits/unsecured loans received from the directors been reduced, without the prior consent of the bank(s)/financial institution(s);

(b) funds procured from the promoters/directors are only subject to such conditions as are laid down in the indenture;

(c) all amounts payable on account of any sitting fees, expenses, commissions, and remuneration to nominee directors, have been duly paid;

(d) no commission has been paid to the promoters, directors, managers or any other persons for furnishing guarantees, counter guarantees, obligations, indemnity or for undertaking any other liability/obligation, without the prior approval of the bank(s)/financial institution(s); and

(e) prior approval of the bank(s)/financial institution(s) has been taken for the appointment/re-appointment of managing director/whole-time director/chairman/consultants, as regards changes in their terms of appointment, except where these are as per the provisions of the Companies Act, 2013. The appointments, where necessary, have the approval of the Central Government.

Checklist for Board Meetings

Verify that all important matters, specifically required by the bank(s)/financial institution(s), were submitted for decision to the Board of Directors and the meetings thereof were both called and conducted, in the manner laid down in the indenture.
Checklist for Technical Experts

Check whether the provisions contained in the indenture, as regards the appointment of experts, their technical training and any other directions, have been complied with, and the bank(s)/financial institution(s) is/are being duly kept informed of such compliance.

Checklist for Licences/Consents

Ensure that:

(a) the registration/licenses/renewals required under the Industries (Development & Regulation) Act, 1951/FEMA, 1999 and from the Central/State Government/other authorities have been obtained;

(b) the rights, powers, privileges, concessions, trade marks, patents and licence agreements necessary in the conduct of the business, have been renewed; and

(c) in case of MSME/SSI unit, the Registration has been renewed;

(d) Pollution Control/Hazardous Waste treatment related permissions have been obtained.

Checklist for Contracts

Ensure that any strictures as regards agreements for supply of plant and equipment, have been complied with, and competitive tenders have been called for, where required.

Checklist for Legal Proceedings

Verify, as regards possible legal proceedings, that:

(a) the bank(s)/financial institution(s) have been intimated of any notices received under any Act, including the application for winding up under the Companies Act, 2013;

(b) where a receiver has been appointed on any of the properties/business undertaking of the company, or any distress or execution has been allowed to be levied on the mortgaged premises the bank(s)/financial institution(s) has/have been intimated about it; and

(c) the company is not party to any material litigation with respect to assets acquired under the loan agreement.

Checklist for Takeover of Management

Verify that no proceedings for winding up have been commenced, nor has any receiver been appointed without the prior consent of the bank(s)/financial institution(s).

Checklist for Financial Position

Check the financial position to ensure that:

(a) the company has not put its funds, nor invested them in purchase of shares of any other concern, without the prior approval of the bank(s)/financial institution(s) as stipulated in the loan agreement;

(b) no money has been withdrawn from the business, out of the capital or in anticipation of profits, without prior consent of the bank(s)/financial institution(s); and

(c) proposals to undertake inter-corporate loans or other investments, have the prior approval of the bank(s)/financial institution(s).

(d) the company has provided adequate provision on depreciation as required under the Companies
Lesson 9  ■  Due Diligence for Banks  259

Act, 2013 in its Book of accounts.

Note:

(1) In case of project under implementation — check whether the margin money has been brought in by the promoters as per the terms of sanction.

(2) Furnish the details of inflow viz. date, amount, channel (name of bank(s)), etc.

(3) Check the compliance of the provisions of the Companies Act, 2013 regarding the powers of the Board.

A specimen Sanction Letter covering terms, conditions, covenants and remarks is placed below for reference.

Specimen sanction letter

<table>
<thead>
<tr>
<th>Relevant Terms, Conditions &amp; Convenants, etc. applicable to the Sanctioned facility(ies)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Terms, Conditions and Covenants</strong></td>
</tr>
<tr>
<td>1. The Company/firm to execute necessary security documents/renewal documents for sanctioned/enhanced limit(s) duly supported by Board resolution and create and register stipulated charges with the authorities specified for the purpose within stipulated time limit before release of sanctioned/enhanced limits.</td>
</tr>
<tr>
<td>2. Company/firm to have title deeds of the immovable assets released from Term Lenders and re-deposit the same at the Bank as an agent and custodian of First Charge and Second Charge holders.</td>
</tr>
<tr>
<td>3. Where Company/firm agrees to give second charge favouring the Bank, it has to complete the process as mentioned in serial “<em><strong>” above and create second charge on block of fixed assets within a period of ___ months (to be as per terms of sanction) to secure the last enhanced limits and the present enhanced limits alongwith loan of ₹</strong></em>___ sanctioned by us outside the consortium.</td>
</tr>
<tr>
<td>4. Guarantor(s) : All fund based and non fund based facilities to be guaranteed (Joint &amp; Several guarantee) by Mr./M/s. _______________. The firm/Company shall not pay any guarantee commission to the guarantors.</td>
</tr>
</tbody>
</table>
5. The release of credit facilities is also subject to vetting of security documents by the bank’s approved advocate and bank’s internal procedure of Credit Process Audit. The charges for vetting of the documents by the Bank’s advocate are payable by firm/Company

6. Stock/book debt statements are to be submitted at a frequency stipulated by the Bank (monthly/quarterly) alongwith select operational data (MSOD) in bank’s prescribed formats. Valuation of stocks to be done at cost/invoice / market price, whichever is lower. Non submission of stock/book debts and MSOD statements by 10th (or the date stipulated in sanction) of the succeeding month will attract penal interest @1% p.a. If these statements are not submitted for a continuous period of 3 months, Bank may initiate further action as deemed necessary by the Bank

Self Explanatory

6 & 7 combined facilitates
— Stock & Book debts statement will facilitate verification of end use of funds given for build up of assets as stipulated
— MSOD facilitates ensuring movement of stocks from RM- WIP-FG-BDS. Helps spot low-nil level of activity if compared with past stock movement
— If these are not commensurate with the funds released, bank may seek reasons for same which can be such as :- advance to suppliers processors/stock in transit not declared/other assets built up/ payment of expenses not relating to mfg but not disclosed/moneys advanced to others without prior approval/cash losses being financed etc.
— Can facilitate random check on valuations/whether prices assumed are as per prevailing market price/inflated if quantitywise summaries are available
— Quality of debtors, in case of well known companies, can be verified. Movement of debtors on aging is available
— LC is a Preferred mode of payment to suppliers since probability of diversion/siphoning of funds is low – the beneficiaries’ business product line is ascer
concerns, unless specifically agreed to by the bank, and also those which are more than 90/180 days old. Drawings would be allowed based on the QIS returns subject to the availability of drawing powers as mentioned above.

tained to verify the product is an input to the manufacturing process/ultimate product of borrower company

— LC acceptances outstanding with bank can be cross verified with LC creditors declared and also the material yet to be received under outstanding LCs estimated

— Non financing of associates book debts is to check double financing/diversion for other uses since associate’s finances are often not subject of detailed scrutiny by this lender

8. Packing Credit will be allowed only against L.C.s opened by acceptable banks and confirmed export orders from approved parties and will be extended for periods not beyond the last shipment date

utilisation of monies

— This is to ensure genuineness of the trade transactions since banks also seek status report on these drawees concerned, independently through D&B.

— The EPC tenor is normally matched with the manufacturing cycle of borrower to ensure need based financing.

9. Bank will obtain status report on drawees before purchase/discount of the bills and such reports will be updated annually; availability of a satisfactory status report shall be a pre-requisite for such purchase/discount of bills.

— This is a check to ensure that accommodation bills are not being raised by borrower to avail finance

— Prima facie verifies the line of business of drawees which should be in same product line/drawee may be a selling agent

— Delayed Payments/Return of bills acts as a warning signal to lender on problems likely to arise

— Return of goods by drawee can indicate rejections due to product deficiencies or delays in dispatches i.e. inability to meet commitments — may be a
10. The firm/company to display bank’s hypothecation plate/board at its Unit/business premises indicating that stocks/assets are hypothecated to the Bank.

—To put public on notice of lender’s interest in the asset of borrowers.

11. All the assets charged/to be charged to the Bank to be kept fully insured at all times against all risks (Burglary, comprehensive risks etc.) and original Insurance cover note/policy in the name of the Bank a/c borrower firm/Company with Bank’s Hypothecation clause to be lodged with the Bank.

—This is to ensure that lender’s interest is noted and protected in the assets financed with the Insurer & claims will be settled only with the lender/s

12. The company to submit all bills/receipts etc. as applicable to project expenditure. A certificate from bank’s approved C.A/Architect/valuer towards expenses incurred on project/progress in implementation of project. Any escalation in the project cost to be met by the promoters/company/firm from their own sources

To verify end use of funds for financing only those assets as were originally approved

That the pricing of equipments is as per the quotations that may have been obtained originally and that the expenditures are within the budgeted figures

—To also verify that the promoter’s have brought in their contributions as originally envisaged, in the form and time period stipulated i.e. Form as equity/quasi equity

13. The Company/firm to submit copy of statutory permissions/clearances like ‘NOC’ from Pollution Control Board and ensure for timely renewal of same from time to time.

(Only illustrative)

—To ensure lender’s funds are not jeopardised due to disruption of activity on account of non-availability/non obtention of/non-adherence to any of the statutory prescriptions

14. Inspection will be done on quarterly basis (in rotation by consortium member banks) or as and when required by the bank. The Bank has the right of deputing its officials/person(s) (like qualified auditors or management consultants or technical experts) duly authorised by the Bank to inspect the unit, assets, books of accounts/records etc. from time to time. Also the Bank may appoint, at its sole discretion, stock/concurrent auditors, valuers, consultants for specific jobs relating to

—To verify that proper records are being maintained

—To verify correctness of data submitted to lender vis-à-vis actuals as per the books

—That the drawals with lenders are in fact supported by the
company’s/firm’s activities, the cost of which will be borne by the company/firm.

— Verify quality of assets/debtors
— To ascertain disputed debtors/non moving stocks/obsolete inventory etc.
— Detect diversion of funds to others including associates as per bank account of company

15. Pre shipment and post shipment limits to be secured by Whole Turnover Package Corporate Guarantee (WTPCG) & WTPSG Schemes of Export Credit Guarantee Corporation (ECGC), with the option to the Bank for obtaining comprehensive ECGC coverage depending upon the risk prevailing in the country where export is being made. Premium payable to ECGC by the Bank in respect of WTPCG policy is to be borne by firm/Company

16. Loan amount of ₹____ is repayable in _____monthly/quarterly/half yearly instalments of ₹__ each commencing from __ months after first date of disbursement with an option to pre-pay with/without prepayment charges. Prepayments will attract additional charges @____(As per terms of sanction).

17. Penal interest of 2% p.a. will be levied on the overdue amount for the period account remains overdrawn due to irregularities such as – non payment of interest immediately on application, non payment of instalments within one month of their falling due, reduction in drawing power/limit, excess borrowings due to over limit, devolvement of L/C, invocation of Guarantee etc. If the account continues to be overdrawn for a period of 90 days, the bank may consider initiation of other action also as deemed fit by the bank.

18. Any default in complying with terms of sanction within the stipulated time will attract penal interest of 1% p.a. from the date of expiry of such time.

19. Lead Bank/processing charges of ₹______ will be
levied annually. Earmarking charges of ₹______ p.a. per account for Earmark Limit of ₹______ at __________branch, Documentation charges of ₹______ and inspection charges @ ₹______ per inspection are payable. Working Capital Demand Loan (WCDL) conversion to FCL/FCL rollover charges as applicable maximum ₹ 25, 000/- per transaction. Out of pocket expenses incurred towards title verification and valuation of property/assets, inspections/techno-economic appraisal of the project/unit will be recovered separately.

20. Commitment charges: A minimum commitment charge of 1% p.a. will be levied on unutilised portion of working capital limits subject to tolerance level of 15% of such limits. Company/firm to intimate in advance about the level of utilisation of the limit through QIS returns. If overall utilisation of fund based limits during the year is less than 60% of the sanctioned limit, then commitment charges of 2% p.a. will be recovered and the limits will be pruned down at the time of review.

21. In case of default either in the payment of interest, the repayment of the principal amounts as and when due and payable or reimbursement of all costs, charges and the expenses when demanded, you shall pay additional interest at the rate of 2% above the interest rate for the facilities on the overdue interest, costs, charges or expenses and/or from the respective due dates for payment and/or epayment.

22. The firm/company is required to submit QIS I, II & III returns. QIS I (showing estimates) is required to be submitted in the week preceding the commencement of the quarter to which it relates, QIS II (showing performance) within six weeks from the close of the quarter to which the statement relates and QIS III (half yearly operating statement) within two months from the close of the half-year. Any delay without specific approval from the bank will attract penal rate of 1%p.a. for the delayed period.

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Self Explanatory

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Self Explanatory

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Self Explanatory

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— QIS I — estimates of performance as furnished by company based on which release of limit for Working Capital can be regulated. These should also be in tune with annual project in submitted

— QIS II – ascertains actuals vis-à-vis projections—in effect verifying end use of funds. Can check diversion of funds

— QIS III- profitability statement can be taken to ensure performance/projections during the half-year
23. Credit Monitoring Arrangement (CMA) data to be submitted at least one month before the due date of review. Any delay without specific approval from the bank will attract penal rate @1% p.a. In case CMA data is not submitted for a continuous period of three months, the bank may take further action as deemed fit by the bank.

24. The company/firm to ensure submission of statement of Assets & Liabilities in Bank’s format CBD–23 (duly certified by a C.A.) along with copies of Income Tax and Wealth Tax returns/assessment orders of all the partners and guarantors every year.

25. The company’s/firm’s entire banking business (including merchant banking, Dividend and interest payments) should be routed through us/members of the consortium proportionate to the sharing of the working capital facilities.

26. Firm/Company to declare/undertake to us:

— to supply to us, audited financial statements of the firm/company within 6 months from closure of financial year. Any delay in submitting these audited financial statements without our specific approval will attract penal interest @ 1% p.a. In case these statements are not received by us for a continuous period of 3 months, the bank may take further action as deemed fit by the bank.

— to provide to us promptly information (alongwith comments/explanation) about all material and adverse changes in your project/business, ownership, management, liquidity, financial position etc.

— that any liabilities or obligations under the facilities shall not, at any time, rank postponed in point and security to any other obligation or

Self Explanatory

To ascertain the movement of net worth of the promoter

— To prevent diversion through other channels

— To exercise partial control on verifying end-use of funds

FOR VERIFICATION OF ALL ASPECTS

— utilized to verify performance vis-à-vis estimates which can reasonably be led to conclusion of proper end use

— for detection of otherwise undisclosed diversions

— diversification in business lines/unrelated or related but undisclosed investments /tie-ups are brought to notice of lender

Say for e.g. Serious internal problems, change in key management personnel, winding up petitions filed etc.

Illustrative only
liabilities to other lending institutions or banks or creditors, unless expressly agreed or permitted by bank.

— not to create or permit to subsist any mortgage, charge (whether floating or specific), pledge, lien or other security interest on any of your undertakings, properties or assets, without our prior consent in writing.

27. A stamped undertaking to be submitted in favour of the Bank to the following effect that during the currency of bank’s credit facilities, the company/firm shall not, without our permission in writing :

— effect any adverse changes in company’s/ firm’s capital structure.
— formulate any scheme of amalgamation or merger or reconstruction.

— implement any scheme of expansion or diversification or capital expenditure except normal replacements indicated in funds flow statement submitted to and approved by the Bank;

— enter into any borrowing or non-borrowing arrangements either secured or unsecured with any other bank, financial institution, company, firm or otherwise or accept deposits in excess of the limits laid down by Reserve Bank of India.

— invest by way of share capital in or lend or advance funds to or place deposits with any other company/firm/concern (including group companies/associates)/persons. Normal trade credit or security deposit in the normal course of business or advance to employees can, however be extended.

— undertake guarantee obligations on behalf of any other company/firm/person

— declare dividend for any year except out of profits relating to that year after meeting all

Self Explanatory

Self Explanatory

Acts as a Deterrent.

Acts as a Deterrent.

Undertaking to prevent utilisation of funds for unauthorised purposes

Prevent diversion of short term funds to long term uses which can seriously impair day to day operations and create strain on cash flow.

Prevents diversion of funds to unauthorised purposes/ investments not approved/ endorsed by lenders etc.

Can be debilitating if amount large and default ensues

To check disproportionate outgo of funds which can adversely
the financial commitments to the bank and making all due and necessary provisions.

— make any drastic change(s) in its management set-up.

— approach capital market for mobilising additional resources either in the form of Debts or equity.

— sell or dispose off or create security or encumbrances on the assets charged to the bank in favour of any other bank, financial institution, company, firm, individual.

— repay monies brought in by the promoters, partners, directors, share holders, their relatives and friends in the business of the company/firm by way of deposits /loans/share application money etc.

28. Declare the relationship, if any, of the directors of the company with the directors of the bank and senior officers of the bank.

29. The Bank reserves its right to appoint its nominee on Company’s Board of Directors - part time/full time to oversee the functioning of the company/to look after bank’s interests.

30. The company/firm to take prior approval from bank for opening any account with any other bank/other branch of our bank.

31. Firm/Company is permitted to open/maintain following C/D accounts with other banks/branches of our bank for specified purposes subject to submission of bank statements of these accounts to us every month/quarter for our perusal. Firm/Company will be required to close these accounts as and when required by bank.

32. The company/firm to submit a stamped declaration cum undertaking to the effect that :-

—the company/firm or its directors/partners/promoters/guarantors/associate concerns of the company/firm are not on ECGC Caution list/impact repayment of lender’s dues

Self Explanatory

To check siphoning of funds

Self Explanatory

To check diversion of funds/utilization for unauthorised purposes/investments

Self Explanatory
specific approval list, RBI’s defaulters/caution list, COFEPOSA defaulters list or our bank’s defaulters list, and that no director of the company is disqualified under the Companies Act, 2013.

—No legal case of any nature has been filed against the company/its associates affecting the financial position substantially, and in case of any suit is/will be filed against the Company, the bank shall be kept informed.

—the company shall not induct a person who is/was a director in a company, which has been identified as a ‘Willful defaulter’ by the Bank, RBI or any Bank/FI, on company’s Board and if such a person is found to be on the Company’s Board, the company shall take expeditious and effective steps for removal of such person/s from Company’s Board.

33. The credit facilities shall be utilised only for the purposes for which same are granted and said facilities shall not be ‘diverted’ or ‘siphoned off’ or used for any other purposes.

34. In case of default in the repayment of loans/advances/abovesaid facilities or in the repayment of interest thereon or any of the installment of Loan as per stipulated terms, or in the event of diversion or siphoning off or utilising the said facilities for any other purpose other than for which it is granted, the Bank and/or the Reserve Bank of India (RBI) will have an unqualified right to disclose or publish the name of the company/firm or its directors/partners as defaulters in such manner and through such medium as the Bank or RBI or such other agency authorised by them, in their absolute discretion may think fit.

35. Please note that the cheques drawn by firm/Company will not be honoured by bank if in its view the payment is going towards a purpose for which the facilities are not sanctioned. Further, please note that Bank will not allow cash withdrawals beyond Rs.________ per cheque/per day.

To prevent diversion to unauthorised purposes/investments/siphoning off of funds
Lesson 9

36. Bank assumes no obligation whatsoever to meet your further (fund based or non fund based) requirements on account of growth in business or otherwise without proper revision and sanction of credit limits decided at the sole discretion of the bank. Further, if sanction terms are not complied with by you or if your account is classified as Non-performing Asset (NPA), then bank may not allow further withdrawals in the account.

37. (a) Notwithstanding what is stated herein above, we shall at any time and from time to time, be entitled to notify you and charge interest/commission/charges at such notified rates and this letter shall be construed as if such revised rates were mentioned herein.

(b) You shall pay to or reimburse all costs, charges, expenses (including charges between the attorney or counsel and bank and those of our internal legal adviser/officer and other experts, consultants or professionals), disbursements, taxes, fees, stamp duties etc. whatsoever, incidental or to arising out of the facilities, their negotiation, the preparation, execution, registration and stamping of the documents relating thereto, the preservation or protection of our rights and interests of the enforcement or realisation of any security or any demand or any attempted recovery of the amounts due from you.

38. We shall be entitled to debit the amounts of all costs, charges and expenses to your account and such amounts shall stand secured by all securities given to or created in our favour in connection with the facilities. You indemnify and keep us fully and completely indemnified from time to time against the liabilities including all costs, charges and expenses stipulated herein whether debited to your account or not.

39. Any failure to exercise or delay in exercising any of our rights hereunder or under any other documents will not act as a waiver of that or any other right nor shall any single or partial exercise preclude any future exercise of that right.

40. So long as any monies are due to us from you under any of the facilities, we shall have a
lien/charge for such amounts on all your credit balances, deposits, securities or other assets with, any of the branches of the Bank or of its subsidiaries any where in the world and upon the happening of any of the events of default referred herein, we shall be entitled to exercise a right of set off between the amounts due and payable to us and the said credit balances, deposits, securities and other assets.

41. You shall not, except after prior written permission from us, make any alterations in your constitution, controlling ownership or any documents relating to its constitution or any other material change in your management or in the nature of your business or operations during the period of the subsistence of facilities.

42. The bank reserves the right to discontinue any/all the credit facilities granted without giving you any prior notice in case of non-compliance and/or breach of any of the terms and conditions based on which the facilities have been sanctioned to you and/or if any information/particulars/documents furnished by you are found to be incorrect.

43. You shall not undertake derivative transactions without approval of the Bank. You should obtain NOC from the Bank before entering into any derivative agreement with any other Bank.

44. The Bank carries out the credit rating exercise every year when the facilities are reviewed. However, it reserves the right to carry out the credit rating exercise of the facilities at frequencies considered necessary and the rate of interest chargeable to the facilities would depend upon the rating obtained by the borrowing firm/Company.

The Bank reserves the right to add, amend, alter, cancel and modify any of the terms and conditions stipulated hereinabove with or without any prior reference to you. Further, the bank’s general rules governing advances shall also apply. The company/firm to abide by such terms and conditions as the bank may stipulate from time to time.
The Company has insured fully all its assets.

Particulars of Insurance cover obtained by the Company are as under:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars of Asset Insured</th>
<th>Value of Asset (₹)</th>
<th>Sum Insured (₹)</th>
<th>Risk Covered</th>
<th>Amount of Policy</th>
<th>Insurance Company</th>
<th>Insurance Policy Number</th>
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<tbody>
<tr>
<td>1.</td>
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<td>M/s …</td>
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</tbody>
</table>

Note: Insert a remark, whether all the assets have been insured and provide a list of assets that haven’t been insured.

Compliance Inputs

— Original insurance policies
— Register of Assets
— Collateral Security offered to the lenders
— Stock Statement
— Premium payment receipts

Checklist for Insurance Policies

(a) Verify the original insurance policies and check carefully the details of assets covered by the policy.

(b) The Company should take a Policy from a General Insurance company registered with IRDA

(c) Policies are issued for a period of one year. Sometimes, short period policies for less than one year are also issued. Hence Policy period should be checked.

— Generally Fire Insurance policies cover immovable properties, stocks etc. Earthquake, Terrorism etc. are given as add on covers. Vehicles should have Valid Comprehensive Insurance Policies.

— Sum insured should represent the Market value/Replacement value as the case may be (not book value) or else, under insurance will be applicable. Name, address, situation (with Building No. etc.) of the Company should tally with the records.

— Name of the mortgagee should be verified.

— Any endorsement during the policy period, noting the changes in the sum insured, situation, risk etc. should be verified.

Checklist for Terms of Insurance

Check the following in regard to compliance of terms of insurance:
(a) the company’s assets have been insured comprehensively. Where a joint insurance on plant and buildings has been taken, the value thereof has been apportioned in the manner prescribed/approved;

(b) the insurance policy has been taken in the joint names of the company and the bank(s)/financial institution(s);

(c) the policy has been kept alive for such full value, as has been determined by the bank(s)/financial institution(s), all premia are being paid on time, and the company has not done any such act as would render the policy void or voidable;

(d) the policy has been taken from an insurance office of repute, as determined by the bank(s)/financial institution(s); and

(e) all moneys received under the insurance policies are held in trust for better securing to the bank(s)/financial institution(s), the payment of all moneys secured under the indenture agreement.

The name of the Company and or any of its Directors does not appear in the defaulters’ list of Reserve Bank of India.

Definition of wilful default

A “wilful default” would be deemed to have occurred if any of the following events is noted:-

(a) The company has defaulted in meeting its payment/repayment obligations to the lender even when it has the capacity to honour the said obligations.

(b) The company has defaulted in meeting its payment/repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

(c) The company has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

In order to prevent the access to the capital markets by the wilful defaulters, a copy of the list of wilful defaulters (non-suit filed accounts) and list of wilful defaulters (suit-filed accounts) are forwarded to SEBI by RBI and Credit Information Bureau (India) Ltd. (CIBIL) respectively.

Compliance Inputs

— Register of Deposits
— Register of Loans
— RBI defaulters list and ECGC’s Specific Approval List: The Reserve Bank of India periodically releases the lists of willful defaulters. These are available on the Reserve Bank of India website.

Checklist

(a) Check that the name of the Company or its Director(s) does not appear in the Defaulters list of Reserve Bank of India;

(b) Check whether the company has/has not entered into any One Time Settlement (OTS) arrangement with any FI/Bank(s) during the period to which the Report pertains.
The name of the Company and/or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation

Compliance Inputs

— Specific Approval List of Export Credit Guarantee Corporation (ECGC):

The ECGC’s Special Approval is not a public document. However, the information about a particular company is made available by the ECGC on a case to case basis. The Practising Company Secretary (PCS) may visit the ECGC’s website www.ecgc.in to obtain the names and contact details of the respective officers in his/her vicinity who can be approached for obtaining the required information.

Checklist

(a) Check that the name of the Company or its Director(s) does not appear in the Specific Approval List of ECGC;

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

Note: Obtain a Report from the management of the company regarding the applicable laws and compliance thereof.

Compliance Inputs

— Original receipts evidencing payment of liabilities/dues of all the ground rents, rates, taxes, duties and outgoings immediately on their becoming due.

— Relevant ledger accounts.

Checklist

(a) Check whether the disputed dues have been paid.

(b) Check that as regards payment of liabilities/dues that the company has been paying all the ground rents, rates, taxes, dues, duties and outgoings immediately on their becoming due.

(c) Check whether satisfactory provisions have also been made for meeting tax liabilities for subsequent years.

(d) Check whether the company has a structured compliance reporting system in place on statutory payments

The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.

Checklist for Utilisation of moneys advanced

(a) Check that any changes/deviations in the time schedule for completion of the project have been made in consultation with the bank.

Checklist for Financial Position

Check the financial position to ensure that:

(a) no money has been withdrawn from the business, out of the capital or in anticipation of profits,
without prior consent of the bank(s)/financial institution(s) ; and

**Checklist for Utilisation of Moneys Advanced**

Ensure that consistency has been maintained in utilisation of moneys advanced. The following aspects may be specifically examined:

(a) funds have been utilised for the purposes laid down in the loan agreement. Where funds have not been so utilised, the requisite permission has been taken;

(b) requisite conditions laid down to qualify for the outstanding balance of the loan have been fulfilled;

(c) the drawals from the loan are being kept in a separate Scheduled Bank Account, payments therefrom are being made in the manner laid down in the indenture, the said scheduled bank has foregone its right to set-off or lien, in respect of the said account, and the borrower is maintaining the records pertaining to the said account, as provided;

(d) no part of the loan moneys has been transferred to call, short term, fixed or any other deposits, without prior consent. Where such consent has been obtained, the scheduled bank has foregone its right to set off any amount due from the company, against the deposits, the deposits have been realised on their due dates and the proceeds thereof re-deposited in the special account;

(e) the expenditure has been financed in the manner provided for in the indenture.

**Diversion and siphoning of funds**

The terms “diversion of funds” and “siphoning of funds” should construe to mean the following:

**Diversion of funds,** would be construed to include any one of the under noted occurrences:

(a) utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;

(b) deploying borrowed funds for purposes/activities or creation of assets other than those for which the loan was sanctioned;

(c) transferring funds to the subsidiaries/Group companies or other corporates by whatever modalities;

(d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;

(e) investment in other companies by way of acquiring equities/debt instruments without approval of lenders;

(f) shortfall in deployment of funds vis-à-vis the amounts disbursed/drawn and the difference not being accounted for.

**Siphoning of funds,** should be construed to occur if any funds borrowed from banks/FIs are utilised for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would have to be a judgement of the lenders based on objective facts and circumstances of the case.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents.

The default to be categorised as wilful must be intentional, deliberate and calculated.
Compliance Inputs

Term Loan

Large term loans

— In most cases, more than one bank will be involved and a lender’s engineer might have been appointed, who is expected to inspect and benchmark progress against milestones and expenditure incurred commensurate with the drawals. The PCS may rely on such certification.

— Wherever letters of credit (inland/foreign) have been opened for specific items of capital expenditure and the relative bill(s) debited to term loan account end use is automatically taken care of.

— It’s quite likely that in some projects where civil construction takes place, architect certificate is asked for. The PCS may rely on such certification.

— Lenders in some specific cases, permit reimbursement of expenditure incurred. PCS are advised to verify that proper certification exists for such transactions.

— Wherever items of expenditure are clearly identified PCS may comment on compliance with monetary outgo in respect of such items.

Mid Size and Small Projects

— Wherever lenders engineer/architect certification is available these may be relied upon; similarly for inland foreign L/C for capital expenditure.

— In other cases PCS may verify mode of payment made to the supplier/intended beneficiary in respect of drawings from term loans.

— Wherever certification such as engineer/chartered engineer’s valuation report exists, reliance can be placed on the same.

Working Capital

Cash Credit Accounts

— Compliance inputs

• Cash and Bank Book
• Stocks/Book debts Statements submitted to the bank(s)
• Monthly Select Operational Data (MSOD)/Quarterly Information System (QIS)/Financial Follow up Report (FFR) filings to banks
• Stock /Book Debt (Receivables) Audit Report commissioned by any of the member bank(s)
• Auditors Report under CARO to ensure compliance
• Quality of Inventory Management system

Suggested alerts:

• Disproportionately large cash payments in relation to normal requirements in a company of its size
• Frequent circular transactions between various bank accounts
• Inordinate delay in submission of stock statements/book debts/quarterly filings to the Bank(s)
• Large differences between MSOD/QIS2/FFR etc. with stock statements and inventory regularly and particularly as on date of balance sheet.

• Delay/default in meeting statutory payments

• Any apparent unrelated payment(s) that come to notice

• Disproportionate holding of Work-in-progress (WIP)

• Regular on account payments to creditors

• Regular on account payments from debtors

• Any differential pricing system to associates

• Any attachment of bank accounts from statutory authorities (input from bank)

• Borrowings from unconventional sources

• Dishonour of cheques

• Unduly large sales returns/return of bills

• Lack of tie ups in project finance resulting in diversion of short term funds

• Winding-up cases if any filed against the company

• Insolvency proceedings against any of the promoter(s)/director(s)

Prosecutions initiated against or show cause notices received by the Company for alleged defaults/offences under various statutory provisions and also fines and penalties imposed on the Company and/or any other action initiated against the Company and/or its directors in such cases are detailed in Annexure....

Compliance Inputs

— In case of show cause notice issued for non-compliance of any of the provisions of the Companies Act, 1956 or Companies Act, 2013 – the explanations given by the company while assessing enormity of the violations in question.

— The notices of prosecution/show cause.

Checklist

(a) Check whether the company has been issued any show cause notice for non-compliance of any of the provisions of the Companies Act, 1956/Companies Act, 2013; if so, verify the explanations given by the company while assessing enormity of the violations in question;

(b) Check whether the notices of prosecution/show cause have been placed before the Board;

(c) Check whether the company has received any prosecution notice;

(d) Check whether any inspection or investigation has been ordered under the Companies Act, 1956 and if so, assess the status at the time of issuing the Compliance Certificate;

(e) Check whether any fines and penalties or any other punishment was imposed on the company;
The Company has deposited within the stipulated time both Employees’ and Employer’s contribution to Provident Fund with the prescribed authorities

Compliance Inputs

- Relevant Ledger Accounts
- No dues certificate from the Provident Fund Authorities

Checklist

Check whether the company has constituted a Provident Fund for its employees or any class of employees and approval under the Employees Provident Fund and Miscellaneous Provisions (EPF & MP) Act, 1952 has been obtained. If yes, check that all moneys contributed to such fund (whether by the company or by the employees) or received or accruing by way of interest or otherwise to such fund have been deposited within 15 days from the date of contribution, receipt of accrual, as the case may be, in an account as specified in clause (a) of subsection (1) of section 418 or invested in the securities mentioned or referred to in clause (a) to (e) of section 20 of the Indian Trust Act, 1882.

LESSON ROUND UP

- In October 1996, various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements were withdrawn by Reserve Bank of India with a view to introducing flexibility in the credit delivery system and to facilitate smooth flow of credit. However, Central Vigilance Commission (CVC), Government of India, in the light of frauds involving consortium/multiple banking arrangements which have taken place in the recent past, expressed concerns on the working of Consortium Lending and Multiple Banking Arrangements in the banking system. The CVC attributed the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of the account of the borrowers among various banks.

- The matter was examined by the Reserve Bank of India (RBI) in consultation with the Indian Banks Association (IBA) who were of the opinion that there is need for improving the sharing/dissemination of information among the banks about the status of the borrowers enjoying credit facilities from more than one bank.

- The Reserve Bank of India vide its Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008 advised all the scheduled commercial Banks (excluding RRBs and LABs) to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in the aforesaid notification.


- This report includes twenty five point compliance checklist covering matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilisation/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc.
### SELF TEST QUESTIONS

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

1. What is the necessity for diligence report for banks?
2. What are the aspects covered in the diligence report for banks?
3. Describe the compliance with respect to listed companies in the context of diligence report for banks?
Lesson 11
Search/Status Reports

LEARNING OBJECTIVES

MCA-21 offers the facility to view certain public documents which include documents relating to registration, modification and satisfaction of Charges.

This facility is handy for users and banks and financial institutions while sanctioning loans and to evaluate the extent up to which the company has already borrowed moneys and created charges on the security of its movable and/or immovable properties. The Banks/Financial Institutions view this document by an online inspection process is called Search/Status Report.

After reading this lesson you will be able to understand the meaning, nature of search report, process involved in online inspection of documents while preparing search reports, provisions of companies act relating to creation, modification or satisfaction of charges.

LESSON OUTLINE

- Legal provisions relating to charges
- E-Filling of Form No. CHG-1, CHG-9, CHG-4
- Requirement of Financial Institutions and corporate lenders
- Checklist 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, 2013 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 favor of other lenders, it enables the lenders to assess the exact position of the company and to foresee where they would stand, if the company would go into liquidation. Normally, practicing Company Secretaries are entrusted with the preparation of status/search reports.

SCOPE AND IMPORTANCE

The scope of a Search report depends upon the requirements of the Bank or Financial Institution concerned.

A Search report prepared enables the Bank/Financial Institution to evaluate the extent up to 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.
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

Section 77(1) provides that it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such Form No. CHG-1 (for other than debentures) or Form No. CHG-9 (for debentures including rectification), on payment of such fees and in such manner as may be prescribed in the Rules, with the Registrar within 30 days of its creation.

The Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees. The application for delay shall be made in Form No. CHG-10 and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect rights of any other intervening creditors of the company.

If registration is not made within a period of three hundred days of such creation, the company shall seek extension of time in accordance with section 87[Rectification by Central Government in register of Charges]. Any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered.

Section 77(2) of the Act states that when a charge is registered with the Registrar under section 77(1), he shall issue a certificate of registration of such charge in Form No. CHG-2 and for registration of modification of Charge in Form No. CHG-3, to the person in whose favour the charge is created.

Further the Act provides that no charge created by the company shall be taken into account by the liquidator or any other creditor unless it is duly registered a certificate of registration of such charge is given by the Registrar. However this does not prejudice any contract or obligation for the repayment of the money secured by a charge. [Section 77(3) & (2)]

According to Section 82 the company shall give intimation to the Registrar of the payment or satisfaction in full of any charge within a period of 30 days from the date of such payment or satisfaction in Form No. CHG-4 along with the fee.

(b) Examination of documents and registration

MCA-21 offers the facility to view documents and also search and other facilities of public documents. This facility is handy for users and banks and financial institutions while sanctioning loans.

This facility enables viewing of public documents of companies for which payment has been made by user. The document can be viewed only within 7 days after the payment has been confirmed. Also, the documents are available for only 3 hours after the user has started viewing the first document of the company.

(a) User has to access My MCA portal and login to the My MCA portal.
(b) Click on the 'My Documents' tab after logging into the system.

(c) List of company names will be displayed, for which user have already paid for public viewing. It also displays

(i) Date of request i.e. the date, when user made the request to view the company document.

(ii) Status of the request i.e. whether viewed or to view.

(d) Click on the view link under status field.

(e) The documents are grouped under five categories i.e. user has to click on the desired category under which the document falls.

(f) If more than one document is listed, the user can arrange them name wise or date wise.

(g) On clicking the document name, the document shall be displayed for viewing.

The public documents under this facility are available for viewing by public on payment of requisite fee. Public documents include Incorporation documents, charge documents, annual returns and balance sheet, change in directors and other documents.

The basic record on the basis of which the report was previously submitted to the banks/institutions, was the Register of Charges maintained in the Office of the ROC. With respect to each company, a Register of charges is maintained by the ROC.

(c) Inspection of register of Charges

Section 85 of the Act provides that every company shall keep at its registered office a register of charges in Form No. CHG-7 which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed in the Rules. A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

The register of charges and instrument of charges, kept under this section shall be open for inspection during business hours—

(a) By any member or creditor without any payment of fees; or

(b) By any other person on payment of such fees as may be prescribed, subject to such reasonable restrictions as the company may, by its articles, impose.

(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.

According to the rule 3(4) of Companies (Registration of Charges) Rules, 2014 made under chapter VI a copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar in pursuance of section 77, 78 or 79 shall be verified as follows—

(a) where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal of the company, or under the hand of any director or company secretary of the company or an authorized officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;
(b) where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorized officer of the charge holder.

Meticulous care will have to be taken in noting down the following particulars from the Register of Charges:

(a) Date of registration (preferably with the serial number) of the document
(b) Date and nature of the document creating the charge
(c) Amount of the charge
(d) Brief particulars of the property charged
(e) Name and address of the person in whose favour the charge is created.

In respect of each of the charges created, it would be essential to identify the modifications effected from time to time by noting down carefully the following particulars:

(a) Date of registration of the document (preferably with the serial number)
(b) Nature and date of the instrument modifying the charge
(c) Effect of Modification.

Each modification should be noted in chronological order and the above particulars should be compiled together for each charge.

If and when the charge is satisfied, fool-proof identification of the exact charge which is satisfied is of paramount necessity. The following particulars can be noted chronologically by way of modification by the 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:

<table>
<thead>
<tr>
<th>Item</th>
<th>Records to be verified</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>Name of the Company</td>
</tr>
<tr>
<td>(b)</td>
<td>Date of Incorporation</td>
</tr>
</tbody>
</table>

Memorandum of Association Certificate of Incorporation or Fresh Certificate of Incorporation/Change of Name.
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
INC-22, MGT-14 Resolution(s) of Board/General Body, INC-28 with copy of *CLB Order.

(e) Name and address of present directors (with their date of joining)
Articles of Association, DIR-12, Register of Directors.

(f) Authorized Share Capital of the company divided into__________ Shares of Rs.___________ each
Articles of Association, DIR-12, Register of Directors.

(g) Paid-up Capital of the company divided into_____________ Shares of Rs.______ each
MGT-14, PAS-3, Register of Members, Accounts Ledger

(h) List of Members with details as to shares held by each of them. The names of directors to be specifically mentioned in such list of shareholders (List of members holding shares of a specified monetary threshold is also asked for in some cases).
PAS-3, 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 F, Clause 79 of Table F may be referred.

(j) Main Objects of the company.
Memorandum of Association

(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.

(Note: If capital is raised other than by cash, it should be shown separately).

*NCLT upon notification

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 CHG-1 and CHG-9

— 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 No. CHG-1.

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 No. CHG-1 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 up to 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, 2013.

(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 CHG-1, 4, 9 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.

(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.

LEGAL PROVISIONS

Sections 77 to 87 made under chapter VI of the Companies Act, 2013 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 up to thirty days in case of particulars relating to creation or modification of the charge. In the case of satisfaction of charge, the delays can be condoned by Regional Director of the respective regions upon a petition (application) filed by the company or interested person.

The prescribed particulars in Form CHG-1 or CHG-9 together with copy of the instrument creating or modifying the charge and those relating to satisfaction of charge in Form CHG-4 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 depict the manner of verifying Forms CHG 1/4/9 relating to charges.

TABLE A

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Relevant Provisions</th>
<th>Charges under Reference</th>
<th>Illustrative Instruments</th>
<th>To Verify Whether Or Not</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.</td>
<td>Section 77 of the Companies Act, 2013</td>
<td>(a) a charge for the purpose of securing any issue of debentures</td>
<td>(a) Hypothecation or mortgage including floating charge</td>
<td>*The instrument is executed and is dated.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(b) a charge on uncalled</td>
<td>(b) Deed of assignment</td>
<td>*The common seal is</td>
</tr>
<tr>
<td></td>
<td>Share capital of the company</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(c) A charge on any immovable property, where-ever situate, or any interest therein</td>
<td>(c) Mortgage</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*The instrument bears adequate stamps in accordance with the applicable Stamp Act</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(d) A charge on any book debts of the company</td>
<td>(d) Hypothecation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*The instrument creates the charge specifying the amount of charge and the assets charged.</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(e) A charge, not being a pledge, on any movable property of the company</td>
<td>(e) Hypothecation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*The instrument modifying a charge refers to the original charge under modification and spells the extent of modification.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(f) A floating charge on the undertaking or any property of the company including stock-in-trade</td>
<td>(f) Hypothecation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*The instrument bears names of the persons in whose favour the charge is created or modified.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(g) A charge on calls made but not paid</td>
<td>(g) Deed of assignment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*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.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(h) A charge on a ship or any share in ship</td>
<td>(h) Hypothecation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(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</td>
<td>(i) Deed of assignment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II.</td>
<td>Section 79 of the Companies Act, 2013</td>
<td>Charges on properties acquired subject to any charge thereon</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Relevant instrument and also the instrument, evidencing the acquisition of the property which is subject to charge.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
*The instrument bears adequate stamps in accordance with the applicable Stamp Act.

**TABLE B**

**Time for Filing Forms**

<table>
<thead>
<tr>
<th>Event</th>
<th>Time Limit</th>
<th>Effect</th>
<th>Relevant provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation of charge or modification of charge or</td>
<td>Within thirty days after the</td>
<td>The date when the</td>
<td>Sections 77 and 79 of the Act.</td>
</tr>
<tr>
<td>acquisition of property which is subject to</td>
<td>date of creation, modification</td>
<td>event takes place is to be excluded while calculating the</td>
<td></td>
</tr>
<tr>
<td>charge</td>
<td>or acquisition</td>
<td>limit</td>
<td></td>
</tr>
<tr>
<td>Satisfaction of the charge.</td>
<td>Within thirty days from the</td>
<td>The date when the</td>
<td>Section 82 of the Act.</td>
</tr>
<tr>
<td></td>
<td>date of satisfaction</td>
<td>event takes place is to be excluded while calculating thirty</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>days</td>
<td></td>
</tr>
</tbody>
</table>

**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 180(1) (c) of the Companies Act, 2013, including details of share capital – authorized, issued, subscribed and paid-up, and the actual borrowing.

(c) List of members of a company.

(d) Copies of resolutions passed at company meeting to be furnished to financial institutions.

Many State Financial/Industrial Investment/Development Corporations have also agreed to accept the certificates issued by Company Secretaries in Practice, in regard to all/some of the aforesaid matters.

**Certification by Company Secretaries in Practice**

The certification to be done by Company Secretaries in Practice has to conform to any specific requirement of the Institution/Corporation. It may be stated that the matters to which certification extends can be verified by the Institutions themselves from the Memorandum/Articles of Association of companies, which are submitted to them. However, Institutions, by way of abundant caution insist for stipulation on certificates by independent professionals like Company Secretaries in Practice, in respect of these matters. The various certifications are explained in the following paragraphs.

**Necessary Powers of a Company and its Directors to Enter into an Agreement**

Resolutions passed at the meeting of the board/general meeting for exercising the power of borrowing have to be checked; in the absence of any provision to the contrary in the articles of association, the borrowing power may be exercised by the Board of directors.

Section 179 of the Companies Act requires *inter alia*, that the power to borrow moneys 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 up to 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 authorized 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 180(1)(c)**

Section 180(1)(c) states that to borrow money, where the money to be borrowed, together with the money
already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart
from temporary loans obtained from the company's bankers in the ordinary course of business:

However, the acceptance by a banking company, in the ordinary course of its business, of deposits of money
from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise,
shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

Section 180(2) provides that every special resolution passed by the company in general meeting in relation
to the exercise of the powers referred to in clause (c) of sub-section (1) shall specify the total amount up to
which monies may be borrowed by the Board of Directors. No debt incurred by the company in excess of the
limit imposed by section 180(1)(c) shall be valid or effectual, unless the lender proves that he advanced the
loan in good faith and without knowledge that the limit imposed by that clause had been exceeded.

**Compliance for borrowing money**

Hold the Board meeting and issue the notice of general meeting.

Hold general meeting and pass the special resolution for transacting the matter stated above in section
180(1)(c) of the act.

File Form MGT-14 along with the fee or additional fee as provided in Companies (Registration of Offices and
Fees) Rules, 2014 with the Registrar within 30 days of passing of the Special resolution.

**LESSON ROUND UP**

- The search/status report enables furnishing of information to the lender as to whether the charges created
  through various documents are in fact registered with ROC and whether such particulars reflect the correct
  position of charges held by lenders.

- MCA21 offers the facility to view documents relating to charges created by the company which is handy for
  banks and financial institutions while granting loans.

- The scope of search report depends upon the requirements of the bank or financial institution concerned.

- Search/status report enables banks/financial institutions to evaluate the extent up to which the company
  has already borrowed moneys or created charges on scrutiny of its movable and/or immovable properties.
<table>
<thead>
<tr>
<th>SELF TEST QUESTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)</td>
</tr>
</tbody>
</table>

1. What is a status/search report? Discuss the format normally followed for Status/Search Report.
2. State the general points to be kept in mind by Company Secretary in Practice while preparing status/search report.
3. State the procedure of registering charges (created/modified) with the Registrar of Companies as required under Section 77 to 87 of the Companies Act 2013.
Lesson 12
Compliance Management

LEARNING OBJECTIVES

Expansion in terms of geographies and functions, has necessitated the corporates to comply with multiple regulations. It requires systematic approach and co-ordination among functional departments, to avoid any material non compliance. Nevertheless, some corporates perceive legal compliance, substantive and procedural, as mundane activity involving costs and fail to realize the cost of non compliance that may have an irreversible negative impact on the reputation of business. Here, the emphasis of the compliance management is on enabling companies acquire the skill-sets and systems to ensure continued adherence of law.

There has emerged a clear need to create proper systems, processes, tools and dynamic corporate compliance management systems. To promote a good compliance management, it is important that functions like tax/legal/finance have constant dialogue amongst themselves of the compliance obligations, discussing grey areas, if any, and seek constant best guidance for promoting compliance. These functions should stay in constant touch with business and identify any new business situations, which may warrant evaluation of newer compliances, and arrangements to be put in place to manage compliances.

After reading this lesson you will be able to understand the importance, need of compliance management, process involved, and systems approach to compliance management. Further the lesson also deals with apparent, adequate and absolute compliances.

LESSON OUTLINE

• The concept, scope, significance and need for compliance management
• Establishment of Compliance Management Framework
• Compliance Management process
• Systems approach to compliance management
• Apparent, Adequate and absolute compliance
• Role of Company Secretary in compliance management
• Compliance Programme
INTRODUCTION

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

The compliance program consists of the policies and procedures which guide in adherence of laws and regulations. The compliance audit is independent testing of level of compliance with various laws and regulations applicable.

Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management must recognize the scope and implications of laws and regulations that apply to the company. They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. To ensure an effective approach to compliance, the participation of senior management in the development and maintenance of a compliance program is necessary. They should review the effectiveness of its compliance management system at periodic intervals, so as to ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management

NEED FOR COMPLIANCE

Corporate accountability is on everyone's mind today. Business executive face significant pressure to comply with multiple regulations. Many companies are adopting comprehensive compliance plans to address emerging regulatory paradigm and those that fail to address the new regulations, pay hefty fines or incurring punitive restrictions on their operations.

The organizations face mounting pressures that are driving them towards a structured approach to enterprise-wide compliance management. Increased liability and regulatory oversight has amplified risk to a point where it demands continuous evaluation of compliance management systems. Furthermore, the multiplication of compliance requirements that organizations face increases the risk of non-compliance, which may have potential civil and criminal penalties.

This focused attention on compliances with spirit and details of laws casts upon Company Secretaries an onerous responsibility to guide the corporates in this direction. They have to advise companies in totality to provide full, timely and intelligible information. To enable companies to put in place an effective Compliance Management System, company secretaries should ensure that companies:

- adhere to necessary industry and government regulations,
- Change business processes according to legislative change,
- Realign resources to meet compliance deadlines,
- React quickly and cost-effectively if regulations change.
Risk of Non-compliance

The risks of non-compliance of the law are many:

1. Cessation of business activities
2. Civil action by the authorities
3. Punitive action resulting in fines against the company/officials
4. Imprisonment of the errant officials
5. Public embarrassment
6. Damage to the reputation of the company and its employees
7. Attachment of bank accounts.

SIGNIFICANCE OF CORPORATE COMPLIANCE MANAGEMENT

1. Better compliance of the law
2. Real time status of legal/statutory compliances
3. Safety valve against unintended non compliances/prosecutions, etc.
4. Real time status on the progress of pending litigation before the judicial/quasi-judicial fora
5. Cost savings by avoiding penalties/fines and minimizing litigation
6. Better brand image and positioning of the company in the market
7. Enhanced credibility/creditworthiness that only a law abiding company can command
8. Goodwill among the shareholders, investors, and stakeholders.
9. Recognition as Good corporate citizen.

Compliance with the requirements of law through a compliance management programme can produce positive results at several levels:

— Companies that go the extra mile with their compliance programs lay the foundation for the control environment.
— Companies with effective compliance management programme are more likely to avoid stiff personal penalties, both monetary and imprisonment.
— Companies that embed positive ethics and effective compliance management programme deep within their culture often enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns.

Clearly, the benefits of implementing and maintaining an effective ethics and compliance program far outweigh its costs. Not only does the compliance management protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

SCOPE OF CORPORATE COMPLIANCE MANAGEMENT

Corporate compliance management should broadly include compliance of:

— Corporate Laws
— Securities Laws
— Commercial Laws including Intellectual Property Rights Laws
— Labour Laws
— Tax Laws
— Pollution Control Laws
— Industry Specified laws
— All other Laws affecting the company concerned depending upon the type of industry/activity.

The details of the above mentioned legislations are given below.

(a) Corporate & Economic Laws

Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws. Some of the important corporate laws are given below in brief:

— Companies Act, 2013 and the Rules and Regulations framed there under, MCA-21 requirements and procedures.
— Secretarial Standards/Accounting Standards/Cost Accounting Standards issued by ICSI/ICAI/ICMAI, respectively.
— Foreign Exchange Management Act, 1999 and the various Notifications, Rules and Regulations framed there under.
— Special Economic Zones Act, 2005.

(b) Securities Laws

— SEBI Act, 1992
— Securities (Contracts) Regulation Act, 1956 and rules made thereunder
— Various rules, regulations guidelines and circulars issued by SEBI
— Provisions of Listing Agreement
— Depositories Act, 1996

(c) Commercial Laws

— Indian Contract Act, 1872
— Transfer of Property Act, 1882
— Arbitration and Conciliation Act, 1996
— Negotiable Instruments Act, 1881
— Sale of Goods Act, 1930

(d) Fiscal Laws
— Income Tax Act, 1961
— Central Excise Act, 1944
— Customs Act, 1962
— Wealth Tax Act, 1957
— Central Sales Tax/State Sales Tax/VAT
— Service Tax.

(e) Labour Laws
— Minimum Wages Act, 1948
— Payment of Bonus Act, 1965
— Payment of Gratuity Act, 1972
— Employees’ Provident Funds and (Misc. Provisions) Act, 1952;
— Employees’ State Insurance Act, 1948;
— Factories Act, 1948;
— Employees’ Compensation Act, 1923;
— Maternity Benefit Act, 1961;
— Industrial Dispute Act, 1947; and

(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

(g) Industry Specific Laws
Legislations applicable to specific categories of industries – electricity, power generation and transmission, insurance, banking, chit funds, etc.

(h) Local Laws
These would include Stamp Act, Registration Act, municipal and civic administration laws, shops and establishments, etc.

Individual companies may suitably add or delete to/from the above list as required.
Establishment of compliance management framework

The Compliance Management encompasses (1) Compliance Identification (2) Compliance Ownership (3) Compliance Awareness (4) Compliance Reporting and (5) Periodical Compliance MIS.

Compliance Identification

This process involves the identification of compliances under various legislations applicable to the company, in consultation with the functional heads. The legal team has to identify the legislations applicable to the company and identify the compliances that are required under each legislation or rules and regulations made there under.

Compliance Ownership

The next important aspect of compliance management is ownership. The ownership of the various compliances has to be described function wise and individual wise. Clear description of primary and secondary ownership is also very important. While the primary owner is mainly responsible for the compliance the secondary owner (usually the supervisor of the primary owner) has to supervise the compliance. Ex: Secretarial Officer /Asst Company Secretary may be primarily responsible and Group Company Secretary’s responsibility is secondary.

Compliance Awareness

The next important step in establishing a legal compliance Management is creation of awareness of the various Legal Compliances amongst those responsible. Many a times compliances are handled by persons who are not fully aware of the requirements of the legislations and hence creating appropriate awareness amongst the owners is very important. This could be done in the form of meetings/trainings explaining the various compliances or some manual containing the details of compliances.

Compliance Reporting

Compliances or non-compliances should be communicated to the Concerned. Reporting of non-compliances ensures that appropriate corrective action is taken by the responsible person, Ex. Automated escalation emails in case of non compliance

Process of Corporate Compliance Reporting (CCR)

Although the actual process of compiling the information under the various laws may vary from company to company and is dependent on various factors such as the number of units and scale of operations, a brief process of the CCR mechanism is as follows:

(A) Functional heads for the reporting of various laws have to be identified. For instance, the Company Secretary would be the functional head for reporting of company law, listing agreement and commercial laws. Similarly, the head of the Personnel Department could report the compliance of labour and industrial laws and the fiscal law compliance would be the domain of finance/accounts departments.

(B) Each of the functional heads may collect and classify the relevant information from the various units/locations pertaining to their department and consolidate them in the form of a report.

(C) The report shall carry an affirmation from the functional heads that the said report has been prepared based on the inputs received from the various units/offices and then list out the specific compliances/non-compliances, as already circulated to the functional heads.
(D) Each of the functional heads will forward their respective compliance reports to the Company Secretary/Managing Director.

(E) The Company Secretary would then brief the Managing Director and with suitable inputs from the Company Secretary, the Managing Director would consolidate and present, under his signature, a comprehensive CCR to the Board for its information, advice and noting.

(F) The whole process of CCR is contingent on the creation and implementation of comprehensive legal Management Information System (MIS).

**Role of Information Technology In Compliance Management Systems Through Web Based Compliance Systems**

A critical component of an effective compliance program is the ability to monitor and audit compliance in a “real time manner.” Yet, as companies cross geographical and industry boundaries, it is becoming harder to perform this role in the traditional manner. As a result, companies are increasingly seeking technology solutions.

Information Technology can play an effective role in implementation of a Corporate Compliance Management Programme across various departments of an organization in terms of real-time compliance reminders, generation of reports, sending warning signals, generation of compliance calendar etc.

Many companies are introducing comprehensive web-based compliance systems that links various offices/units for better co-ordination and continued compliance. Companies prefer to introduce full-fledged compliance management systems for smooth compliance of multiple laws. Web-based compliance software are available industry-wise and tailor made compliance software can also be made according to company specifications which has to be updated on continuous basis.

**The Systems Approach to compliance management**

A well-designed compliance management programme has abilities to perform the following key functions across the enterprise:

— **Compliance Dashboard:** The compliance programme must provide a single enterprise-wide dashboard for all users to track and trend compliance events. All compliance events should be easily viewed interactively through the enterprise compliance dashboard. External auditors, internal auditors, compliance officers can use the dashboards to make decisions on the compliance status of the organization.

— **Policy and Procedure Management:** A well-designed document management system forms the basis of managing the entire lifecycle of policies and procedures within an enterprise. Ensuring that these policies and procedures are in conformity with the ever-changing rules and regulations is a critical requirement. The creation, review, approval and release process of the policy documents and SOPs (Standard Operating Procedures) should be driven by collaborative tools that provide core document management functionality.

— **Event Management:** The compliance management system must have ability to capture and track events, cases and incidents across the extended enterprise. Compliance officers, call center personnel, IT departments, QA personnel, ethics hotline should be able to log in any adverse event across the enterprise, upon which the necessary corrective and preventive actions are initiated.

— **Rules and Regulations:** A well-designed compliance management solution must offer capabilities for organization to continuously stay in sync with changing rules and regulations. As soon as there are
regulatory changes, the various departments should be notified proactively through “email based” collaboration. This process critically enables the organization to dynamically change their policies and procedures in adherence to the rules and regulations. While tracking a single regulation may be manually feasible, it becomes an error-prone task to track all local, state, and central regulations including those taking place across the globe. A well-designed Compliance management programme offers up-to-date regulatory alerts across the enterprise.

— **Audit Management:** Audits have now become part of the enterprise core infrastructure. Internal audits, financial audits, external audits, vendor audits must be facilitated through a real-time system. Audits are no more an annual activity and corporations offer appropriate audit capabilities. Appropriate evidence of internal audits becomes critical in defending compliance to regulations.

— **Quality Management:** Most organizations have internal operational, plant-level or departmental quality initiatives to industry mandates like Six-sigma or ISO 9000. A well-designed compliance management program incorporates and supports ongoing quality initiatives. Most quality practitioners agree that compliance and quality are two sides of the same coin. Therefore, it is critical to ensure that compliance management solution offers support for enterprise-wide quality initiatives.

— **Training Management:** Most compliance programs often require evidence of employee training. Regulations like Clause 49 of Listing Agreement and Sarbanes-Oxley Act, stress on employee training. In USA, lack of documented training can lead to fines and penalties. Often the compliance office has to work closely with the HR organization to facilitate employee training. Well-designed compliance program requires a well-integrated approach to training management.

— **Compliance Task Management:** Organizations must plan, manage and report status of all compliance related activities from a centralized solution. Automated updates from the various compliance modules should provide for up-to-the-minute status reporting that could be viewed by the Board, corporate compliance officer, entity compliance coordinators, quality offices and others as designated.

### Compliance solutions

In this age of information technology and outsourcing, where corporate solutions are available at every step and in respect of every matter, there are several companies offering ‘compliance solutions’.

**Approach to Compliance Solutions**

Compliance solution providers adopts following approaches for creating or enhancing an ethics and compliance program for companies—

**Risk/Cultural Assessment:** Through employee surveys, interviews, and document reviews, a company’s culture of ethics and compliance at all levels of the organization is validated. Our Reports and recommendations with detail observations identify gaps between company’s current practices and benchmarks with international practices.

**Program Design/Update:** In this phase, compliance solution providers help company in creating guideline documents that outline the reporting structure, communications methods, and other key components of the code of ethics and compliance program. This encompasses all aspects of the program, from grass roots policies to structuring board committees that oversee the program; from establishing the mandatory anonymous complaint reporting mechanism—i.e., compliance and ethics help line or whistleblower hot line—to spelling out the specifics of the code of ethics in a way that is easily understood by everyone at all levels of organization.
**Policies and Procedures:** In this phase compliance solution providers help company to develop or enhance the detailed policies of the program, including issues of financial reporting, antitrust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, securities, and sexual harassment, among others.

**Communication, Training, and Implementation:** Even the best policies and procedures are useless if they are not institutionalized—they must become part of the fabric of the organization. Compliance solution providers help company to clearly articulate, communicate, and reinforce not only the specifics of the program, but also the philosophy behind it, and the day-to-day realities of it. In this way, key stakeholders and other personnel are more likely to embrace the program and incorporate it into their attitudes and behaviours.

**Ongoing self-Assessment, Monitoring, and Reporting:** The true test of a company’s ethics and compliance program comes over time. How do one know in one year or five that both the intent and letter of the law are still being observed throughout organization? How does the program and the organization adapt to changing legislation and business conditions? As the organization evolves for example, through mergers and acquisitions will the program remain relevant? The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organisations achieve sustained success.

### APPARENT, ADEQUATE AND ABSOLUTE COMPLIANCES

Corporates are expected to comply with the regulatory prescriptions in their true letter and spirit and should be seen as an opportunity to make their systems and processes more robust and bring them in line with global practice, resulting in the enhanced trust level of stakeholders. As regards corporate disclosure, there has been a paradigm shift from letter to spirit because of factors like demand from stakeholders, regulatory shift from control to self regulation, market competition etc.

Good Corporate Governance demands compliances level that match the intentions of legislature, expectations of stakeholders and requirements of regulators. The compliances, however, generally found to fall in three categories, i.e. Apparent Compliances, Adequate Compliances and Absolute Compliances.

Apparent compliance is a disguise form of non-compliance, which is worse than a non compliance. The classic example for Apparent Compliances are generating documents such as notice, agenda, minutes on papers for board and general meeting which are not actually held.

Adequate compliance is compliance in letters. The aspects specified in law are complied in letters, without getting into the spirit of the law, e.g. box ticking practices.

Absolute compliances are those which are in line with the spirit and intent of the law. A typical example in this regard is demonstrating shareholder democracy as prescribed by law. When a company complies with law in spirit it gains public confidence as well. For example, Infosys has set new and effective standards in communicating with shareholders, stock exchanges and general public at large. Its Annual Report is said to be a trend setter and has been commended as an ideal report by SEC. This company has demonstrated through its practices and procedures its commitment to enhance investor-relations and has amply rewarded its shareholders through its impressive performance and its value based management philosophyy helps increase its brand value. The company has achieved trust of stakeholders by having a strategic balance between wealth and welfare.

Experts view Annual report as self appraisal report of the company. The shift from shareholder concept to stakeholder concept has necessitated the corporates to provide a transparent report which is viewed by all
stakeholders such as shareholders, creditors, lenders, strategic investors etc as a potential source of information. In order to attain corporate sustainability and to ensure a level playing field with international market, corporates has to necessarily increase their level of compliance from apparent to adequate leading to level of absolute, compliances.

**SECRETARIAL AUDIT AND COMPLIANCE MANAGEMENT SYSTEM**

The compliance system and processes in a company are dependent mainly on the following factors:

(a) Nature of business(es).
(b) Geographical domain of its area of operation(s).
(c) Size of the company both in terms of operations as well as investments, technology, multiplicity of business activities and manpower employed.
(d) Jurisdictions in which it operates.
(e) Whether the company is a listed company or not.
(f) Regulatory authority(ies) in respect of its business operations.
(g) Nature of the company viz., private, public, government company, etc.

Based on the above the Secretarial Auditor can constitute a broad idea about the desired system and process to be adopted by a company. For example, a multi product / multi operation company is supposed to comply all the applicable corporate laws in addition to regulatory framework applicable at products/operations.

At corporate level, monitoring of such complex web of compliances are generally made on a back-to-back mechanism. In such cases Boards’ reporting on compliances are made on the basis of reports/certification provided by field level management. As a better compliance structure in such cases it is desired to have an internal checking mechanism about the quality of such report either on regular basis or sample basis.

Now-a-days most of the large companies have adopted Enterprise Resource Planning (ERP) Systems to cater to their complex operations. In many a cases, compliance system becomes a part of these modules. Auditing in such systems requires the Auditor to enter and to have access within the system. While taking up the audit assignment, the Auditor needs to ensure that access would be given so that assessment of proper system and process of compliance is made.

Auditing of compliance system and process is not a fault finding exercise, rather a device to scale up compliance mechanism of a company commensurate to its size and operations. It is desired that the Secretarial Auditor as an expert in corporate compliance would advice the companies to build up strong corporate compliance system in case the system appears to be insufficient during the audit process.

**Role of Company Secretaries in Compliance Management**

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the ‘Compliance Manager’ of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary. These disclosures can be classified into statutory disclosures, non-statutory disclosures, specifies disclosures and continuous disclosures. Clause 49 of Listing Agreement spells out elaborately on various aspects of disclosures which are to be made by the company such as contingent liabilities, related party transactions, proceeds from initial public offerings, remuneration of directors and various details giving the threats, risks and opportunities under management discussion and analysis in the corporate governance report which is published in the annual accounts duly
certified by the professional like company secretaries. A Company Secretary has to ensure that these disclosures are made to shareholders and other stakeholders in true letter and spirit.

In nutshell, the Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

**COMPLIANCE PROGRAMME**

**Prologue:**

Compliance is a permanent and integral part of business processes that is ongoing and needs continuous tuning in line with the business environment and the applicable regulatory ambit. Compliance programme should provide processes for

- preventing non-compliances through mechanism such as Compliance risk Management, Policies, processes & Procedures, Training and Communication, Code of Conduct & ethics programme etc.;
- detecting non-compliances through mechanisms such as effective whistle blowing, compliance controls, compliance audits etc.;
- responding to non-compliance through remedial action, implementation of control tools for non-reurrence of such non-compliance etc.

Through an effective Compliance Programme, the business and its stakeholders learns about the compliance responsibilities individually and for the organisation as a whole, making them a part of business processes; reviews operations to ensure responsibilities are carried out and requirements are met; and takes corrective action.

The objective of this template is to help the secretarial auditor in evaluating the critical aspects of compliance management. Check-lists have been provided under each heads, along with the intent of the questions. Secretarial Auditor may fine tune the same to company specific depending on the nature of industry, size of organisation and other relevant aspects that impacts the compliance programme.

**COMPLIANCE PROGRAMME - TEMPLATE**

**The Objectives**

The objective of compliance programme is to manage the compliance risk effectively, to promote ethical culture in the organisation, resulting in the maintenance and enhancement of the reputation of the Company. Compliance management through systematic processes helps in achieving 100% compliance with letter and spirit.

The objective of Compliance Programme is-

- To establish and maintain centralised mechanism to ensure compliance with all applicable laws (both Indian and International).
- To establish and maintain effective co-ordination of functional units and the compliance department under the overall supervision of the Board.
- To incorporate changes in the existing applicable laws or introduction of new laws, into the compliance process in real time manner.
- Effective communication of the changes in the regulatory mandates to the applicable functional and
other units in real time manner.

- To provide training on compliance requirements at regular intervals.
- To introduce and implement ethics programmes for Board, Senior Management and other staff members.
- To establish pro-active compliance risk management culture into the organisation.
- To establish effective monitoring and control systems.
- To adopt fair market practices.
- To establish mechanisms to prevent, detect, report and to respond to non-compliances.
- To introduce effective whistle blowing mechanism.
- To establish compliance dashboard.

### The Scope

1. **A. Compliance with applicable laws**
   - ......................
   - ......................
   - ......................
   - ......................
   - ......................

   (To be updated and amended from time to time)

2. **B. Adherence to Company Specific internal policies and procedures**
   - Code of Conduct
   - Code on prevention of Insider Trading
   - Policy on related party transaction
   - IT Policy
   - ......................
   - ......................

3. **Adherence with Vision and Mission statement of the Company.**
4. To devise code of conduct for Board, senior management and employees
5. Conducting training on compliance, ethics, code of conduct.
7. Appointment of Chief Compliance officer.
8. Quarterly compliance Report to be presented to the Board.
9. Identification and classification of various compliance risks.
10. Organisation of compliance Audit, feedback, remedies.
11. ......................
Compliance Risk

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, internal policies, and procedures, or ethical standards. This risk exposes the institution to fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced expansion potential and an inability to enforce contracts.

The Chief Compliance Officer

The Corporate Compliance Officer (CCO) is the custodian of the Corporate Compliance Plan. The CCO should report on compliance activities that include but are not limited to:

- To establish and review the centralised compliance programme in tune with business environment, strategic decisions of the company and the regulatory amendments.
- To guide and educate the Board on various compliances, regulatory and policy based compliances.
- To devise clear compliance structure.
- Liaison between Board, Functional heads and compliance staff.
- To advise the Compliance department regularly and as and when required.
- To devise annual compliance plan.
- To define the role and responsibilities of functional units and disseminate the information.
- To organise training for the Board and the staff on ethics and compliance.
- To establish and strengthen the Compliance Dashboard.
- Inform the Board and the functional departments about changes in the applicable regulatory landscape and its implications on the organisation.
- To establish processes for effective monitoring and control.
- To present quarterly compliance report before the Board.
- ........................................
- ........................................
- ........................................

Board Level Corporate Compliance Committee

The primary responsibility of the Corporate Compliance Committee is to oversee the company’s Corporate Compliance Program with respect to:

(I) compliance with the laws, rules and regulations applicable to the company

(II) Compliance with the Company’s Code of Conduct;

(III) Compliance with Company’s policies and procedures;

(IV) Compliance with established standards;

(V) Compliance with prevention and detection of fraud, misappropriation etc.

(VI) Oversight of the risk management activities of the Company and the protection of stakeholders.

(VII) Making recommendation to revise the compliance management programme
The Compliance Department

The Company should have a dedicated compliance department which should be independent and sufficiently resourced. It should not be entrusted with any business targets. They have to work closely with functional units. The staff of compliance department should have fair knowledge of applicable laws, internal policies etc and should be imparted training at regular intervals. The Chief Compliance Officer shall oversee the activities of Compliance Department.

The Compliance Dashboard

- The Compliance Dashboard should alert the company in the risk prone areas or non compliances.
- It should display the compliance obligations on the compliance calendar or dashboard
- Before the date of regulatory mandate, an e-mail should be sent to the compliance owner.
- The Compliance owner should send the response once compliance is done.

The compliance dashboard helps in simplifying the compliance obligation, effectively managing the compliance risk, facilitating board oversight, effective co-ordination of functional units.

Compliance System- Checklists

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Question</th>
<th>Yes/No</th>
<th>Intent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Board Oversight</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Does the Board approve quarterly Compliance Report?</td>
<td>Yes</td>
<td>The Board should be updated with the compliance of applicable laws at least every quarter, ensuring compliance by all functional heads and presented by Compliance department/Chief compliance officer helps in effective Board oversight.</td>
</tr>
<tr>
<td>2</td>
<td>Does the Board review Compliance Management programme at regular intervals?</td>
<td>No</td>
<td>Compliance Management programme has to be revisited at regular intervals in tune with the business environment, regulatory changes etc.</td>
</tr>
<tr>
<td>3</td>
<td>Do the members make use of Compliance Dashboard effectively and act upon it when required?</td>
<td>Yes</td>
<td>The Board Members are expected to visit Compliance Dashboard every day in over-seeing the compliance level in the organisation</td>
</tr>
<tr>
<td>4</td>
<td>Is the board updated with the applicable laws ?</td>
<td>Yes</td>
<td>The Board should be updated with the applicable laws at regular intervals that helps the board in reviewing compliance plan, overseeing compliances, reading compliance dashboard etc.,</td>
</tr>
</tbody>
</table>

Chief Compliance Officer

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Question</th>
<th>Yes/No</th>
<th>Intent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Has the Company appointed Chief Compliance officer?</td>
<td>No</td>
<td>Overall Ownership should lie with an exclusive individual who has strong hold on laws, rules and regulations. Appointment of Chief Compliance Officer helps in effective co-ordination of Compliance by business units.</td>
</tr>
<tr>
<td>2</td>
<td>Has the role of Chief Compliance officer been specifically defined?</td>
<td>Yes</td>
<td>As part of Compliance programme, the specific duties of Chief compliance officer be defined. This helps in casting the responsibility as well.</td>
</tr>
<tr>
<td></td>
<td>Question</td>
<td>Answer</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>-------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Is the Chief Compliance officer an independent person?</td>
<td>Chief Compliance Officer shall be an independent person who should not have any pecuniary interest with the company and should not be associated with any specific business unit.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Is the Chief Compliance officer reporting to CEO?</td>
<td>Chief Compliance Officer reporting directly to CEO helps in direct and effective communication of compliance aspects with the top management.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Does the compliance officer participate in major decisions?</td>
<td>The Chief Compliance officer should participate in important strategic and contractual decisions. This helps him in assessing the legal implications of the same on the company.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Systems and Processes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Has the company in place, a centralised mechanism for tracking and monitoring compliance?</td>
<td>When there are business/ functional units at different locations, centralised mechanism of tracking and monitoring compliance helps in effective co-ordination of different business units.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Has the company in place the process for development and approval of table of applicable laws, function wise and criticality wise?</td>
<td>The company should have defined process in place in updating the table of applicable laws. For example at every quarter or introduction of new law or amendment to existing law, as the case may be</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Has the company in-built mechanism in place for identification of various laws and its applicability to the organisation, specifically based on the functions? If so, is the implementation process for the same is effectively reviewed and monitored?</td>
<td>The process should provide for alerts whenever there is any change in the regulatory ambit applicable to the Company.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Has the company paid any penalty for any compliance failure? If so, has the company gap analysis and has taken remedial measures?</td>
<td>The Compliance mechanism should provide for no-tolerance to non-compliances. Non-compliances are to be addressed through establishing necessary controls for the same.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Has the company appointed designated compliance official (Compliance owners) at unit level?</td>
<td>Compliance Owners at unit level helps in ensuring compliance in the respective business units.</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Has the company co-ordinated the activities of designated compliance</td>
<td>Co-ordination of unit level compliances are essential for ensuring overall compliance.</td>
<td></td>
</tr>
</tbody>
</table>
official, functional heads, Chief Compliance officer and the Board of Directors?

7 Is the Compliance Management subject to periodic Audit?

<table>
<thead>
<tr>
<th>Corporate Compliance Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong> Has the company constituted corporate compliance committee?</td>
</tr>
<tr>
<td><strong>2</strong> Is functional directors and chief compliance officer participating in the meetings of Corporate Compliance Committee?</td>
</tr>
<tr>
<td><strong>3</strong> Does the committee meet atleast in every quarter?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Compliance Risk Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong> Is Compliance risk a part of ERM?</td>
</tr>
<tr>
<td><strong>2</strong> Has the company classified the compliance risk based on criticality (Legislation-wise)?</td>
</tr>
<tr>
<td><strong>3</strong> Do the Compliance owners aware of financial implications of critical non-compliances?</td>
</tr>
<tr>
<td><strong>4</strong> Does the Company undertake Compliance Risk Analysis?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Training and Communication</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong> Has the company imparted training to senior management &amp; employees on compliance programme covering regulatory aspects and</td>
</tr>
</tbody>
</table>
2. How does the company communicate with the employees on ethical issues?

Reiterating on ethical issues is essential in any organisation, that would bring overall ethical culture in the organisation.

**LESSON ROUND UP**

- A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc.
- A tool, which helps companies comply with provisions of various governing legislations as well as rules, regulations and guidelines issued thereunder, is a Compliance Solution.
- In the context of corporate governance, ethics is the intent to observe the spirit of law—in other words, it is the expressed intent to do what is right.
- Corporate Compliance Management can add substantial business value only if compliance is done with due diligence.
- The Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

**SELF TEST QUESTIONS**

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

1. Write a brief note on apparent, adequate and absolute compliances.
2. Describe the scope of compliance management.
3. Explain compliance management process in general.
4. Explain the systems approach to compliance management.
The objective of this study lesson is to enable the students to understand

- Meaning of Corporate Restructuring
- Need & Scope of Corporate restructuring
- Various Modes of Restructuring
- Historical Background
- Emerging Trends
- Planning formulation execution of various restructuring strategies
- Role of professionals in restructuring process

The speed of business dynamics demands the business organizations not only to revamp their internal business strategies like effective market expansion, increased customer base, product diversification and innovation etc., but also expects the corporates to devise inorganic business strategies like mergers, acquisitions, takeovers etc., that results in faster pace of growth, effective utilization of resources, fulfillment of increasing expectations of stakeholders. These restructuring strategies work positively for the business both during the time of business prosperity and recession.

This lesson would help you in understanding the concept of corporate restructuring, available tools, historical background & emerging trends in restructuring strategies etc., the role of professionals like company secretaries in the process of restructuring right from the strategy development and pre diligence stage till the post integration stage.
There are primarily two ways of growth of business organization, i.e. organic and inorganic growth.

Organic growth is through internal strategies, which may relate to business or financial restructuring within the organization that results in enhanced customer base, higher sales, increased revenue, without resulting in change of corporate entity.

Inorganic growth provides an organization with an avenue for attaining accelerated growth enabling it to skip few steps on the growth ladder. Restructuring through mergers, amalgamations etc constitute one of the most important methods for securing inorganic growth.

**Growth can be organic or inorganic**

A company is said to be growing organically when the growth is through the internal sources without change in the corporate entity. Organic growth can be through capital restructuring or business restructuring.

Inorganic growth is the rate of growth of business by increasing output and business reach by acquiring new businesses by way of mergers, acquisitions and take-overs and other corporate restructuring Strategies that may create a change in the corporate entity.

The business environment is rapidly changing with respect to technology, competition, products, people, geographical area, markets, customers. It is not enough if companies keep pace with these changes but are expected to beat competition and innovate in order to continuously maximize shareholder value. Inorganic growth strategies like mergers, acquisitions, takeovers and spinoffs are regarded as important engines that help companies to enter new markets, expand customer base, cut competition, consolidate and grow in size quickly, employ new technology with respect to products, people and processes. Thus the inorganic growth strategies are regarded as fast track corporate restructuring strategies for growth.

**MEANING OF CORPORATE RESTRUCTURING**

Restructuring as per Oxford dictionary means “to give a new structure to, rebuild or rearrange”.

As per Collins English dictionary, meaning of corporate restructuring is a change in the business strategy of an organization resulting in diversification, closing parts of the business, etc, to increase its long-term profitability.

Corporate restructuring is defined as the process involved in changing the organization of a business. Corporate restructuring can involve making dramatic changes to a business by cutting out or merging departments. It implies rearranging the business for increased efficiency and profitability. In other words, it is a comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving corporate objectives-synergies and continuing as competitive and successful entity.

**Corporate Restructuring as a Business Strategy**

Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Restructuring may involve major layoffs or bankruptcy, though restructuring is usually designed to minimize the impact on employees, if possible. Restructuring may involve the company's sale or a merger with another company. Companies use restructuring as a business strategy to ensure their long-term viability. Shareholders or creditors might force a restructuring if they observe the company's current business strategies as insufficient to prevent a loss on their investments. The nature of these threats can vary, but common catalysts for restructuring involve a loss
of market share, the reduction of profit margins or declines in the power of their corporate brand. Other motivators of restructuring include the inability to retain talented professionals and major changes to the marketplace that directly impact the corporation's business model.

| Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Corporate restructuring is an inorganic growth strategy. |

**NEED AND SCOPE OF CORPORATE RESTRUCTURING**

Corporate Restructuring is concerned with arranging the business activities of the corporate as a whole so as to achieve certain predetermined objectives at corporate level. Such objectives include the following:

- orderly redirection of the firm’s activities;
- deploying surplus cash from one business to finance profitable growth in another;
- exploiting inter-dependence among present or prospective businesses within the corporate portfolio;
- risk reduction; and
- development of core competencies.

When we say corporate level it may mean a single company engaged in single activity or an enterprise engaged in multi activities. It could also mean a group having many companies engaged in related or unrelated activities. When such enterprises consider an exercise for restructuring their activities they have to take a wholesome view of the entire activities so as to introduce a scheme of restructuring at all levels. However such a scheme could be introduced and implemented in a phased manner. Corporate Restructuring also aims at improving the competitive position of an individual business and maximizing it's contribution to corporate objectives. It also aims at exploiting the strategic assets accumulated by a business i.e. natural monopolies, goodwill, exclusivity through licensing etc. to enhance the competitive advantages. Thus restructuring would help bringing an edge over competitors.

Competition drives technological development. Competition from within a country is different from cross-country competition. Innovations and inventions do not take place merely because human beings would like to be creative or simply because human beings tend to get bored with existing facilities. Innovations and inventions do happen out of necessity to meet the challenges of competition. Cost cutting and value addition are two mantras that get highlighted in a highly competitive world. Monies flow into the stream of production in order to be able to face competition and deliver the best possible goods at the convenience and affordability of the consumers. Global Competition drives people to think big and it makes them fit to face global challenges. In other words, global competition drives enterprises and entrepreneurs to become fit globally. Thus, competitive forces play an important role. In order to become a competitive force, Corporate Restructuring exercise could be taken up. Also, in order to drive competitive forces, Corporate Restructuring exercise could be taken up.

The scope of Corporate Restructuring encompasses enhancing economy (cost reduction) and improving efficiency (profitability). When a company wants to grow or survive in a competitive environment, it needs to restructure itself and focus on its competitive advantage. The survival and growth of companies in this environment depends on their ability to pool all their resources and put them to optimum use. A larger company, resulting from merger of smaller ones, can achieve economies of scale. If the size is bigger, it enjoys a higher corporate status. The status allows it to leverage the same to its own advantage by being able to raise larger funds at lower costs. Reducing the cost of capital translates into profits. Availability of funds allows the enterprise to grow in all levels and thereby become more and more competitive.
Corporate Restructuring .....an Example

ABC Limited has surplus funds but it is not able to consider any viable projects. Whereas XYZ Limited has identified viable projects but has no money to fund the cost of the project. The merger of ABC LTD and XYZ Limited is a mutually beneficial option and would result in positive synergies of both the Companies.

Corporate Restructuring aims at different things at different times for different companies and the single common objective in every restructuring exercise is to eliminate the disadvantages and combine the advantages. The various needs for undertaking a Corporate Restructuring exercise are as follows:

(i) to focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure.

(ii) consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.

(iii) revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.

(iv) acquiring constant supply of raw materials and access to scientific research and technological developments.

(v) capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed.

(vi) Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

Planning, formulation and execution of various restructuring strategies

Corporate restructuring strategies depend on the nature of business, type of diversification required and results in profit maximization through pooling of resources in effective manner, utilization of idle resources, effective management of competition etc.,

Planning the type of restructuring requires detailed business study, expected business demand, available resources, utilized/idle portion of resources, competitor analysis, environmental impact etc., The bottom line is that the right restructuring strategy provides optimum synergy for the organizations involved in the restructuring process.

It involves examination of various aspects before and after the restructuring process.

Important aspects to be considered while planning or implementing corporate restructuring strategies

The restructuring process requires various aspects to be considered before, during and after the restructuring. They are

- Valuation & Funding
- Legal and procedural issues
- Taxation and Stamp duty aspects
- Accounting aspects
- Competition aspects etc.
- Human and Cultural synergies

Based on the analysis of various aspects, a right type of strategy is chosen.
Lesson 1 □ Corporate Restructuring – Introduction & Concepts

Types of Corporate Restructuring Strategies

Various types of corporate restructuring strategies include:
1. Merger
2. Demerger
3. Reverse Mergers
4. Disinvestment
5. Takeovers
6. Joint venture
7. Strategic alliance
8. Slump Sale
9. Franchising
10. Strategic alliance etc.

1. Merger

Merger is the combination of two or more companies which can be merged together either by way of amalgamation or absorption. The combining of two or more companies, is generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock.

Mergers may be

(i) **Horizontal Merger:** It is a merger of two or more companies that compete in the same industry. It is a merger with a direct competitor and hence expands as the firm's operations in the same industry. Horizontal mergers are designed to achieve economies of scale and result in reducing the number of competitors in the industry.

(ii) **Vertical Merger:** It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities. On the other hand, Forward integration may result if a company decides to take over the retailer or Customer Company. Vertical merger provides a way for total integration to those firms which are striving for owning of all phases of the production schedule together with the marketing network.

(iii) **Co generic Merger:** It is the type of merger, where two companies are in the same or related industries but do not offer the same products, but related products and may share similar distribution channels, providing synergies for the merger. The potential benefit from these mergers is high because these transactions offer opportunities to diversify around a common case of strategic resources.

(iv) **Conglomerate Merger:** These mergers involve firms engaged in unrelated type of activities i.e. the business of two companies are not related to each other horizontally nor vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology. Conglomerate mergers are merger of different kinds of businesses under one flagship company. The purpose of merger remains utilization of financial resources enlarged debt capacity and also synergy of managerial functions. It
does not have direct impact on acquisition of monopoly power and is thus favoured throughout the world as a means of diversification.

2. Demerger

It is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. A demerger is often done to help each of the segments operate more smoothly, as they can focus on a more specific task after demerger.

3. Reverse Merger

Reverse merger is the opportunity for the unlisted companies to become public listed company, without opting for Initial Public offer (IPO). In this process the private company acquires the majority shares of public company, with its own name.

4. Disinvestment

Disinvestment means the action of an organization or government selling or liquidating an asset or subsidiary. It is also known as "divestiture".

5. Takeover/Acquisition

Takeover means an acquirer takes over the control of the target company. It is also known as acquisition. Normally this type of acquisition is undertaken to achieve market supremacy. It may be friendly or hostile takeover.

- **Friendly takeover:** In this type, one company takes over the management of the target company with the permission of the board.

- **Hostile takeover:** In this type, one company takes over the management of the target company without its knowledge and against the wish of their management.

6. Joint Venture (JV)

A joint venture is an entity formed by two or more companies to undertake financial activity together. The parties agree to contribute equity to form a new entity and share the revenues, expenses, and control of the company. It may be project based joint venture or functional based joint venture.

- **Project based Joint venture:** The joint venture entered into by the companies in order to achieve a specific task is known as project based JV.

- **Functional based Joint venture:** The joint venture entered into by the companies in order to achieve mutual benefit is known as functional based JV.

7. Strategic Alliance

Any agreement between two or more parties to collaborate with each other, in order to achieve certain objectives while continuing to remain independent organizations is called strategic alliance.

8. Franchising

Franchising may be defined as an arrangement where one party (franchiser) grants another party (franchisee) the right to use trade name as well as certain business systems and process, to produce and market goods or services according to certain specifications.
The franchisee usually pays a one-time franchisee fee plus a percentage of sales revenue as royalty and gains.

9. Slump sale

Slump sale means the transfer of one or more undertaking as a result of the sale of lump sum consideration without values being assigned to the individual assets and liabilities in such sales. If a company sells or disposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration, then it results in a slump sale.

CORPORATE RESTRUCTURING - HISTORICAL BACKGROUND

In earlier years, India was a highly regulated economy. Though Government participation was overwhelming, the economy was controlled in a centralized way by Government participation and intervention. In other words, economy was closed as economic forces such as demand and supply were not allowed to have a full-fledged liberty to rule the market. There was no scope of realignments and everything was controlled. In such a scenario, the scope and mode of Corporate Restructuring were very limited due to restrictive government policies and rigid regulatory framework.

These restrictions remained in vogue, practically, for over two decades. These, however, proved incompatible with the economic system in keeping pace with the global economic developments if the objective of faster economic growth were to be achieved. The Government had to review its entire policy framework and under the economic liberalization measures removed the above restrictions by omitting the relevant sections and provisions.

The real opening up of the economy started with the Industrial Policy, 1991 whereby 'continuity with change' was emphasized and main thrust was on relaxations in industrial licensing, foreign investments, transfer of foreign technology etc. With the economic liberalization, globalization and opening up of economies, the Indian corporate sector started restructuring to meet the opportunities and challenges of competition.

The economic and liberalization reforms, have transformed the business scenario all over the world. The most significant development has been the integration of national economy with 'market-oriented globalized economy'. The multilateral trade agenda and the World Trade Organization (WTO) have been facilitating easy and free flow of technology, capital and expertise across the globe. A restructuring wave is sweeping the corporate sector the world over, taking within its fold both big and small entities, comprising old economy businesses, conglomerates and new economy companies and even the infrastructure and service sector. From banking to oil exploration and telecommunication to power generation, petrochemicals to aviation, 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.

With the increasing competition and the economy, heading towards globalisation, the corporate restructuring activities are expected to occur at a much larger scale than at any time in the past. Corporate Restructuring play a major role in enabling enterprises to achieve economies of scale, global competitiveness, right size, and a host of other benefits including reduction of cost of operations and administration.

EMERGING TRENDS

Doing Deals Successfully in India – A Survey by KPMG India and Merger Market in 2012

In order to present a composite view of effective practices that have emerged from inbound investors’ experience conducting M&A in India. KPMG in India and mergermarket in the year 2012, shortlisted a
number of successful deals based on their size and prominence in the Indian marketplace.

They conducted interviews with key M&A Heads or equivalent from International companies involved in these transactions over the course of 2012. The report represents a summary of these conversations and the learnings that have emerged from these transactions.

Almost all participants acknowledged that India was an important part of their overall global expansion strategy, and by and large, participants have been pleased with the success of their respective deals despite the fact that some are still in the process of completing integration.

The key insights that emerged are as follows:

**Acquirers come to India for its domestic market and the innovation capabilities of its companies**

The primary attraction for acquirers when investing in India is the potential of its domestic market and the opportunity to use India as a springboard to access some of the regional South Asian, Middle East and even African markets. Participants also cited capabilities for innovation that Indian companies have built over the last two decades, especially to serve low cost value conscious consumers in the emerging markets as a key reason behind doing deals in India.

**Investable targets are hard (but not impossible) to find**

Given India’s size, its federal regulatory structure and socio-political diversity, most businesses take a regional approach to market growth in the country, and as a result, few truly national players exist. Having said that, many of the regional markets these businesses serve have the potential of being as large as or even larger than national markets in other countries.

Coverage and availability of information on domestic companies in India is still patchy, making secondary market scans difficult. And while auction processes are prevalent, many deals are done based on local relationships and a deep understanding of the regional operations of potential targets. In fact, for many of the successful acquisitions and partnerships highlighted in this report, acquirers were in India building relationships well before their transactions materialized either by forming an Indian subsidiary or by maintaining trading relationships.

Even once a potential deal is on the table it can take time for a seller to furnish historical financials and realistic forecasts that link back to past performance. Most acquirers tended to take an independent view of a target’s growth prospects while factoring in the right level of investment support post deal.

**It takes time and effort to get to know the family**

Managing the relationship with the promoter (seller) can be of paramount importance for a successful deal. Promoters are also typically involved in direct management of the business, and selling would mean losing regular income, personal status and an important family asset. Furthermore, promoter-led businesses often have more than one decision maker and depending on family history, internal politics often become part of the M&A process. For International Companies looking to acquire in India, it means spending considerable months to get to know and understand the promoters and the family well, before starting a transaction conversation.

**The process can seem long and complicated (because it often is)**

The deal process in India can initially seem long even when there is no competitive bidding process. Finding issues with compliance, tax or historical financial performance is common during diligence and these may seem like deal breakers at first.
To manage these challenges, acquirers preferred to implement transaction structures that allow buyers to leave liabilities behind with the sellers where possible, while ensuring sufficient engagement from promoters to ensure a smooth transition post deal. Participants also highlighted the need to build a business forecast bottom up, seeking independent verification of future contract commitments and an assessment of the dependence on promoter relationships for continuity of business.

Respondents to this study also highlighted the fact that sellers in India are often inexperienced in the M&A process and can start the process without adequate preparation. Where possible, buyers should request involvement of professional advisors on the sell side and ask for a well managed process including electronic data rooms, verified financial information, explanation of discrepancies with published results, etc., at the start of the process.

*The hard work begins once the deal is done*

Most participants had a small base in India prior to the acquisition and hence integration of local domestic operations with the target was not really a big challenge. Key focus during the integration revolved around navigating cultural differences, managing employee expectations from an international acquirer and alignment of management styles. Their approach was cautious, with over half the respondents spending between 1-3 years to complete the integration activities. In almost all the cases, integration was a distinct project led by teams based locally and with significant senior management involvement.

Reflecting on the overall success of the transaction, most respondents felt that they were by and large happy with the overall outcome of the deal and with the quality of management that they had acquired as a result of the transaction.

### M & A trends in India 2-11-2013

Mergers and Acquisition (M&A) activity in the Indian market continued at pace in 2013, despite ongoing uncertainty over the country’s wider economic prospects.

Overall, 500 publically announced M&A deals were recorded in 2013, amounting to US $28.19 billion in transactions. Although representing a 16% year-on-year drop in volume and 20% year-on-year decline in total value of deals, the analysis suggests that investor’s interest in India remains relatively stable in light of ongoing economic pressure which have seen inflation rate rises and a depreciating rupee over the past 12 months.

Five M&A deals valued at over one billion US dollars were witnessed in 2013, compared with four such deals in 2012; although still a sharp drop from the 10 deals of this caliber recorded in 2011. Excluding 2012’s blockbuster Vedanta Group restructuring deal (valued at US $12billion), the value of M&A in 2013 represents a 15% year-on-year increase.

Private equity (PE) deals in 2013 saw steady improvement, with a 12% year-on-year increase in deal volumes (totaling 450) and a 40% year-on-year rise in total value (reaching US $10.39 billion). Top sectors for PE investment included: IT & ITES (20%), Pharma, Healthcare & Biotech (14%), Real Estate (13%), Telecoms (12%), Banking (11%) and Automotives (8%). There were 23 private equity investments over the year with recorded values of over US $100 million each.

Despite an overall mixed year in 2013, the Indian economy still retains pockets of competitiveness; particularly in sectors such as the pharmaceutical and aviation industries, which will likely see M&A activity increase in 2014 as the commercial and regulatory environments in India play strongly in their favour.

Though not a blockbuster year, 2013 proved to be fairly resilient despite political and fiscal uncertainties in
India. The gradual stabilization of the rupee and key stock indices in the second half of the year offer promising signs, and we’re hopeful this cautiously positive sentiment will lead to resurgence in M&A activity following the 2014 elections. India – corporate and otherwise – is bracing itself, while looking ahead.”

**Table 1: Deal summary for Indian M&A and PE activity for 2011-2013**

<table>
<thead>
<tr>
<th>Deal Summary</th>
<th>Volume</th>
<th>Value (US$bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cross Border</td>
<td>216</td>
<td>234</td>
</tr>
<tr>
<td>Mergers &amp; Internal Restructuring</td>
<td>288</td>
<td>262</td>
</tr>
<tr>
<td>Total M&amp;A</td>
<td>140</td>
<td>102</td>
</tr>
<tr>
<td>PE</td>
<td>644</td>
<td>598</td>
</tr>
<tr>
<td>Grand Total</td>
<td>373</td>
<td>401</td>
</tr>
<tr>
<td>Cross Border includes:</td>
<td>1,017</td>
<td>999</td>
</tr>
</tbody>
</table>

| Inbound                             | 142    | 140  | 139  | 28.73  | 5.96 | 8.64 |
| Outbound                            | 146    | 122  | 82   | 10.84  | 8.55 | 9.25 |

*Source: Grant Thornton Co. UK*

### Expanding role of professionals in corporate restructuring process

The restructuring process does not only involve strategic decision making based on the market study, competitor analysis, forecasting of synergies on various respects, mutual benefits, expected social impact etc, but also the technical and legal aspects such as valuation of organizations involved in restructuring process, swap ratio of shares if any, legal and procedural aspects with regulators such as Registrar of Companies, High Court etc., optimum tax benefits after merger, human and cultural integration, stamp duty cost involved etc.

It involves a team of professionals including business experts, Company Secretaries, Chartered Accountants, HR professionals, etc., who have a role to play in various stages of restructuring process. The Company Secretaries being the vital link between the management and stakeholders are involved in the restructuring process through out as co-coordinator, in addition to their responsibility for legal and regulatory compliances.

The restructuring deals are increasing day by day to be in line with business dynamics and international demands. It necessitates the expanded role of professionals in terms of maximum quality in optimum time.

### Companies Act, 2013

The Companies Act, 2013 has brought many enabling provisions with regard to mergers, compromise or arrangements, especially with respect to cross border mergers, time bound and single window clearances, enhanced disclosures, disclosures to various regulators, simplified procedure for smaller companies etc. It may be noted that Section 230-240 of the Companies Act, 2013 and the rules made thereunder are yet to be notified.

### Salient Features of Companies Act, 2013 relating to Corporate Restructuring (Section 230-240)

- National Company Law Tribunal to assume jurisdiction of High Court.
• **Section 230(2)** – Application for compromise or arrangement to be accompanied by an affidavit, disclosing
  1. All material facts relating to the company.
  2. Reduction of capital if any included in the compromise or arrangement;
  3. Any scheme of corporate debt restructuring consented to by not less than 75% of the secured creditors in value along with creditors responsibility statement, report of the auditor as to the funds requirement after CDR and the conformity to liquidity test etc.

• **Proviso to Section 230(3)** – Notice relating to compromise or arrangement and other documents to be placed on the website of the company.

• **Section 230(5)** – Notice of meeting for approval of the scheme of compromise or arrangement be sent to various regulators including:
  1. The Central Government;
  2. Income-tax Authorities;
  3. Reserve Bank of India (`RBI');
  4. Securities Exchange Board of India (`SEBI');
  5. The Registrar;
  6. Respective Stock Exchange;
  8. The Competition Commission of India; if necessary; and
  9. Other Sectoral regulators which could likely be affected by the scheme. Representation, if any, by the above authorities will have to be made within a period of 30 days from receipt of notice.

• **Proviso to Section 230(4)** – Persons holding not less than 10% of the shareholdings or persons having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statement, entitled to object the scheme of compromise or arrangement.

• **Proviso to Section 230(7)** – No sanction for Compromise or arrangement if accounting treatment is no AS compliant.

• **Section 234** – Cross border Merger permitted. The 1956 act permits merger of foreign company with Indian company and not vice versa.

• **Section 233 (10)** – Abolishing the practice of companies holding their own shares through a trust (Treasury Stock) in case of merger of holding and subsidiary companies. Ultimately the shares are to be cancelled.

• **Section 233** – Fast track mergers introduced. – The new Act enables fast track merger without the approval of NCLT, between:
  1. Two or more small companies. Small company is defined under the Act.
  2. Holding and wholly owned subsidiary company
  3. Other class of companies as may be prescribed

• **Section 230(6)** – Approval of scheme by postal ballot thereby involving wider participation;

• **Section 230(11)** – Any compromise or arrangement may also include takeover offer made in prescribed manner. In case of listed companies, takeover offer shall be as per the regulations framed by SEBI.
LESSON ROUND UP

• Growth of organization may be organic/inorganic growth. Growth in the factors of production is organic growth, whereas corporate restructuring initiatives leads to inorganic growth which is relatively faster.

• Restructuring may be financial restructuring, technological, market and organizational restructuring.

• The most commonly applied tools of corporate restructuring are amalgamation, merger, demerger, acquisition, joint venture, disinvestments etc.

• The important aspects to be considered during Corporate Restructuring process are financial, valuation, stamp duty, taxation and accounting aspects.

• The regulatory framework for corporate restructuring includes, The Companies Act, 1956, notified Sections of Companies Act, 2013, SEBI(SAST) Regulations; 2011, Listing agreement, Indian Stamp Act, 1899, Companies(Court) Rules; etc.

• The restructuring process over the years has expanded the role of professionals in the restructuring process at various stages.

• The companies Bill; 2012 has provided several provisions for revamping the corporate restructuring process in India.

SELF TEST QUESTIONS

1. What are different types of growth strategies?
2. Briefly discuss the scope and mode of Corporate Restructuring.
3. Discuss about different restructuring strategies.
4. Write a brief note on the role of professionals in restructuring strategies.
5. Restructuring is just not a strategic plan. Discuss.
Lesson 11
Financial Restructuring

LESSON OUTLINE

- Need for financial restructuring
- Reorganisation of capital
- Reduction of share capital
- Buyback of shares – concept and objects
- SEBI (Buy back of Securities) Regulations, 1998
- Companies (Court) Rules (for reduction of Capital).

LEARNING OBJECTIVES

Financial restructuring of a company involves rearrangement of its financial structure so as to make the company’s finances more balanced, i.e., the company should be neither overcapitalized nor undercapitalized. Reduction of Capital, reorganization of capital through consolidation, subdivision, buy back of shares, further issue of shares etc., are various forms of financial restructuring.

The Provisions relating to alteration of Share Capital and of buy-back of Shares has already been notified under Companies Act, 2013. However, the provisions relating to reduction of capital is not yet notified as it involves approval of National Company Law Tribunal. Accordingly the lesson covers provisions of Companies Act 2013 relating to buy-back of shares and provisions of Companies Act, 1956 for reduction of capital.

After reading this lesson you will be able to understand the legal and procedural aspects relating to reduction and reorganization of capital, buy-back of shares by listed and unlisted companies including aspects as to quantum, sources, restrictions etc.
The Provisions relating to alteration of Share Capital and of buy-back of Shares have already been notified under Companies Act, 2013. However, the provisions relating to reduction of capital are not yet notified as it involves approval of National Company Law Tribunal. Accordingly the lesson covers provisions of Companies Act 2013 relating to buy-back of shares and provisions of Companies Act, 1956 for reduction of capital.

INTRODUCTION

Companies have access to a range of sources from which they finance business. These funds are called ‘Capital’. The sources of capital can be divided into two categories; internally generated funds and funds provided by third parties. Whichever form of capital is used, it will fall into one of the two categories – debt or equity.

Determination of the proportion of own funds and borrowed funds

Internally generated funds are an important component of a company’s capital structure but it would be unusual for a company to grow at a fast pace only through internal generation of funds. The deficit between the funds which a company requires to fund its growth and the funds which are generated internally, is funded by provision of capital from third parties.

Cost of various types of capital

Equity capital is the permanent capital of the company, which does not require any servicing in the form of interest. However, the return to the equity capital is in the form of dividend paid to the equity shareholders out of the profits earned by the company. The ideal capital structure would be to raise money through the issue of equity capital.

Debt is essentially an obligation, the terms of which are, inter alia, the repayment of the principal sum within a specific time together with periodic interest payments. Perhaps the easiest form of capital for a company to raise is, a loan from a bank. This form of loan capital may be comparatively expensive than equity.

However, as regards servicing of capital there are advantages of issuing debt instruments. Dividend is not a deductible expense when calculating a company’s taxable profit; it is on the contrary an appropriation of profits. On the other hand, interest paid by a company on debt finance is an allowable expense when calculating a company’s tax, thereby reducing its taxable profit.

Broadly speaking, the financial structure of a company comprises its

(i) paid up equity and preference share capital;
(ii) various reserves;
(iii) all borrowings in the form of –
   (a) long-term loans from financial institutions;
   (b) working capital from banks including loans through commercial papers;
   (c) debentures;
   (d) bonds;
   (e) credits from suppliers;
A company may require any one or more of the above keeping in view its financial requirements at a particular point of time. A dynamic Board should constantly review the financial structure of the company and effect financial restructuring and reorganisation whenever the need arises.

NEED FOR FINANCIAL RESTRUCTURING

A company is required to balance between its debt and equity in its capital structure and the funding of the resulting deficit. The targets a company sets in striking this balance are influenced by business conditions, which seldom remain constant.

When, during the life time of a company, any of the following situations arise, the Board of Directors of a company is compelled to think and decide on the company’s restructuring:

(i) necessity for injecting more working capital to meet the market demand for the company's products or services;
(ii) when the company is unable to meet its current commitments;
(iii) when the company is unable to obtain further credit from suppliers of raw materials, consumable stores, bought-out components etc. and from other parties like those doing job work for the company.
(iv) when the company is unable to utilise its full production capacity for lack of liquid funds.

Financial restructuring of a company involves rearrangement of its financial structure so as to make the company’s finances more balanced.

Let us understand the meaning of over capitalization and under capitalization.

A company is said to be over-capitalized, if its earnings are not sufficient to justify a fair return on the amount of share capital and debentures that have been issued. Otherwise, it is said to be over capitalized when total of owned and borrowed capital exceeds its fixed and current assets i.e. when it shows accumulated losses on the assets side of the balance sheet.

If the owned capital of the business is much less than the total borrowed capital than it is said to be under capitalization. We may say that the owned capital of the company is disproportionate to the scale of its operation and the business is dependent more upon borrowed capital.

Let us remember

Under capitalization may be the result of excess volume of trading and over capitalization may be due to insufficient volume of trading.
Restructuring of under-capitalized Company

An under-capitalized company may restructure its capital by taking one or more of the following corrective steps:

(i) injecting more capital whenever required either by resorting to rights issue/preferential issue or additional public issue.

(ii) resorting to additional borrowings from financial institutions, banks, other companies etc.

(iii) issuing debentures, bonds, etc. or

(iv) inviting and accepting fixed deposits from directors, their relatives, business associates and public.

Restructuring of over-capitalized company

If a company is over-capitalized, its capital also requires restructuring by taking following corrective measures:

(i) Buy-back of own shares.

(ii) Paying back surplus share capital to shareholders.

(iii) Repaying loans to financial institutions, banks, etc.

(iv) Repaying fixed deposits to public, etc.

(v) Redeeming its debentures, bonds, etc.

State whether the following statement is true or false.

A over capitalized company can resort to buy- back of shares.

Ans: True

ALTERATION OF CAPITAL

Power of limited company to alter its share capital (Section 61)

According to section 61 of the Companies Act 2013 a limited company having a share capital derives its power to alter its share capital through its articles of association. As per the section the company may alter its memorandum in its general meeting to—

(a) increase its authorised share capital by such amount as it thinks expedient;

(b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.

The proviso to Section 61(1)(b) clarifies that No consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner (This proviso yet to be notified).

(c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the
memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled. The cancellation of shares shall not be deemed to be a reduction of share capital.

**REORGANISATION OF CAPITAL**

In accordance with Section 390(b) Companies Act 1956, the expression “arrangement” includes a re-organisation of the share capital of the Company by the consolidation of shares of different classes or by division of shares of one class into shares of different classes or by both these methods.

Accordingly, as per Section 390(b), the reorganization of share capital of a company may take place—

(1) by the consolidation of shares of different classes, or

(2) by the division of shares of one class into shares of different classes, or

(3) by both these methods [Section 390(b)].

Besides, a company may reorganize its capital in different ways, such as — (a) reduction of paid-up share capital; (b) conversion of one type of shares into another etc.,

**REDUCTION OF SHARE CAPITAL**

Reduction of capital means reduction of issued, subscribed and paid-up capital of the company.

<table>
<thead>
<tr>
<th>Reduction of capital requires</th>
<th>Special Resolution</th>
<th>Authorisation in Articles</th>
<th>Confirmation of court</th>
</tr>
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</table>

The need for reduction of capital may arise in various circumstances such as

- trading losses
- heavy capital expenses and assets of reduced or doubtful value.

As a result, the original capital may either have become lost or a company may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets [Indian National Press (Indore) Ltd., In re. (1989) 66 Com Cases 387, 392 (MP)].

**Do you know?**

Section 100 Companies Act 1956 is applicable to a company limited by shares or a company limited by guarantee and having share capital. An unlimited company can reduce the share capital in the manner specified in the Articles and Memorandum of the company, as Section 100 Companies Act 1956 is not applicable.
MODES OF REDUCTION

The mode of reduction, as laid down in Section 100 of the Companies Act, is as follows:

A company limited by shares or a company limited by guarantee and having a share capital may, if authorised by its articles, by special resolution, and subject to its confirmation by the Court on petition, reduce its share capital in any way and in particular:

(a) by reducing or extinguishing the liability of members in respect of uncalled or unpaid capital e.g., where the shares are of Rs. 100 each with Rs. 75 paid-up, reduce them to Rs. 75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of Rs. 25 per share;

(b) by paying off or returning paid-up capital not wanted for the purposes of the company, e.g., where the shares are fully paid-up, reduce them to Rs. 75 each and pay back, Rs. 25 per share;

(c) by paying off the paid-up capital on the conditions that it may be called up again so that the liability is not extinguished;

(d) by following a combination of any of the preceding methods;

(e) by writing off or canceling the capital which has been lost or is under represented by the available assets e.g. a share of Rs. 100 fully paid-up is represented by Rs. 75 worth of assets. In such a situation reality can be re-introduced by writing off Rs. 25 per share. This is the most common method of reduction of capital. The assets side of the balance sheet may include useless assets which are cancelled. On the other side i.e. on the liability side share capital is reduced.

Case Laws on Reduction of Capital

1. Can appeal against order of Single Judge allowing reduction, by a sole public shareholder, be allowed, when there is no fault in reasoning of Single Judge?

Where a company, reducing its share capital by cancelling and extinguishing some equity shares held by its subsidiary and some shares held by the public, passes the requisite resolution approving the reduction by a special majority in an extraordinary general meeting called for in this regard, and there is no fault in the reasoning given by the Single Judge approving the same, and also the valuation of shares, the appeal by a sole shareholder objecting to the said reduction is liable to be dismissed.

(Chander Bhan Gandhi v. Reckitt Benckiser (India) Ltd. [2012] 107 CLA 511 (Del.))

2. Whether the role of the court, while approving scheme of reduction of capital is limited to the extent of ensuring that the scheme is not unconscionable or illegal or unfair or unjust?

The role of the court, while approving scheme of reduction of capital, is limited to the extent of ensuring that the scheme is not unconscionable or illegal or unfair or unjust. Merely because the determination of the share exchange ratio or the valuation of shares is done by a different method which might result in a different conclusion would not justify interference of the court, unless found to be unfair. The court does not have the expertise nor the jurisdiction to delve into the deep commercial wisdom exercised by the creditors and members of the company who have approved the scheme by the requisite majority. Thus, where the valuer has used widely accepted methodologies, i.e., the discounted cash flow methodology and the comparable companies methodology which inter alia include the P/E multiple analysis for valuation of shares, there is no reason why the valuation report of the valuer, which is fair, reasonable and based on cogent reasoning, and which has also been accepted by a majority of the non-promoter shareholders of the company, should not be accepted by the court.
Rejecting the objections of the interveners/objectors that the fair value of shares arrived at by the valuer is not in the interest of the promoter shareholders, the High Court approved the valuation of shares and allowed the petition confirming reduction of share capital.

_Wartsila India Ltd.v. Janak Mathuradas and Others_[2010] 99 CLA 463 (Bom.)

**3. Can the share premium account be utilized for reducing share capital?**

The capital was proposed to be reduced by utilization of the Securities Premium Account and General Reserve. There was to be no diminution of liabilities or repayment of paid up capital. No reduction of issued, subscribed or paid up capital was involved. The Court said that the proposed reduction not being prejudicial in any manner was, therefore to be allowed.

_(Alembic Ltd., Re (2008) 144 Com Cases 105 : (2009)89 SCL 19(Guj))_

**4. Can the reduction result in extinguishment of class of shares?**

A scheme of amalgamation and arrangement involved reduction of share capital by extinguishment of shares of a particular class. The reduction was approved by majority of shareholders and creditors of transferee company. The court approved the reduction and extinguishment of portion of shares was held to be permissible as no one was prejudicially affected.

_(Siel Ltd., Re (2008) 144 Com Cases 469 : (2009)89 SCL 434(Del))_

**Reduction of share capital without sanction of the Court**

The following are cases which amount to reduction of share capital but where no confirmation by the Court is necessary:

(a) **Surrender of shares** – “Surrender of shares” means the surrender of shares already issued to the company by the registered holder of shares. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [Collector of Moradabad v. Equity Insurance Co. Ltd., (1948) 18 Com Cases 309: AIR 1948 Oudh 197]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted for further liability on shares.

The Companies Act contains no provision for surrender of shares. Thus surrender of shares is valid only when Articles of Association provide for the same and:

(i) where forfeiture of such shares is justified; or

(ii) when shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. However, in the case of forfeiture, it is at the initiative of company and in the case of surrender it is at the initiative of member or shareholder.

(b) **Forfeiture of shares** – A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Court.
(c) *Diminution of capital* – Where the company cancels shares which have not been taken or agreed to be taken by any person.

(d) Redemption of redeemable preference shares.

(e) Purchase of shares of a member by the company.

(f) Buy-back of its own shares.

**Does buy back of shares requires court’s confirmation as prescribed under Section 100?**

**Ans**: No

**Equal Reduction of Shares of One Class**

Where there is only one class of shares, *prima facie*, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalizing the amount so paid-up. [Marwari Stores Ltd. v. Gouri Shanker Goenka (1936) 6 Com Cases 285]. The same principle is to be followed where there are different classes of shares.

It is, however, not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Accordingly, where reduction is not involved, Section 100 would not be attracted. [Asian Investment Ltd. Re. (1992) 73 Com Cases 517, 523 (Mad)].

**Restructuring of Debts and reduction of capital**

The petitioner-company was referred to the corporate debt restructuring (‘CDR’) forum for re-scheduling and restructuring its debt. As per restructuring package, as approved by CDR forum, for every 10 equity shares the company would cancel 4 equity shares and in lieu of such cancellation, 4 non-cumulative preference shares would be allotted and the existing equity shareholders would continue to hold remaining 6 shares without any alteration of rights. When the petitioner-company moved to the High Court for confirmation of its restricting package, the objector opposed the scheme on the ground that it would suffer financial loss. Taking an overall view and considering the proposed scheme of reduction of share capital in larger perspective, the High Court found no reason not to confirm the proposed action of the company to reduce its share capital. The High Court observed that the proposal is likely to improve the financial resources of the company, and to increase the share of profit available for expansion and growth of the company. Moreover, the proposal does not involve diminution of any liability in respect of unpaid capital or the payment to any shareholder of any paid-up capital.

*Essar Steel Ltd Re(2005)59SCL 457:(2006) 130 Com cases 123(Guj)*

**Creditors’ Right to Object to Reduction**

After passing the special resolution for the reduction of capital, the company is required to apply to the Court by way of petition for the confirmation of the resolution under Section 101 Companies Act 1956. Where the proposed reduction of share capital involves either (i) diminution of liability in respect of unpaid share capital, or (ii) the payment to any shareholder of any paid-up share capital, or (iii) in any other case, if the Court so directs, the following provisions shall have effect:

The creditors having a debt or claim admissible in winding up are entitled to object. To enable them to do so, the Court will settle a list of creditors entitled to object. If any creditor objects, then either his consent to the
proposed reduction should be obtained or he should be paid off or his payment be secured. The Court, in
deciding whether or not to confirm the reduction will take into consideration the minority shareholders and
creditors.

A Company might decide to return a part of its capital when its paid-up share capital is in excess of its needs.
It is not simply handed over to shareholders in proportion to their holdings. Their class rights will be
considered with the Court treating the reduction as though it was analogous to liquidation. Therefore, the
preference shareholders who have priority to return of capital in liquidation will be the first to have their share
capital returned to them in a share capital reduction, even if they prefer to remain members of the company.

There is no limitation on the power of the Court to confirm the reduction except that it must first be satisfied
that all the creditors entitled to object to the reduction have either consented or been paid or secured [British

When exercising its discretion, the Court must ensure that the reduction is fair and equitable. In short, the
Court shall consider the following, while sanctioning the reduction:

(i) The interests of creditors are safeguarded;

(ii) The interests of shareholders are considered; and

(iii) Lastly, the public interest is taken care of.

**Confirmation and Registration**

Section 102 of the Companies Act 1956 states that if the Court is satisfied that either the creditors entitled to
object have consented to the reduction, or that their debts have been determined, discharged, paid or
secured, it may confirm the reduction.

The Court may also direct that the words “and reduced” be added to the company’s name for a specified
period, and that the company must publish the reasons for the reduction and the causes which led to it, with
a view to giving proper information to the public.

Section 103 states that the Court’s order confirming the reduction together with the minutes giving the details
of the company’s share capital, as altered, should be delivered to the Registrar who will register them. The
reduction takes effect only on registration of the order and minutes, and not before. The Registrar will then
issue a certificate of registration which will be a conclusive evidence that the requirements of the Act have
been complied with and that the share capital is now as set out in the minutes. The Memorandum has to be
altered accordingly.

**Conclusiveness of certificate for reduction of capital**

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive
although it was discovered later that the company had no authority under its articles to reduce capital [Re
Walkar & Smith Ltd., (1903) 88 LT 792 (Ch D)]. Similarly, in a case where the special resolution for reduction
was an invalid one, but the company had gone through with the reduction, the reduction was not allowed to
be upset [Ladies’s Dress Assn. v. Pulbrook, (1900) 2 QB 376].

**Let us remember!!!!**

*The effective date of reduction of capital is the date on which the Registrar of Companies registers
the order of the court and the minutes approved by the court.*
Liability of Members in respect of Reduced Share Capital

On the reduction of share capital, the extent of the liability of any past or present member or any call or contribution shall not exceed the difference between the amount already paid on the share, or the reduced amount, if any, which is deemed to have been paid thereon by the member, and the amount of the shares fixed by the scheme of the reduction.

If, however any creditor entitled to object to the reduction of share capital is not entered in the list of creditors by reason of his ignorance of the proceedings for reduction and, after the reduction the company is unable to pay his debt or claim, then:

(a) every member at the time of registration of the Court’s order for reduction is liable to contribute for the payment of the debt or claim, an amount not exceeding the amount which he would have contributed on the day before registration of the order and minutes; and

(b) if the company is wound up, the Court on the application by the creditor and on proof of his ignorance, may settle a list of contributories and make and enforce calls and orders on the contributories, settled on the list, as if they were ordinary contributories in a winding up.

It is further provided that, if any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction; or knowingly misrepresents the name or amount of the debt or claim of any creditor; or abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable to be punishable with imprisonment upto one year, or with fine or with both (Section 105).

Reduction of Share Capital And Scheme Of Compromise Or Arrangement

Arrangement includes 'a reorganisation of share capital of the company' and reorganisation can involve reduction of share capital. However, as part of the scheme of compromise or arrangement, distinct formalities as prescribed under section 100 do not have to be observed [Maneckchowk and Ahmedabad Mfg. Co.Ltd., Re (1970) 2 Comp LJ 300 (Guj); also Vasant Investment Corporation Ltd. v. Official Liquidator (1981) 51 Comp Cas 20 (Bom); Mcleod & Co.Ltd. v. S.K. Ganguly (1975) 45 Comp Cas 563 (Cal)]. It may however be noted that, in all such cases involving reduction of share capital in the scheme of compromise or arrangement, the petition seeking confirmation of the court with respect to the scheme must also expressly mention that the company is also seeking, at the same time, the confirmation of the court with respect to the reduction of share capital, and that, while seeking the consent of the members to the scheme, the consent of the members with respect to the reduction of share capital had also been obtained.

The power of court to give to creditors an opportunity of raising objections to the reduction of capital is discretionary. In an appropriate case, for example, where the interests of creditors are duly and fully protected, the court may exercise its discretion against calling upon the creditors to raise objections.
Procedure for reduction of capital – a Flow Chart

Check Articles of Association whether it authorizes reduction of capital.

If no alter the Articles

Convene Board Meeting and General Meeting to pass necessary special resolution

Comply with procedural aspects as to aspects like issue of notice, intimation/filings to stock exchanges if securities are listed etc

Pass special resolution and file e-form 23 with Registrar of Companies

Refer to Companies (Court) Rules 1959 for format and details. Petition to be accompanied by Certified copy of Memorandum and Articles of Association, special resolution, Balance Sheet & P&L account, Minutes of the meeting at which special resolution is passed, requisite court fee.

Apply to the concerned High Court by way of petition for confirmation of the reduction by way of petition verified by affidavit

Whether the proposed reduction results in diminution of liability in respect of unpaid share capital or payment to any shareholder of any paid-up share capital

If yes, follow the procedure laid down in rules 48 to 59 of Companies Court Rules, 1959

No

File form 21 with registrar of companies with respect to court order sanctioning the reduction.

File with the court a list of creditors accompanied by a duly verified affidavit

issue the notice to all the creditors through prepaid registered post

within 7 days from the date of filing the list, the notice and the list of creditors should be advertised in the manner directed by the judge and an affidavit proving such dispatch and publication, to be filed with the court.

the result of the notices duly signed by the company’s advocate and verified by the company should be filed with the Court.

a certificate from the advocate regarding the result of the settlement of the list of creditors shall be filed with the Court.

Advertise the date fixed for hearing of the petition.

Advertisement of petition not less than 14 days before the date fixed for hearing.

Advertising of petition not less than 14 days before the date fixed for hearing.
BUY BACK OF SHARE

According to Section 68(1) of the Companies Act, 2013 a company whether public or private, may purchase its own shares or other specified securities (hereinafter referred to as “buy-back”) out of:

(i) its free reserves; or
(ii) the securities premium account; or
(iii) the proceeds of any shares or other specified securities.

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.

“Specified securities” as referred to in the explanation to the section includes employees’ stock option or other securities as may be notified by the Central Government from time to time.

“Free reserves” as referred to in the explanation includes securities premium account.

Authorisation

The primary requirement is that the articles of association of the company should authorise buyback. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buyback. Buy-back can be made with the approval of the Board of directors at a meeting and/or by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy back. In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

Quantum of Buyback

(a) Board of directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and such buy back has to be authorized by the board by means of a resolution passed at the meeting.

(b) Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company. In respect of any financial year, the shareholders can approve by special resolution upto 25% of total equity capital in that year.

Post buy-back debt-equity ratio

The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves i.e the ratio shall not exceed 2:1. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

All the shares or other specified securities for buy-back are to be fully paid-up.

Buyback by listed/unlisted companies

➢ The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and
The buy-back in respect of shares or other specified securities other than listed securities is in accordance with such rules made under Chapter IV of the Companies Act, 2013.

**Time gap**

No offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

**Explanatory statement**

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

- a full and complete disclosure of all material facts;
- the necessity for the buy-back;
- the class of shares or securities intended to be purchased under the buy-back;
- the amount to be invested under the buy-back; and
- the time-limit for completion of buy-back.

*(Rule 17 of Companies (Share Capital and Debentures) Rules 2014 (hereinafter called the rules)*

Additionally the Rules provide for following disclosures in explanatory statement with respect to private companies and unlisted public companies:

- the date of the board meeting at which the proposal for buyback was approved by the board of directors of the company;
- the objective of the buy-back;
- the class of shares or other securities intended to be purchased under the buy-back;
- the number of securities that the company proposes to buyback;
- the method to be adopted for the buy-back;
- the price at which the buy-back of shares or other securities shall be made;
- the basis of arriving at the buy-back price;
- the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;
- the time-limit for the completion of buy-back;
- the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
  - the aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;
  - the maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;
- if the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy-back —
(i) the quantum of shares proposed to be tendered;

(ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

(l) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;

(m) a confirmation that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-

(i) that immediately following the date on which the general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;

(ii) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of one year from that date; and

(iii) the directors have taken into account the liabilities (including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013

(n) a report addressed to the Board of directors by the company’s auditors stating that-

(i) they have inquired into the company’s state of affairs;

(ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;

(iii) that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document; and

(iv) the Board of directors have formed the opinion as specified in clause (m) on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

Procedure

According to Rule 17(2) the company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a letter of offer in Form No.SH-8, along with the fee as prescribed. Such letter of offer shall be dated and signed on behalf of the Board of directors of the company by not less than two directors of the company, one of whom shall be the managing director, where there is one.

Filing Declaration of Solvency with SEBI/ROC [Rule 17(3)]

When a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution or board resolution as the case may be, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board (in case of listed companies), a declaration of solvency in Form SH-9 signed by at least
two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an affidavit as specified in said form.

**Dispatch of letter of Offer [Rule 17(4)]**

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

The letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document; [Rule 17(1)]

**Validity [Rule 17(5)]**

The offer for buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of the letter of offer.

**Acceptance on proportional basis [Rule 17(6)]**

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

**Time limit for verification: [Rule 17(7)]**

The company shall complete the verifications of the offers received within 15 days from the date of closure of the offer and the shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within 21 days from the date of closure of the offer.

**Payment of consideration/returning of share certificates**

The company shall within seven days of the time limit of verification:

(a) make payment of consideration in cash to those shareholders or security holders whose securities have been accepted, or

(b) return the share certificates to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

**Separate Account [Rule 17(8)]**

The company shall immediately after the date of closure of the offer, open a separate bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares tendered for buy-back.

The company shall confirm in its offer the opening of a separate bank account adequately funded for this purpose and to pay the consideration only by way of cash. [Rule 17(10)]

**Other conditions [Rule 17(10)]**

The rules further provide that the company shall ensure that—

(a) the company shall not withdraw the offer once it has announced the offer to the shareholders; and

(b) the company shall not utilize any money borrowed from banks or financial institutions for the purpose of buying back its shares; and
(c) the company shall not utilize the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities for the buy-back.

**Time limit for completion of buyback [Section 68(4)]**

Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

**Methods of buy-back [Section 68(5)]**

The buy-back may be—

(a) from the existing shareholders or security holders on a proportionate basis;

(b) from the open market;

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

**Extinguishment of securities bought back [Section 68(7)]**

When a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

**Prohibition of further issue of shares or securities [Section 68(8)]**

When a company completes a buy-back of its shares or other specified securities it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of Preference shares or debentures into equity shares.

**Register of buy-back [Section 68(9)]**

When a company buys back its shares or other specified securities, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

According to the rules the register of shares or securities bought back shall be maintained in Form SH-10, at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. Entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose. [Rule 17(12)(a)]

**Return of buyback [Section 68(10)]**

A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board (in case of listed companies) a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed.

The company shall file with the Registrar, and in case of a listed company with the Registrar and the SEBI, a return in the Form No. SH-11 along with the ‘fee’. There shall be annexed to the return filed with the Registrar in Form No. SH-11, a certificate in Form No. SH-15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and rules made thereunder. [Rule 17(13) and Rule 17(14)]
Penal Provisions [Section 68(11)]

If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Transfer to and application of Capital Redemption Reserve Account: (Section 69)

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Circumstances prohibits buy-back

Under Section 70 of the Companies Act, 2013, no company shall directly or indirectly purchase its own shares or other specified securities—

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment 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 banking company: However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

- No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92 (Annual Return), 123 (Declaration of Dividend), 127 (punishment for failure to distribute dividend) and section 129 (Financial Statement).

INCOME TAX ASPECTS

Section 46A of the Income Tax Act, 1961 provides that any consideration received by a security holder from any company on buy back shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the security holder as capital gains.

The computation of capital gains shall be in accordance with the provisions of Section 48 of the Income Tax Act, 1961.

In respect of Foreign Institutional Investors (FIIs), as per the provisions of Section 196D(2) of the Income Tax Act, 1961 no deduction of tax at source shall be made before remitting the consideration for equity shares tendered under the offer by FIIs as defined under Section 115AD of the Income Tax Act, 1961. NRIs, OCBs and other non-resident shareholders (excluding FIIs) will be required to submit a No Objection Certificate (NOC) or tax clearance certificate obtained from the Income Tax authorities under the Income Tax Act. In case the aforesaid NOC or tax clearance certificate is not submitted, the company should deduct tax at the maximum marginal rate as may be applicable to the category of shareholders on the entire consideration amount payable to such shareholders.
BUY-BACK PROCEDURE FOR LISTED SECURITIES

All the listed companies are required to comply with SEBI (Buy Back of Securities) Regulations 1998 and as amended from time to time, in addition to the provisions of the companies Act. These regulations broadly cover the following aspects.

1. Special Resolution and its additional disclosure requirements
2. Methods of buy back including buy back through reverse book building, from existing shareholders through tender offer etc.,
3. Filing of offer documents, public announcement requirements.
4. Offer procedure/opening of escrow account etc.,
5. General obligations of company, merchant banker etc

Special Resolution and its additional disclosure requirements (Regulation 5)

Sub-regulation (1) of Regulation 5 of the Regulations, lays down that for the purposes of passing a special resolution the explanatory statement to be annexed to the notice for the general meeting shall contain disclosures as specified in Schedule II Part A to the Regulations.

Sub-regulation (2) provides that a copy of the above resolution shall be filed with SEBI and the stock exchanges where the shares or other specified securities of the company are listed, within seven days from the date of passing of the resolution.

In case of Board approval

As per, Regulation 5A of the Regulations, provides a company, authorized by a resolution passed by the Board of Directors at its meeting to buy back its shares or other specified securities, shall file a copy of the resolution, with the SEBI and the stock exchanges, where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution.

Disclosures under Schedule II Part A

An explanatory statement containing full and complete disclosure of all the material facts and the following disclosures prescribed in Schedule II Part A of the Regulations should be annexed to the notice where the buy-back is pursuant to shareholders’ approval.

(i) Date of the Board meeting at which the proposal for buy back was approved by the Board of Directors of the company;
(ii) Necessity for the buy back;
(iii) Maximum amount required under the buy back and its percentage of the total paid up capital and free reserves;
(iv) Maximum price at which the shares or other specified securities are proposed be bought back and the basis of arriving at the buyback price;
(v) Maximum number of securities that the company proposes to buy back;
(vi) Method to be adopted for buyback as referred in sub-regulation (1) of regulation 4;
(vii) the aggregate shareholding of the promoter and of the directors of the promoters, where the promoter is a company and of persons who are in control of the company as on the date of the notice convening the General Meeting or the Meeting of the Board of Directors;
(b) aggregate number of shares or other specified securities purchased or sold by persons including persons mentioned in (a) above from a period of six months preceding the date of the Board Meeting at which the buyback was approved till the date of notice convening the general meeting;

(c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates;

(viii) Intention of the promoters and persons in control of the company to tender shares or other specified securities for buy-back indicating the number of shares or other specified securities, details of acquisition with dates and price;

(ix) A confirmation that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institutions or banks;

(x) A confirmation that the Board of Directors has made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-

(a) that immediately following the date on which the General Meeting or the meeting of the Board of Directors is convened there will be no grounds on which the company could be found unable to pay its debts;

(b) as regards its prospects for the year immediately following that date that, having regard to their intentions with respect to the management of the company’s business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and

(c) in forming their opinion for the above purposes, the directors shall take into account the liabilities as if the company were being wound up under the provisions of the Companies Act, 1956 (including prospective and contingent liabilities);

(xi) A report addressed to the Board of Directors by the company’s auditors stating that-

(i) they have inquired into the company’s state of affairs;

(ii) the amount of the permissible capital payment for the securities in question is in their view properly determined; and

(iii) the Board of Directors have formed the opinion as specified in clause (x) on reasonable grounds and that the company will not, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date.

**METHODS OF BUY-BACK**

According to Regulation 4 of the Regulations, a company may buy back its own shares or other specified securities by any one of the following methods:

(a) from the existing security-holders on a proportionate basis through the tender offer;

(b) from the open market through:

   (i) book-building process,

   (ii) stock exchange

(c) from odd-lot holders.
It may be noted that no offer of buy back for 15% or more of paid up capital and free reserves, shall be made from the open market.

In terms of Regulation 4(4) a company shall not make any offer of buy-back within a period of one year reckoned from the date of closure of the preceding offer of buy-back, if any.

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**Can a company buy back its shares or any specified securities through negotiated deal on or off the stock exchange?**

No, Regulation 4(2) does not permit buy back through negotiated deals (of and on stock exchange), private arrangement, spot transactions.

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**Buy-back from existing security-holders through tender offer**

According to Regulation 6 of the Regulations, a company may buy back its securities from its existing security-holders on a proportionate basis in accordance with the provisions of the Regulations. It may be noted that fifteen percent of the number of securities which the company proposes to buy back or number of securities entitled as per their shareholding, whichever is higher, shall be reserved for small shareholders.

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**Additional Disclosures.**

In addition to disclosure required under Schedule II Part A, regulation 7 requires the following disclosures to be made to the explanatory statement.

- (a) the maximum price at which the buy-back of shares or other specified securities shall be made and whether the Board of Directors of the company are being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;

- (b) if the promoter intends to offer their shares or other specified securities,
  - (i) the quantum of shares or other specified securities proposed to be tendered, and
  - (ii) the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy-back including information of number of shares or other specified securities acquired, the price and the date of acquisition.

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**Public announcement and Filing of offer documents (Regulation 8)**

The company which has been authorised by a special resolution or a resolution passed by the Board of Directors at its meeting shall make a public announcement within two working days from the date of resolution in at least one English National Daily, one Hindi National Daily and a Regional language daily all with wide circulation at the place where the Registered office of the company is situated and shall contain all the material information as specified in Schedule II, Part A.

A copy of the public announcement along with the soft copy, shall also be submitted to the Board simultaneously through a merchant banker.

The company shall within five working days of the public announcement file with the Board a draft-letter of offer, along with soft copy, containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company.

The Board may give its comments on the draft letter of offer not later than seven working days of the receipt
of the draft letter of offer. In the event the Board has sought clarifications or additional information from the merchant banker to the buyback offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

In the event the Board specifies any changes, the merchant banker to the buyback offer and the company shall carryout such changes in the letter of offer before it is dispatched to the shareholders.

The company shall file along with the draft letter of offer, a declaration of solvency in the prescribed form and in a manner prescribed in the Companies Act.

**Offer procedure (Regulation 9)**

1. A company making a buyback offer shall announce a record date for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buyback offer.

2. The letter of offer along with the tender form shall be dispatched to the security holders who are eligible to participate in the buyback offer, not later than five working days from the receipt of communication of comments from the Board.

3. The date of the opening of the offer shall be not later than five working days from the date of dispatch of letter of offer.

4. The offer for buy back shall remain open for a period of ten working days.

5. The company shall accept shares or other specified securities from the security holders on the basis of their entitlement as on record date.

6. The shares proposed to be bought back shall be divided in to two categories; (a) reserved category for small shareholders and (b) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.

7. After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in the offer by security holders in that category and thereafter from security holders who have tendered over and above their entitlement in other category.

**Escrow account**

Regulation 10 of the SEBI Regulations provides that-

1. the company should as and by way of security for performance of its obligations under the Regulations, on or before the opening of the offer, deposit in an escrow account the sum as specified in Sub-regulation (2).

2. the escrow amount is payable in the following manner:
   
   (i) if the consideration payable does not exceed Rs 100 crores—25 per cent of the consideration payable;

   (ii) if the consideration payable exceeds Rs 100 crores—25 per cent upto Rs 100 crores and 10 per cent thereafter;

3. the escrow account referred to above shall consist of:
(a) cash deposited with a scheduled commercial bank, or
(b) bank guarantee in favour of the merchant banker, or
(c) deposit of acceptable securities with appropriate margin, with the merchant banker, or
(d) a combination of (a), (b) and (c) above;

4. where the escrow account consists of deposit with a scheduled commercial bank, the company while opening the account, should empower the merchant banker to instruct the bank to issue a banker’s cheque or demand draft for the amount lying to the credit of the escrow account, as provided in the Regulations;

5. where the escrow account consists of bank guarantee, such bank guarantee shall be in favour of the merchant banker and valid until thirty days after the closure of the offer;

6. where the escrow account consists of securities, the company should empower the merchant banker to realise the value of such escrow account by sale or otherwise. If there is any deficit on realisation of the value of the securities, the merchant banker shall be liable to make good any such deficit;

7. in case the escrow account consists of bank guarantee or approved securities, these shall not be returned by the merchant banker till the completion of all obligations under the Regulations;

8. where the escrow account consists of bank guarantee or deposit of approved securities, the company is also required to deposit with the bank in cash, a sum of at least one per cent of the total consideration payable, as and by way of security for fulfilment of the obligations under the Regulations by the company;

9. on payment of consideration to all the security-holders who have accepted the offer and after completion of all the formalities of buy-back, the amount, guarantee and securities in the escrow, if any, should be released to the company;

10. SEBI, in the interest of the security-holders, may, in case of non-fulfilment of obligations under the Regulations by the company forfeit the escrow account either in full or in part;

11. the amount so forfeited may be distributed pro rata amongst the security-holders who accepted the offer and the balance, if any, shall be utilised for investor protection.

**Payment to the Security holders**

Regulation 11 of the Regulations lays down that—

1. The company should immediately after the date of closure of the offer, open a special account with a SEBI registered banker to an issue and deposit therein, such sum as would, together with the amount lying in the escrow account make up the entire sum due and payable as consideration for the buy-back and for this purpose, may transfer the funds from the escrow account.

2. The company shall complete the verifications of offers received and make payment of consideration to those security holders whose offer has been accepted or return the shares or other specified securities to the security holders within seven working days of the closure of the offer.

**Extinguishing of bought-back securities (Regulation 12)**

The company shall extinguish and physically destroy the security certificates so bought back in the presence of a Registrar to issue or the Merchant Banker and the Statutory Auditor within fifteen days of the date of
acceptance of the shares or other specified securities. The company shall also ensure that all the securities bought - back are extinguished within seven days of the last date of completion of buy – back.

The shares or other specified securities offered for buy-back if already dematerialised shall be extinguished and destroyed in the manner specified under the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996, and the bye-laws framed thereunder.

The company shall, furnish a certificate to the Board certifying compliance as specified above and duly certified and verified by -

(i) the registrar and whenever there is no registrar by the merchant banker;

(ii) two directors of the company one of whom shall be a managing director where there is one;

(iii) the statutory auditor of the company,

The certificate shall be furnished to the Board on a monthly basis by the seventh day of the month succeeding the month in which the securities certificates are extinguished and destroyed.

The company shall furnish, the particulars of the security certificates extinguished and destroyed, to the stock exchanges where the shares of the company are listed on a monthly basis by the seventh day of the month succeeding the month in which the securities certificates are extinguished and destroyed. The company shall also maintain a record of security certificates which have been cancelled and destroyed as prescribed in the Companies Act.

**Buy-back from Open Market**

Regulation 14 of the Regulations lays down that a buy-back of shares or other specified securities from the open market may be in any one of the following methods:

(i) Through stock exchange.

(ii) Book-building process.

The company shall ensure that atleast 50% of the amount earmarked for buy back, as specified in resolutions (Board/special resolution) is utilized for buying back shares and other specified securities.

The company shall ensure that atleast fifty per cent of the amount earmarked for buy-back, as specified in resolutions (Board/Special Resolution) is utilized for buying-back shares or other specified securities.”

**Buy-back through the stock exchange (Regulation 15)**

Regulation 15 of the Regulations provides that a company should buy-back its specified securities through the stock exchange as provided hereunder:

- the special resolution/ board resolution as under Regulation 5 and 5A respectively, should specify the maximum price at which the buy-back will be made;

- the buy-back of securities should not be from the promoters or persons in control of the company;

- the company should appoint a merchant banker and make a public announcement as referred to in Regulation 8 within seven days from the date of passing the resolution under Regulation 5 and 5A;

- the public announcement shall be made within 7 working days from the date of passing special resolution;
simultaneously with the issue of such public announcement, the company shall file a copy of the public announcement with the Board.

the company shall submit the information regarding the shares or other specified securities bought-back, to the stock exchange on a daily basis in such form as may be specified by the Board and the stock exchange shall upload the same on its official website immediately;"

the company shall upload the information regarding the shares or other specified securities bought-back on its website on a daily basis;"

the buy-back offer shall open not later than seven working days from the date of public announcement and shall close within six months from the date of opening of the offer."

the buy-back should be made only on stock exchanges having Nationwide Trading Terminal facility and only through the order matching mechanism except ‘all or none’ order matching system;

the company shall submit information regarding the shares or other specified securities bought back, to the stock exchange on daily basis in such form as may be specified by the board;

the identity of the company as a purchaser would appear on the electronic screen when the order is placed.

The company shall upload the information regarding the shares or other specified securities bought back, on its website on daily basis.

**Buy –Back of physical shares or other specified securities (Rule 15 B)**

A company shall buy-back its shares or other specified securities in physical form through open market method as provided hereunder:

(a) a separate window shall be created by the stock exchange, which shall remain open during the buy-back period, for buy-back of shares or other specified securities in physical form.

(b) the company shall buy-back shares or other specified securities from eligible shareholders holding physical shares through the separate windowspecified in clause (a), only after verification of the identity proof and address proof by the broker.

(c) the price at which the shares or other specified securities are bought back shall be the volume weighted average price of the shares or other specified securities bought-back, other than in the physical form, during the calendar week in which such shares or other specified securities were received by the broker:

Provided that the price of shares or other specified securities tendered during the first calendar week of the buy-back shall be the volume weighted average market price of the shares or other specified securities of the company during the preceding calendar week.

Explanation: In case no shares or other specified securities were bought back in the normal market during calendar week, the preceding week when the company has last bought back the shares or other specified securities may be considered.

**Escrow account (Rule 15 B)**

(1) The Company shall, before opening of the offer, create an escrow account towards security for performance of its obligations under these regulations, and deposit in escrow account 25 per cent of the amount earmarked for the buy-back as specified in the resolutions.
(2) The escrow account referred to in sub-regulation (1) may be in the form of,—

(a) cash deposited with any scheduled commercial bank; or

(b) bank guarantee issued in favour of the merchant banker by any scheduled commercial bank.

(3) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the company shall while opening the account, empower the merchant banker to instruct the bank to make payment of the amounts lying to the credit of the escrow account, to meet the obligations arising out of the buy-back.

(4) For such part of the escrow account as is in the form of a bank guarantee:

(a) the same shall be in favour of the merchant banker and shall be kept valid for a period of thirty days after the closure of the offer or till the completion of all obligations under these regulations, whichever is later.

(b) the same shall not be returned by the merchant banker till completion of all obligations under the regulations.

(5) Where part of the escrow account is in the form of a bank guarantee, the company shall deposit with a scheduled commercial bank, in cash, a sum of at least 2.5 per cent of the total amount earmarked for buy-back as specified in the resolutions referred to in regulation 5 or regulation 5A. as and by way of security for fulfillment of the obligations under the regulations by the company.

(6) The escrow amount may be released for making payment to the shareholders subject to atleast 2.5% of the amount earmarked for buy-back as specified in the resolutions referred to in regulation 5 or regulation 5A remaining in the escrow account at all points of time.

(7) On fulfilling the obligation specified at sub regulation (3) of Regulation 14, the amount and the guarantee remaining in the escrow account, if any, shall be released to the company.

(8) In the event of non-compliance with sub-regulation (3) of regulation 14, except in cases where,-

a. volume weighted average market price (VWAMP) of the shares or other specified securities of the company during the buy-back period was higher than the buy-back price as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

b. inadequate sell orders despite the buy orders placed by the company as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

c. such circumstances which were beyond the control of the company and in the opinion of the Board merit consideration, the Board may direct the merchant banker to forfeit the escrow account, subject to a maximum of 2.5 per cent of the amount earmarked for buy-back as specified in the resolutions.

(9) In the event of forfeiture for non-fulfillment of obligations specified in sub regulation (8), the amount forfeited shall be deposited in the Investor Protection and Education Fund of Securities and Exchange Board of India.

**Extinguishment of certificates (Rule 16)**

Subject to the provisions of sub-regulation (2) and sub regulation (3), the provisions of regulation 12 pertaining to extinguishment of certificates shall be applicable mutatis mutandis.

(2) The company shall complete the verification of acceptances within fifteen days of the payout.
(3) The company shall extinguish and physically destroy the security certificates so bought back during the month in the presence of a Merchant Banker and the Statutory Auditor, on or before the fifteenth day of the succeeding month:

Provided that the company shall ensure that all the securities bought-back are extinguished within seven days of the last date of completion of buyback.

**Buy-back through book-building (Regulation 17)**

A company can buy-back its securities through the book-building process as provided hereunder:

1. (a) The special regulation as in Regulation 5 or 5A, should specify the maximum price at which the buy-back will be made.

(b) The company should appoint a merchant banker.

(c) A public announcement as referred to in Regulation 8 shall be made at least seven days prior to the commencement of the buy-back.

(d) Subject to the provisions of Sub-clauses (i) and (ii), the provisions of Regulation 10 regarding escrow account are applicable:
   (i) The deposit in the escrow account should be made before the date of the public announcement.
   (ii) The amount to be deposited in the escrow account should be determined with reference to the maximum price as specified in the public announcement containing detailed methodology of the book-building process, manner of acceptance, format of acceptance to be sent by the security-holders pursuant to public announcement and details of bidding centres.

(e) A copy of the public announcement must be filed with SEBI within two days of the announcement along with the fees as specified in Schedule IV to the Regulations. The Public announcement shall also contain the detailed methodology of the book building process, the manner of acceptance, the format of acceptance to be sent by the security holders pursuant to the public announcement and the details of bidding centres.

(f) The book-building process should be made through an electronically linked transparent facility.

(g) The number of bidding centres should not be less than thirty and there should be at least one electronically linked computer terminal at all the bidding centres.

(h) The offer for buy-back should be kept open to the security-holders for a period of not less than fifteen days and not exceeding thirty days.

(i) The merchant banker and the company should determine the buy-back price based on the acceptances received and the final buy-back price, which should be the highest price accepted should be paid to all holders whose securities have been accepted for the buy-back.

**Obligations of the company**

According to Regulation 19 of the Regulations,

The company shall ensure that:

(a) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material contains true, factual and material information and does not contain any
misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

(b) the company shall not issue any specified securities including by way of bonus till the date of closure of the offer is made under these Regulations;

(c) the company shall pay consideration only by cash;

(d) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the SEBI or public announcement of the offer to buy-back is made;

(e) the promoter or the person shall not deal in the specified securities of the company in the stock exchange or off market, including inter-se transfer of shares among the promoters during the period “from the date of passing the resolution under regulation 5 or regulation 5A till the closing of the offer.

(f) the company shall not raise further capital for a period of one year from the closure of buy-back offer, except in discharge of its subsisting obligations.

No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act.

The company should nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors [Sub-regulation (3)].

The particulars of the said security certificates extinguished and destroyed should be furnished by the company to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of the certificates [Sub-regulation (4)].

The company should not buy-back the locked-in securities and non-transferable securities till the pendency of the lock-in or till the securities become transferable [Sub-regulation (5)].

The company should issue, within two days of the completion of buy-back, a public advertisement in a national daily, inter alia, disclosing the following:

(i) number of securities bought;

(ii) price at which the securities were bought;

(iii) total amount invested in the buy-back;

(iv) details of the security-holders from whom securities exceeding one per cent of the total securities were bought-back; and

(v) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

Obligations of the merchant banker

Regulation 20 provides that the merchant banker should ensure that:

(a) the company is able to implement the offer;

(b) the provision relating to escrow account has been made;
(c) firm arrangements for monies for payment to fulfil the obligations under the offer are in place;

(d) the public announcement of buy-back is made and the letter of offer has been filed in terms of the Regulations;

(e) the merchant banker should furnish to SEBI, a due diligence certificate which should accompany the draft letter of offer;

(f) the merchant banker should ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary.

(g) the merchant banker should ensure compliance of Section 77A and Section 77B of the Companies Act, and any other applicable laws or rules in this regard;

(h) upon fulfillment of all obligations by the company under the Regulations, the merchant banker should inform the bank with whom the escrow or special amount has been deposited to release the balance amount to the company and send a final report to SEBI in the specified form, within 15 days from the date of closure of the buy-back offer.

<table>
<thead>
<tr>
<th>LESSON ROUND UP</th>
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<tbody>
<tr>
<td>• According to section 61 of the Companies Act 2013 a limited company having a share capital derives its power to alter its share capital through its articles of association.</td>
</tr>
<tr>
<td>• In accordance with Section 390(b) Companies Act 1956, the expression “arrangement” includes a re-organisation of the share capital of the Company by the consolidation of shares of different classes or by division of shares of one class into shares of different classes or by both these methods</td>
</tr>
<tr>
<td>• A company limited by shares or a company limited by guarantee and having a share capital may, if authorised by its articles, by special resolution, and subject to its confirmation by the Court on petition, reduce its share capital.</td>
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<tr>
<td>• “Surrender of shares” means the surrender of shares already issued to the company by the registered holder of shares. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital.</td>
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<tr>
<td>• Diminution of capital, the company cancels shares which have not been taken or agreed to be taken by any person.</td>
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<tr>
<td>• According to Section 68(1) of the Companies Act, 2013 a company whether public or private, may purchase its own shares or other specified securities out of:(i) its free reserves; or(ii) the securities premium account; or (iii) the proceeds of any shares or other specified securities.</td>
</tr>
<tr>
<td>• When a company buys back its shares or other specified securities , it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.</td>
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<tr>
<td>• Section 46A of the Income Tax Act, 1961 provides that any consideration received by a security holder from any company on buy back shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the security holder as capital gains.</td>
</tr>
<tr>
<td>• All the listed companies are required to comply with SEBI (Buy Back of Securities) Regulations 1998 and as amended from time to time, in addition to the provisions of the Companies Act, 2013.</td>
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### SELF TEST QUESTIONS

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

1. Briefly explain the need of financial restructuring and highlight reasons in the context of over capitalised and under capitalised companies.

2. What do you mean by ‘buy-back’ of shares or specified securities as under the Companies Act, 2013? Explain the relevant provisions of the Act.

3. What are the different alternatives available to a public company for ‘buy-back’?

4. Enumerate the provisions relating to Escrow account and offer procedure as under SEBI (Buy-back of Securities) Regulations, 1998.

5. Discuss the obligation of Merchant Banker under SEBI (Buy-back of Securities) Regulations, 1998.
PROFESSIONAL PROGRAMME

ETHICS, GOVERNANCE AND SUSTAINABILITY

MODULE 2 - PAPER 6
Lesson 1
INTRODUCTION: ETHICS AND GOVERNANCE

LESSON OUTLINE
- Introduction
- Governance through Inner conscience
- Ethics
- Ethics in Business
- Corporate Governance Ethics
- Theories of Ethics
- Scope of Business Ethics
- Advantages of Business Ethics
- Conclusion
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the importance of Business Ethics and its advantages to the organization.

Promotion of culture of ethics is an imperative, and it is increasingly being realized that it is the bedrock of good governance which ultimately re-instills the confidence of the stakeholder in the company.

The objective of the study lesson is to enable the students understand the following:
- Inner Conscience and its Linkage to Governance
- The concept of business ethics
- The ethics philosophy
- Scope of Business Ethics in
  - Compliance
  - Finance
  - Human Resources
  - Marketing
  - Production
- Advantages of Ethics

“Ethics is knowing the difference between what you have a right to do and what is right to do.”

-Potter Stewart
INTRODUCTION
Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate sustainability are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express and embody itself in the corporate life. In this study we examine the concept of ethics and its importance for the business, corporate governance and governance through inner conscience and sustainability.

GOVERNANCE THROUGH INNER CONSCIENCE
To be able to do the right thing in the right way, in each case and at every moment, one must be in the right consciousness.

- Sri Aurobindo

Inner consciousness is the awareness, the capacity to listen to the inner voice that tells us that there is someone who is looking up at us and also warns that there is someone who is watching us. The soul and core of Corporate Governance is not the conduct or behavior that we see outwardly. It is internalized values that an organization and its top management follow.

The essence of a human being is consciousness and the world we create around us is the expression of our consciousness. The creative and the beautiful as well as the corrupt and degenerate are the outcome of our consciousness. The great thoughts and deeds of Mahatma Gandhi or Mother Teresa are the result of their consciousness. Similarly, the scams of WorldCom and Satyam are also the result of corresponding consciousness. The quality of our consciousness is not determined by the Intelligence Quotient or our intellect.

The quality our consciousness depends on the part of the consciousness in which we live. There are two parts in our consciousness. First is the lower physical-vital being driven predominantly by self-interest, material needs and sensuous desires, quite often degenerating into greed. The second is the higher mental, moral and spiritual being seeking for truth, beauty, goodness, harmony and unity. The corporate governance, to be truly effective and enduring, has to be based on this higher part of our human nature or conscience.

An important quality of this higher part of our conscience is self-governance. This higher self in us doesn't need the threat of external Law or the lure of an external reward to remain good or ethical; it has an intrinsic motivation for ethics and self-regulation. This ideal of self-governance must be highest goal of all governance. Self-governing Individual in a self-governing community must be the highest ideal of corporate governance. We are, individually and collectively, still far away from this ideal. We still need laws because we are not yet ready for self-governance. But we must keep this ideal as a pole-star and gradually progress or evolve towards it through a combination of enlightened regulation of the external environment and inner transformation through education and inner discipline.

Ideally, corporate governance should endeavour to create corporate consciousness and an environment in which those who are charged with governance and those who are governed display genuine ethical, social and ecological responsibilities.

ETHICS
The term "ethics" is derived from the Greek word "ethos" which refers to character, guiding beliefs, standards and ideals that pervade a group, a community or people. The Oxford Dictionary states ethics as "the moral principle that governs a person's behaviour or how an activity is conducted". The synonyms of ethics as per
Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct and standards.

Ethics refers to well-founded standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues. Thus, ethics relates to the standards of conduct and moral judgments that differentiate right from wrong. Ethics is not a natural science but a creation of the human mind. For this reason, it is not absolute and is open to the influence of time, place and situation.

In bygone times, kings used to keep food testers who used to eat the food prepared for the king before it was offered to him. This was royal clinical research to find out if the food was poisoned. This practice was not questioned because the king was regarded as the most important person in the kingdom, and his life was more precious than that of anyone else. It was the ethics of the time.

What is considered ethical behaviour in one society might be considered unethical in another. For example, euthanasia (mercy killing) is permitted in some countries but it is considered strictly unethical in most countries.

Ethics has following features:

→ Ethics is a conception of right or wrong conduct. Ethics tells us when our behaviour is moral and when it is immoral. It deals with the fundamental human relationship, how we think and behave towards others and how we want them to think and behave towards us.

→ Ethics relates to the formalised principles derived from social values. It deals with the moral choices that we make in the course of performing our duties with regard to the other members of society. Hence, it is relevant in the context of a society only.

→ Ethical principles are universal in nature. They prescribe obligations and virtues for everybody in a society. They are important not only in business and politics but in every human endeavour.

→ There exist no sharp boundaries between ethical and non-ethical. Therefore, people often face ethical dilemmas wherein a clear cut choice becomes very difficult.

→ The concepts of equity and justice are implicit in ethics. Fair and equitable treatment to all is its primary aim.

→ Ethics and legality of action do not necessarily coincide. What a society interprets as ethical or unethical ends up expressed in laws. The legality of actions and decisions does not necessarily make them ethical. For example, not helping an injured person in a road accident may be unethical but not illegal.

ETHICS IN BUSINESS

The Concept of Business Ethics

Business ethics is one of the important branches of applied ethics. Business ethics is the application of general ethical ideas to business. "Business ethics refers to the moral principles and standards and a code of conduct that businessmen are expected to follow while dealing with others. Business essentially is a means of society to use scarce resources to produce in an efficient manner those goods and services which society wants and is willing to pay for. Businesses must balance their desire to maximise profits against the needs of stakeholders. The significant issues in business ethics include ethical management of enterprise in
relation to its stakeholders in particular and natural environment in general.

Ethics is necessary and important in business due to several reasons, some of which are given below

- There is a kind of social contract between the society and business by which the society expects the business to work in its interest. Society creates and accepts business enterprises; hence it expects them to work in a manner which is not detrimental to its well being and interests. Technological advancements have to be made but their impact on the environment and mankind has he kept in mind.

- Ethical conduct is in the long-term interests of businessmen. A business enterprise that is honest and fair to its customers, employees, and other stakeholders earns their trust and good will. It ultimately results in customer satisfaction, healthy competition, industrial growth and high earnings. Businesses must balance their desire to maximise profits against the requirements of stakeholders. Maintaining this balance often requires tradeoffs. To address this unique aspect of business, rules are articulated to guide it to earn profits without harming individuals or society as a whole. While referring to business activity profile, Mahatma Gandhi once mentioned that all business entrepreneurs should ask themselves the question whether the activities they are contemplating would be of some use to the common man. This statement emphasizes the importance of nobility of business purpose.

- Ethical business behaviour is not only about good business but about good citizenship as well. Morally conscious businessmen have created names and built great business empires. They serve customers with good quality products at fair prices, treat their employees with great respect, reward their shareholders with good returns and pay their taxes honestly.

- Ethical policies and practices enable a business enterprise to build goodwill for itself. A business organisation that adheres to a code of conduct gains a competitive advantage and builds long term value. On the other hand, unethical practices lead to the ultimate downfall of big organisations too.

- Business can prosper only when a society is stable and peaceful. Unethical practices at times create distrust, disorder and turmoil in society.

Business ethics refers to a 'code of conduct' which businessmen are expected to follow while dealing with others. ‘Code of conduct’ is a set of principles and expectations that are considered binding on any person who is member of a particular group. The alternative names for code of conduct are ‘code of ethics’ and ‘code of practice’.

Business ethics comprises of the principles and standards that guide behaviour in the conduct of business. Businesses must balance their desire to maximize profits against the needs of the stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of businesses, articulated as well as implicit rules are developed to guide the businesses to earn profits without harming individuals or society as a whole.

The coverage of business ethics is very wide as it deals with norms relating to a company and its employees, suppliers, customers and neighbors, its fiduciary responsibility to its shareholders. It reflects the philosophy of business, one of whose aims is to determine the fundamental purposes of a company.

Business ethics stands for the saneness or purity of purpose that is upheld through carefully designed actual practices of business enterprises. It is an embodiment of conscious concern towards execution of business processes in tune with the nobility of the purpose.
While referring to business activities, Mahatma Gandhi once mentioned that all businesses have a social responsibility which has nothing to do with its ordinary economic activity. For instance, if there is a natural calamity in an area adjoining a business organisation, the society would expect the business to participate in the relief work. Such a social responsibility arises out of ethical considerations and not out of profit-making considerations. Therefore, the responsibility towards society is a moral obligation arising out of business ethics, which in turn is steeped in the philosophy of business.

**CORPORATE GOVERNANCE ETHICS**

Business ethics and corporate governance of an organization go hand in hand. In fact, an organization that follows ethical practices in all its activities will, in all probability, follow best corporate governance practices as well.

Corporate governance is meant to run companies ethically in a manner such that all stakeholders including creditors, distributors, customers, employees, the society at large, governments and even competitors are dealt with in a fair manner. Good corporate governance should look at all stakeholders and not just the shareholders alone. Corporate governance is not something which regulators have to impose on a management, it should come from within.

A business organization has to compete for a share in the global market on its own internal strength, in particular on the strength of its human resource, and on the goodwill of its other stakeholders. While its state-of-the-art technologies and high level managerial competencies could be of help in meeting the quality, cost, volume, speed and breakeven requirements of the highly competitive global market, it is the value-based management and ethics that the organization has to use in its governance. This would enable the organization to establish productive relationship with its internal customers and lasting business relationship with its external customers.

**THEORIES OF ETHICS**

**Ethical Theories**

Ethical theories arise in different contexts, so they address different problems. They also represent some ethical principles. There are many ethical theories but in general there are two major kinds of ethical theories: Deontological and Teleological ethical theories. Broadly speaking Deontological theories emphasise on consequences, whereas Deontological theories are interested more in duty.

**Deontological Theories – Kantian Ethics**

Deontological theories of ethics are different from utilitarian theories of ethics. According to Deontological theories, though the consequences of an act is good, some acts are always wrong. In deontological theories actions are judged as ethical or unethical based on duty or intentions of an actor. The most important defender of deontological ethics is Immunuel Kant who forwards his moral theory in 1788.

Kant's ethical theory includes duty without regard to human happiness. His moral theory is based on his view of the human being as having the unique capacity for rationality. No other animal possesses such a propensity for reasoned thought and action, and it is exactly this ability which obliges us to act according to the moral law / duty. Kant's moral theory emphasises acting in accordance with and for the sake of duty. Kant believed that inclinations, emotions and consequences should play no role in moral action. This means that motivation for action must be based on obligation. Morality should provide us with a framework of rational principles (rules) that guide and restrict action, independent of personal intentions and desires.
It is worth mentioning that another divergence between the theories of utility and deontology is the way in which they are constructed: utilitarianism is concerned with actively maximising the good while deontology is more negatively focused on avoiding the morally impermissible (or on the constraints of action).

The moral worth of an action is determined by the will. The human will is the only thing in the world that can be considered good without qualification, according to Kant. Good will is exercised by acting according to moral duty/law. The moral consists of a set of moral maxims which are categorical in nature.

According to Kant, every action has a maxim. Maxim means rule of principle. He tries to provide a universal law that is true under any circumstances for everyone. It can be concluded that deontological ethics based on Kantian ethics emphasises a universal morality. The principle of deontological ethics can be summed up in the phrase, “treat others as you would be treated”.

Kant distinguishes two kinds of imperatives; hypothetical and categorical imperatives. Hypothetical imperatives are conditional, whereas categorical imperatives are unconditional and they must be obeyed under any conditions. Hence, according to Kantian ethics is an action passes the test of categorical imperative, the action is ethical. It can be claimed that categorical imperative rules out some certain practices, such as theft, fraud, coercion and so on in business left. If Kantian ethics can be applied in business life, it provides universal place in business world.

**Teleological Theories**

Teleology is derived from the Greek word ‘telos’ meaning ends or purposes. This theory holds that ends or consequences of an act determine whether the act is good or bad. Rightness of actions is determined solely by their good consequences. Teleological approach is also known as consequential ethics.

Businessmen commonly think in terms of purposeful actions as in, for example, management by objectives. Teleological analysis of business ethics leads to the consideration of the full range of stakeholders in any business decision, including the management, the staff, the customers, the shareholders, the country, humanity and environment.

**Utilitarian Approach**

Utilitarianism is an ethics of welfare. Business guided by utilitarian approach focuses on behaviours and their results, not on the means of such actions. It can be described by the phrase, “the greatest good for the greatest number.” The utilitarian approach prescribes ethical standards for managers in the areas of organisational goals, i.e., maximisation of profits; and having efficiency which denotes optimum utilization of scarce resource.

Utilitarianism prescribes that the moral worth of an action is solely determined by its contribution to overall utility, that is, its contribution to the happiness and satisfaction of the greatest member. For example, one may be tempted to steal from a rich wastrel to give to a starving family. Hence, this approach is also referred as consequential approach. Utilitarianism is a general term for any view that holds that actions and policies should be evaluated on the basis of the benefits and costs they impose on the society. The policy which produces the greatest net benefit on lowest net costs in considered right.

The best way to analyse any decision including a business decision is by doing a cost benefit analysis. Several government agencies, legal theorists and moralists advocate utilitarianism.

Jeremy Bentham is considered as the founder of traditional utilitarianism. He propagates on objective basis
for making value judgments that would provide common acceptable norm for determining social policy and social legislation.

The utilitarian principle states, “an action is right from ethical print of view if and only if they seem total of utilities produced by that act are greater than the sum total of utilities produced by any other act that can be performed at that point of time by any person”. This approach gives precedence to good over right.

There are some limitations in the utilitarian approach. It is impossible to measure utility of different actions on a common scale. How can utility of one action be compared to that of the other? At times benefits and cost of an action cannot be even predicted accurately. For example, it is not possible to predict advantages of building housing for the underprivileged. Moreover, non-economic goods, such as life, equality, health, beauty and justice cannot be traded for economic goods. But utilitarianism assumes that all goods are tradable for some quantity of another good.

Both Utilitarianism and Kantian ethics have important implications in business world. Therefore, both of them can be applied in business ethics. However, both have some negative points. Some are of the view that utilitarian ethics is more applicable to business ethics than Kantian ethics, because the aim of any business is to gain profit/benefit. The fundamental feature of utilitarianism is to maximize utility.

**Virtue Theory**

Virtue theory of ethics is a very old concept existing since the time of Aristotle (384BC), and there are a variety of theories that fall under the category of virtue theory. It is, firstly, important to understand what is meant by virtue – it is a slightly old – fashioned term. Whereas the other normative theories attempt to answer the question of ‘the right action’ (or ethical behaviour), virtue theory is more concerned with answering the question of how to live a good life or how to be a good person. Virtue theory aims to offer an account of the characteristics one must have to be considered virtuous.

**The Emergence of Modern Virtue Theory**

Virtue theory went out of favour with the advent of Kantianism and Utilitarianism. However, it re-emerged in 1958 with the publication of paper entitled “Modern Moral Philosophy” by Elizabeth.

According to Aristotle, “role of ethics is to enable us to lead a successful and good life”. This in Aristotle's view is possible only for virtuous people. In his words “virtue is a character trait that manifests itself in habitual action”. For example, honesty does not imply telling the truth once but has to be the trait of a person who tells the truth as general practice. Thus, we can define virtue as a trait of character that is essential for leading a successful life. Aristotle considers pride and shame to be virtues on the grounds that we should be proud of our accomplishments and ashamed of our failings. Virtues should contribute to the idea of a good life. They are not merely means to happiness but are constituents of it.

The virtues of successful living apply to business as well. But everyday life virtues cannot be applied to business unconditionally. Any manager while looking at employee welfare cannot always avoid layoff. Certain amount of concealment is justified and acceptable in business negotiations. Therefore, applying virtue ethics to business would require determining the end at which business activity aims. Hence, honesty in business is not necessarily the same as honesty in other spheres of life. Whether any trait is a virtue in business is to be determined by the purpose of business and by the extent to which that trait contributes to that purpose.
Justice Theory
Justice approach is also known as fairness approach. Greek philosophers have contributed to the idea that all equals should be treated equally. Justice does not depend on consequences; it depends on the principle of equality.

The contemporary American Philosopher John Rawl's objection to utilitarianism is that it does not give adequate attention to the way in which utility is distributed among different individuals. As an alternative to the utilitarian idea of society with highest welfare, Rawls proposes a society that recognizes its members as free and equal person who attempt to advance their own interests and come into conflict with others pursuing their self interests.

The key to a well-ordered society is the creation of institutions that enable individuals with conflicting ends to interact in mutually beneficial ways. The focus here is on social justice. Rawls promotes “Play It Safe”. He argues that a rational person should choose the alternative in which the worst possible outcome is still better than the worst possible outcome of any other alternative.

Theory of Egoism
Egoism is derived from the Latin word 'ego' meaning 'I'. The theory of egoism holds that the good is based on the pursuit of self-interest. This model takes into account harms, benefits and rights for a person’s own welfare. Under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company is providing scholarship benefits to the needy students, ultimately it is in the company’s self interest.

Theory of Relativism
Theory of Relativism promotes the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects. It holds that there are no absolute truths in ethics and that what is morally right or wrong varies from person to person or from society to society. The term often refers to truth relativism, which is the doctrine that there is no absolute truth, i.e., that truth is always relative to some particular frame of reference, such as a society or a culture. For example, killing animals for sport (like bull fighting) could be right in one culture and wrong in another.

SCOPE OF BUSINESS ETHICS
Ethical problems and phenomena arise across all the functional areas of companies and at all levels within the company which are discussed below:

Ethics in Compliance
Compliance is about obeying and adhering to rules and authority. The motivation for being compliant could be to do the right thing out of the fear of being caught rather than a desire to abide by the law. An ethical climate in an organisation ensures that compliance with law is fuelled by a desire to abide by the laws. Organisations that value high ethical values comply with the laws not only in letter but go beyond what is stipulated or expected of them.

Ethics in Finance
The ethical issues in finance that companies and employees are confronted with include:

— In accounting – window dressing, misleading financial analysis.
— Related party transactions not at arm length
— Insider trading, securities fraud leading to manipulation of the financial markets.
— Executive compensation.
— Bribery, kickbacks, over billing of expenses and facilitation payments.
— Fake reimbursements.

**Case of an unethical practice**

*Mr. A is a respected senior officer in the company. He enjoys all the benefits and perquisites from the company, including a car with a driver, medical facility and reimbursements of certain expenditures.*

*During the months of September, October and December it was observed that his telephonic reimbursements were on a rising note. From Rs. 500 p.m. it went up to Rs. 2500 p.m. The matter was reported and investigated. It was found that Mr. A has made arrangements with the Telephone Company to make a single bill for two telephone numbers at his residence.*

*The effect of a petty misappropriation especially at the top level trickles down to all levels.*

**Ethics in Human Resources**

Human resource management (HRM) plays a decisive role in introducing and implementing ethical practices in an organisation. Ethics should be a pivotal issue for HR specialists. The ethics of human resource management (HRM) covers those ethical issues that arise around the employer-employee relationship, such as the rights and duties issues between the employer and employee.

The ethical issues faced by HRM include:

— Discrimination issues, i.e., discrimination on the bases of age, gender, race, religion, disabilities etc.
— Sexual harassment.
— Affirmative Action.
— Issues surrounding the representation of employees and the democratization of the workplace and trade unionisation.
— Issues affecting the privacy of the employee: workplace surveillance, drug testing, etc.
— Discrimination of whistle-blowers.
— Issues relating to the fairness of the employment contract and the balance of power between the employer and employee.
— Occupational safety and health issues.

Companies tend to shift economic risks onto the shoulders of their employees. The boom of performance-related pay system and flexible employment contracts are indicators of these newly established forms of shifting risk.
Case of unethical practice
A middle level executive, Mr. X, based in Delhi, opts for a 3 day training programme in Bangalore, which happens to be his hometown. He also applies leave for 3 days immediately following the training, which is granted to him.

Mr. X reaches the venue of the training. On the first day, he registers himself, takes the training kit, attends the training for two hours, befriends a dealing officer and arranges to have the presentations, etc. sent to him. He does not attend the training programme thereafter.

Mr. X sends a report of the training as soon as he returns. His reporting officer summons him and asks him where he was during the training. At first, Mr. X reacts in a defensive manner saying that he was at the training site. The reporting officer then tells him that the company, in order to extend the training to other employees as well had got in touch with the programme organizers requesting them for a one to one meeting with Mr. X already present there and were informed of his absence. When confronted with this, Mr. X admits that he had not attended the training programme.

Ethics in Marketing
Marketing ethics is that area of applied ethics which deals with the moral principles behind the operation and regulation of marketing. The issue of marketing ethics is not limited to the kind of products alone. It also deals with how such products are delivered to the customers. The ethical issues confronted in this area include:

- Pricing: price fixing, price discrimination and price skimming.
- Anti-competitive practices, like manipulation of supply, exclusive dealing arrangements and tying arrangements.
- Misleading advertisements.
- Contents of advertisements.
- Decision making.
- Children and marketing.
- Surrogate advertising: For example, many liquor firms carry advertisements of products, like apple juice, soda and water.
- Black markets and grey markets.

Ethics in Production
This area of business ethics deals with the duties of a company to ensure that their products and production processes do not cause harm to society at large. Some of the more acute dilemmas in this area arise out of the fact that there is usually a degree of danger in any product or its production process and it is difficult to define the degree of permissibility, since the degree of permissibility may depend on the changing state of preventative technologies or changing social perceptions of acceptable risk.

- Defective, addictive and inherently dangerous products and
- Ethical relations between the company and the environment include pollution, environmental ethics and carbon emissions trading.
- Ethical problems arising out of new technologies, for example, genetically modified food.
- Product testing ethics.
The most systematic approach to fostering ethical behavior in business is to build a corporate culture that would link ethical standards and business practices.

**ADVANTAGES OF BUSINESS ETHICS**

More and more companies have begun to recognize the relation between business ethics and financial performance. Companies displaying a "clear commitment to ethical conduct" consistently outperform those companies that do not display an ethical conduct.

A company that adheres to ethical values and dedicatedly takes care of its employees is rewarded with equally loyal and dedicated employees.

1. **Attracting and retaining talent**

People aspire to join organizations that have high ethical values. Such companies are able to attract the best talent. The ethical climate matters a lot to the employees. Ethical organizations create an environment that is trustworthy, making employees willing to rely on company's policies, ability to take decisions and act on those decisions. In such a work environment, employees can expect to be treated with respect, and will have consideration for their colleagues and superiors as well. Thus, companies' policies cultivate teamwork, promote productivity and support employee-growth.

Retaining talented people is as big a challenge for the company as getting them in the first place. Work is a mean to an end for the employees and not an end in itself. The relationship with their employer must be a win-win situation in which their loyalty should not be taken for granted. Talented people will invest their energy and talent only in organizations with values and beliefs that matches their own. In order to achieve this equation, managers need to build culture, compensation and benefit packages, and career paths that reflect and foster certain shared values and beliefs.

2. **Investor Loyalty**

Investors are concerned about ethics, social responsibility and reputation of the company in which they invest. Investors are becoming more and more aware that an ethical climate provides a foundation for efficiency, productivity and profits. Relationship with any stakeholder, including investors, based on dependability, trust and commitment results in sustained loyalty.

3. **Customer satisfaction**

Customer satisfaction is a vital factor of a successful business strategy. Repeated purchases/orders and an enduring relationship with mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company only when it adopts ethical practices. When a company with a belief in high ethical values is perceived as such, the crisis or mishaps along the way is tolerated by the customers as minor aberrations. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified and it is ensured that organizational behavior is aligned to those values. An organization with a strong ethical environment places its customers’ interests as foremost. Ethical conduct towards customers builds a strong competitive position for the company. It promotes a strong public image too.

4. **Regulators**

Business should act ethically not only to benefit itself and to build its reputation, but also for the benefit of its key stakeholders.

Regulators eye companies functioning ethically as responsible citizens. The regulator need not always monitor the functioning of the ethically sound company. Any organisation that acts within the confines of business ethics not only earns profit but also gains reputation publicly.
To summarise, companies that are responsive to employees’ needs have lower turnover in staff.

— Shareholders invest their money into a company and expect a certain level of return from that money in the form of dividends and/or capital growth.

— Customers pay for goods, give their loyalty and enhance a company’s reputation in return for goods or services that meet their needs.

— Employees provide their time, skills and energy in return for salary, bonus, career progression and experience.

CONCLUSION

In making ethics work in an organization it is important that there is synergy in vision statement, mission statement, core values, general business principles and the code of ethics. A commitment by corporate management to follow an ethical code of conduct confers a variety of benefits. An effective ethics programme requires continual reinforcement of strong values. Organisations are challenged with the task to make their employees live and imbibe their ethical codes and values. To ensure a right ethical climate, a right combination of spirit and structure is required.

Corporate Ethics is much needed to stress the importance of sustainability, social development, stakeholders and consumers satisfaction. It is an orientation to provide a valuable service instead of displaying more orientation for profits. Ethics, point out what is good and what is bad and also what is right or wrong. It brings to the notice of the business community the importance of honesty, sincerity and fairness which makes them alert and socially conscious. It reconciles conflicting interest of various sections of the society such as workers, shareholders, consumers, distributors, suppliers, competitors and government and thus, expedites a better relation between business and the society.
Lesson 2

Ethical Principles in Business

**Whistle Blower Policy**

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

2. This mechanism should also provide for adequate safeguards against victimization of director(s) / employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases.

3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board’s report.

This has been made a mandatory requirement for all the listed company with effect from October 01, 2014. The company should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices. The audit committee is responsible to review its functioning, and a disclosure be made in the Annual Report about the Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.
Lesson 3

Conceptual Framework of Corporate Governance

Some of the Provisions Relating to Corporate Governance under Companies Act, 2013

The Companies Act, 2013 enacted on August 30, 2013 envisages radical changes in the sphere of Corporate Governance in India. It is set to provide a major overhaul in Corporate Governance norms and have far-reaching implications on the manner in which corporate operates in India.

Some of the Provisions of Companies Act, 2013 related to Corporate Governance are:

1. Mandatory provisions related to independent directors, woman director, Key Managerial Personnel and Performance Evaluation of the Board.
2. Enhanced disclosures and assertions in Board Report, Annual Return and Directors’ Report with regard to Managerial Remuneration, risk management, internal control for financial reporting, legal compliance, Related Party Transactions, Corporate Social Responsibility, shareholding pattern, public money etc.
3. Stricter yet forward-looking procedural requirements for Secretarial compliances and ICSI Secretarial Standards made mandatory.
4. Enhanced scope of Related Party Transactions and introduction of concept of arm’s length pricing.
5. Enhanced restrictions on appointment and rotation of Auditors. Separation of role of Chairperson and Chief Executive Officer.
6. Introduction of mandatory provisions regarding Whistle Blower Policy, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee, and Corporate Social Responsibility Committee.

Corporate Governance through listing Agreement

SEBI vide its circular No. CIR/CFD/POLICY CELL /2/2014 dated April 17, 2014 came out with Corporate Governance in listed entities - Amendments to Clause 49 of the Equity Listing Agreement which lays down the detailed corporate governance norms for listed companies providing for stricter disclosures and protection of investor rights, including equitable treatment for minority and foreign shareholders. The new norms are aligned with the Companies Act, 2013 and are aimed to encourage companies to adopt best practices on corporate governance. The highlights of the revised Clause 49 are as follows:

- Exclusion of nominee Director from the definition of Independent Director.
- At least one woman director on the Board of the company.
- Compulsory whistle blower mechanism.
- Expanded role of Audit Committee.
- Prohibition of stock options to Independent Directors.
- Separate meeting of Independent Directors.
- Constitution of Stakeholders Relationship Committee.
- Enhanced disclosure of remuneration policies.
- Performance evaluation of Independent Directors and the Board of Directors.
- Prior approval of Audit Committee for all material Related Party Transactions (RPTs)
- Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting.
- Mandatory constitution of Nomination and Remuneration Committee. Chairman of the said committees shall be independent.
• The maximum number of Boards an independent director can serve on listed companies be restricted to 7 and 3 in case the person is serving as a whole time director in a listed company.
• To restrict the total tenure of an Independent Director to 2 terms of 5 years. However, if a person who has already served as an Independent Director for 5 years or more in a listed company as on the date on which the amendment to Listing Agreement becomes effective, he shall be eligible for appointment for one more term of 5 years only.
• The scope of the definition of RPT has been widened to include elements of Companies Act and Accounting Standards.
Lesson 4
Board Effectiveness - Issues and Challenges

Who are Board of Directors?

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company. They are also referred as board of governors, board of managers, board of regents, board of trustees, or simply referred to as "the board".

Who are Directors?

As per Section 2(34) of the Companies Act, 2013 ‘director’ means a director appointed to the Board of the Company.

GOVERNANCE FUNCTIONARIES

1. Executive Director

The term executive director is usually used to describe a person who is both a member of the board and who also has day to day responsibilities in respect of the affairs of the company. Executive directors perform operational and strategic business functions such as:

- managing people
- looking after assets
- hiring and firing
- entering into contracts

Executive directors are usually employed by the company and paid a salary, so are protected by employment law. Examples of executive directors are production director, finance director or managing director or whole time director.

Section 2(54) of the Companies Act, 2013 defines Managing Director as - "managing director" means a director who, by virtue of articles of a company or an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of a managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

2. Non Executive Director

They are not in employment of the company. They are the members of the Board, who normally do not take part in the day-to-day implementation of the company policy. They are generally appointed to provide the company with the benefits of professional expertise and outside perspective to the board. They play an effective role in governance of listed companies, but they may or may not be independent director.

3. Shadow Director
Shadow Director is a person who is not formally appointed as a director, but in accordance with whose directions or instructions the directors of a company are accustomed to act. However, a person is not a shadow director merely because the directors act on advice given by him in a professional capacity.

Holder of controlling or majority stock (share) of a private firm who is not (technically) a director and does not openly participate in the firm’s governance, but whose directions or instructions are routinely complied with by the employees or other directors. In the eyes of law, he or she is a de facto director and is held equally liable for the obligations of the firm with the other de facto and de jure directors.

Can a shadow director be counted for the Board Quorum?

4. Woman Director

Second Proviso to section 149 provides that such class or classes of companies as may be prescribed in Companies (Appointment and Qualification of Directors) Rules, 2014, shall have at least one woman director.

Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014, prescribes the following class of companies shall appoint at least one woman director-
(i) every listed company;
(ii) every other public company having:-
   (a) paid–up share capital of one hundred crore rupees or more; or
   (b) turnover of three hundred crore rupees or more.

A company, which has been incorporated under the Act and is covered under provisions of second proviso to sub-section (1) of section 149 shall comply with such provisions within a period of six months from the date of its incorporation; However any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

Explanation.- For the purposes of this rule, it is hereby clarified that the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

Clause 49(II) (A) of the Listing Agreement also requires that at least one woman director shall be appointed on the board of all listed companies.

5. Resident Director

Section 149 (3) of the Act has provided for residence of a director in India as a compulsory i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. MCA has also issued clarification with regard to Resident Directors.
Clarification by MCA

1. Whether the provision regarding Resident Director is applicable in the current calendar/financial year.
   
   - The matter has been examined. It has been clarified that the residency requirement would be reckoned from the date of commencement of section 14 of the Act i.e. 1st April, 2014. The first previous calendar year, for compliance with these provisions would, therefore, be Calendar year 2014. The period to be taken into account for compliance with these provisions will be the remaining period of calendar year 2014 i.e. 1st April to 31st December. Therefore, on a proportionate basis the number of days for which the director(s) would need to be resident in India, during Calendar year 2014, shall exceed 136 days.

   - Regarding newly incorporated companies it is clarified that companies incorporated between 1.4.2014 to 30.9.2014 should have a resident director either at the incorporation stage itself or within six months of their incorporation. Companies incorporated after 30.9.2014 needs to have the resident director from the date of incorporation itself.

6. Independent Director

The word ‘independent’ with reference to board composition was used for the first time in corporate legislation in relation to investment companies by a Report that introduced the Investment Company Act, 1940. It suggested that at least 40 percent of the Board of directors of an investment company shall be independent for safeguarding the investors.

In United Kingdom, 1973 Lord Watkinson was appointed by Confederation of British Industries to recommend on more responsible corporate sector. He submitted his report titled ‘Responsibilities of the British Public Company’, which recommended appointment of non-executive directors to the Board.

Role of Independent Director

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.

Independent Directors bring a valuable outside perspective to the deliberations. They contribute significantly to the decision-making process of the Board. They can bring on objective view to the evaluation of the performance of Board and management. In addition, they can play an important role in areas where the interest of management, the company and shareholders may diverge such as executive remuneration, succession planning, changes in corporate control, audit function etc.

Independent directors are required because they perform the following important role:

(i) Balance the often conflicting interests of the stakeholders.

(ii) Facilitate withstanding and countering pressures from owners.

(iii) Fulfill a useful role in succession planning.

(iv) Act as a coach, mentor and sounding Board for their full time colleagues.

(v) Provide independent judgment and wider perspectives.

CII Task Force report entitled “Desirable Corporate Governance: A Code”, 1998 and SEBI’s Kumar Mangalam Birla Committee Report, 1999 initiated the concept of Independent Directors in India. The CII’s
Task Force and the Kumar Mangalam Birla Committee extensively debated the issue of independent directors. The Task Force said in its report that “the identities of members of Board crucial to excellence is of course obvious. Equally vital, however are their individual competencies, experience and track record, which must match the business that the company is in. And a mix of operational managers, who have the insider’s perspective and external professionals, who bring in the outsider’s cool detachment, will provide the collective capability that a Board needs.”

A. Birla Committee agreed on the following definition of “Independence”:

“Independent directors are directors who apart from receiving director’s remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the Board may affect their independence of judgment”.

B. The Naresh Chandra Committee defined an independent director as follows:—

An independent director of a company is a non-executive director who:

1. Apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;

2. Is not related to promoters or management at the Board level, or one level below the Board (spouse and dependent, parents, children or siblings);

3. Has not been an executive of the company in the last three years;

4. Is not a partner or an executive of the statutory auditing firm, the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity;

5. Is not a significant supplier, vendor or customer of the company;

6. Is not a substantial shareholder of the company, i.e. owing two per cent or more of the block of voting shares;

7. Has not been a director, independent or otherwise, of the company for more than three terms of three years each (not exceeding nine years in any case):

An employee, executive director or nominee of any bank, financial institution, corporations or trustees of debenture and bond holders, who is normally called a “nominee director”, will be excluded from the pool of directors in the determination of the number of independent directors. In other words, such a director will not feature either in the numerator or the denominator.

C. Companies Act, 2013 and various Rules made there under

Who is an Independent Director?

Section 149(6) of Companies Act, 2013 defines independent director as below:

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

**Clarification by MCA**

1. whether a transaction entered into by an Independent Director with the company concerned at par with any member of the general public and at the same price as is payable/paid by such member of public would attract the bar of 'pecuniary relationship' under section 149(6)(c).

It has been clarified that in view of the provisions of section 188 which take away transactions in the ordinary course of business at arm’s length price from the purview of related party transactions, an Independent Director will not be said to have 'pecuniary relationship' under section 149(6)(c) in such cases.

2. Whether receipt of remuneration, (in accordance with the provisions of the Act) by an Independent Director from a company would be considered as having pecuniary interest while considering his appointment in the holding company, subsidiary company or associate company of such company.

The matter has been examined in consultation with SEBI and it has been clarified that 'pecuniary relationship' provided in section 149(6) (c) of the Act does not include receipt of remuneration, from one or more companies, by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission approved by the members, in accordance with the provisions of the Act.

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(e) who, neither himself nor any of his relatives—

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.
Who shall appoint Independent Director?
Section 149(4) read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides for such class or classes of companies where the appointment of Independent director is mandatory. (Discussed in Lesson 4)

What are the Qualifications of an Independent Director?
Rule 5 of Companies (Appointment and Qualification of Directors) Rules, 2014 made under Chapter XII provides that an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.

What is the Manner of selection of an Independent Director?
According to section 150 (1) of the Act, independent directors may be selected from a data bank of eligible and willing persons maintained by the agency (any body, institute or association as may be authorised by Central Government). Such agency shall put data bank of independent directors on the website of Ministry of Corporate Affairs or any other notified website. Company must exercise due diligence before selecting a person from the data bank referred to above, as an independent director.

This section further stipulates that the appointment of independent directors has to be approved by members in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

Any person who desires to get his name included in the data bank of independent directors shall make an application to the agency in Form DIR-1 Application for inclusion of name in the databank of Independent Directors which includes the personal, educational, professional, work experience, other Board details of the applicant (Rule 6(4)).

The agency may charge a reasonable fee from the applicant for inclusion of his name in the data bank of independent directors (Rule 6 (5)).

An existing or applicant of such data bank of independent directors shall intimate any changes in his particulars within fifteen days of such change to the agency (Rule 6 (6)).

Rule 6 (7) prescribed that the databank posted on the website shall:
- a. be accessible at the specified website;
- b. be substantially identical to the physical version of the data bank;
- c. be searchable on the parameters specified in rule 6 (2);
- d. be presented in a format or formats convenient for both printing and viewing online; and
- e. contains a link to obtain the software required to view print the particulars free of charge.

What is Declaration of Independence?
A statement/ declaration by an independent director that he meets the criteria of independence is a good governance practice. Companies are encouraged to obtain such a certificate at the time of appointment as well as annually. There is always a possibility that independent director loses his independent status while holding his office. In such a situation the director must approach the Board and communicate his status, in turn company is expected to make adequate disclosures to the shareholders.

Section 149(7) of Companies Act, 2013 states that every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence.

What are Code of Conduct for an Independent Director?
Eighth proviso to Section 149 provides that the independent directors shall abide by the provisions specified
in Schedule IV. It is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

The code of conduct for independent directors regarding guidelines for professional conduct, roles, functions and duties, manner of appointments and reappointments, resignation/removal, separate meetings and evaluation mechanism.

**What is the Tenure of an Independent Director?**

The tenure of an independent director affects his independence. An independent director with "externality" may lose its independence or may become not so independent due to friendship established with the internal directors and the management. It is therefore necessary to limit the tenure of an independent director. Excessively long tenure of independent directors reflects: Closeness of the relationship between the independent director and management and lack of Board renewal.

As per proviso 10 to Section 149 of the Companies Act, 2013, subject to provisions of Section 152, an independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

### Clarifications by MCA:

1. Can independent directors appointed prior to April 1, 2014 continue and complete their remaining tenure, under the provisions of the Companies Act, 1956 or they should demit office and be re-appointed (should the company so decide) in accordance with the provisions of the new Act.

   Explanation to section 149(11) clearly provides that any tenure of an independent director on the date of commencement of the Act shall not be counted for his appointment/ holding office of director under the Act. In view of the transitional period of one year provided under section 149(5), It has been clarified that it would be necessary that if it is intended to appoint existing independent directors under the new Act, such appointment shall be made expressly under section 149(10)/ (11) read with Schedule IV of the Act within one year from 1st April, 2014, subject to compliance with eligibility and other prescribed conditions.

2. Whether it would be possible to appoint an individual as an ID for a period less than five years.

   It has been clarified that section 149(10) of the Act provides a term of "up to five consecutive years" for an Independent Directors. As such while appointment of an 'ID' for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of independent director for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years.

   Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

   Provided further no independent director shall hold office for two consecutive terms but shall be eligible for appointment as independent director after the expiration of three years of ceasing to be an independent director in the company. (Section 149(11))
What are the provisions related to remuneration of independent Directors?
Section 149(9) provides that notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director shall not be entitled to any stock option and may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

How to evaluate Performance of an Independent director?
Section 178(2) read with Schedule IV: The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director’s performance. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

What is the Legal position of an Independent Director?
Independent directors are invited to sit on the board purely on account of their special skills and expertise in particular fields and they represent the conscience of the investing public and also take care of public interest. Independent directors bear a fiduciary responsibility towards shareholders and the creditors. The company and the board are responsible for all the consequences of actions taken by the officers of the company.

As per Section 149(12), notwithstanding anything contained in this Act, an independent director; shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

Further, Section 149(13) states that the provisions of sections 152(6) & (7) in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

D. Clause 49 of the Listing Agreement

Meaning
The expression ‘independent director’ shall mean a non-executive director, other than a nominee director of the company:

a. who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

b. (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
   (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

c. apart from receiving director’s remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

d. none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

e. who, neither himself nor any of his relatives —
   (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately
preceding the financial year in which he is proposed to be appointed;
(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately
preceding the financial year in which he is proposed to be appointed, of —
(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding,
subsidiary or associate company; or
(B) any legal or a consulting firm that has or had any transaction with the company, its holding,
subsidiary or associate company amounting to ten per cent or more of the gross turnover of such
firm;
(iii) holds together with his relatives two per cent or more of the total voting power of the company; or
(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives
twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its
holding, subsidiary or associate company or that holds two per cent or more of the total voting power
of the company;
(v) is a material supplier, service provider or customer or a lessor or lessee of the company;
f. who is not less than 21 years of age.

**Term of Office**
An independent director shall hold office for a term up to five consecutive years on the Board of a company
and shall be eligible for reappointment for another term of up to five consecutive years on passing of a
special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a
company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one
more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for
appointment as independent director in the company only after the expiration of three years of ceasing to be
an independent director in the company.

**Limit on number of directorships**
a. A person shall not serve as an independent director in more than seven listed companies.

b. Further, any person who is serving as a whole time director in any listed company shall serve as an
independent director in not more than three listed companies.

**Formal letter of appointment to Independent Directors**
a. The company shall issue a formal letter of appointment to independent directors in the manner as
provided in the Companies Act, 2013.

b. The letter of appointment along with the detailed profile of independent director shall be disclosed on the
websites of the company and the Stock Exchanges not later than one working day from the date of such
appointment.

**Performance evaluation of Independent Directors**
a. The Nomination Committee shall lay down the evaluation criteria for performance evaluation of
independent directors.

b. The company shall disclose the criteria for performance evaluation, as laid down by the Nomination
Committee, in its Annual Report.

c. The performance evaluation of independent directors shall be done by the entire Board of Directors
(excluding the director being evaluated).

d. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue
the term of appointment of the independent director.

**Separate meetings of the Independent Directors**
a. The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.

b. The independent directors in the meeting shall, *inter-alia*:

i. review the performance of non-independent directors and the Board as a whole;

ii. review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

iii. assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

**Training of Independent Directors**
a. The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.

b. The details of such training imparted shall be disclosed in the Annual Report.

**Remuneration to Independent Directors**
Clause 49 provides that all fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders’ resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fee to non-executive directors, if made within the limits prescribed under the Companies act, 2013 for the payment of sitting fees without approval of the Central government.

7. **Nominee Director**
A nominee director belongs to the category of non-executive director, and is appointed on behalf of an interested party.

It is pertinent to mention here that there is a divergent view as to whether a nominee director can be considered independent or not. Naresh Chandra Committee in its report stated that ‘nominee director’ will be excluded from the pool of directors in the determination of the number of independent directors. In other words, such a director will not feature either in the numerator or the denominator.

While Clause 49 specifically provides that nominee directors appointed by an institution, which has invested in or lent to the company shall be deemed to be independent directors. Section 149(6) of the Companies Act, 2013 specifically excludes nominee director from being considered as Independent.

8. **Lead Independent Director**
Internationally, it is considered a good practice to designate an independent director as a lead independent director or senior independent director. He coordinates the activities of other non-employee directors and advises chairman on issues ranging from the schedule of board meetings to recommending retention of advisors and consultants to the management.
Acts as the principal liaison between the independent directors of the Board and the Chairman of the Board;

Develops the agenda for and preside at executive sessions of the Board’s independent directors;

Advises the Chairman of the Board as to an appropriate schedule for Board meetings, seeking to ensure that the independent directors can perform their duties responsibly while not interfering with the flow of Company operations;

Approves with the Chairman of the Board the agenda for Board and Board Committee meetings and the need for special meetings of the Board;

Advises the Chairman of the Board as to the quality, quantity and timeliness of the information submitted by the Company’s management that is necessary or appropriate for the independent directors to effectively and responsibly perform their duties;

Recommends to the Board the retention of advisors and consultants who report directly to the Board;

Interviews, along with the chair of the Nominating and Corporate Governance Committee, all Board candidates, and make recommendations to the Nominating and Corporate Governance Committee;

Assists the Board and Company officers in better ensuring compliance with and implementation of the Governance Guidelines;

Serves as Chairman of the Board when the Chairman is not present; and

Serves as a liaison for consultation and communication with shareholders.

California Public Employees’ Retirement System (CalPERS) provides that where the Chairman of the board is not an independent director, and the role of Chairman and CEO is not separate, the board should name a director as lead independent director who should have approval over information flow to the board, meeting agendas, and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

Other roles of the lead independent director should include chairing meetings of non-management directors and of independent directors, presiding over board meetings in the absence of the chair, serving as the principle liaison between the independent directors and the chair, and leading the board/director evaluation process. Given these additional responsibilities, the lead independent director is expected to devote a greater amount of time to board service than the other directors.

9. Chairman

The responsibility for ensuring that boards provide the leadership which is expected of them is that of their chairman. Chairmen, however, have no legal position; they are whoever the board elects to take the chair at a particular meeting. Boards are not bound to continue with the same chairman for successive meetings. In law, all directors have broadly equal responsibilities and chairmen are no more equal than any other board member. Chairmen are an administrative convenience and a means of ensuring that board meetings are properly conducted.

Thus from a statutory point of view there is no necessity for a board to have a continuing chairman. The chairmanship could, for example, rotate among board members. Although board chairmen have no statutory position, the choice of who is to fill that post is crucial to board effectiveness. If the chairman is not up to the task, it is improbable that the meeting will achieve anything but frustration and waste of that most precious of resources—time. Continuity and competence of Chairmanship is vital to the contribution which boards make to their companies. The leaders which boards give to their companies, stems from the leadership which chairmen give to their boards.
The Chairman’s primary responsibility is for leading the Board and ensuring its effectiveness.

The role of the Chairman includes:

→ setting the Board agenda, ensuring that Directors receive accurate, timely and clear information to enable them to take sound decisions, ensuring that sufficient time is allowed for complex or contentious issues, and

→ encouraging active engagement by all members of the Board;

→ taking the lead in providing a comprehensive, formal and tailored induction programme for new Directors, and in addressing the development needs of individual Directors to ensure that they have the skills and knowledge to fulfill their role on the Board and on Board Committees;

→ evaluating annually the performance of each Board member in his/her role as a Director, and ensuring that the performance of the Board as a whole and its Committees is evaluated annually. Holding meetings with the non executive Directors without the executives being present;

→ ensuring effective communication with shareholders and in particular that the company maintains contact with its principal shareholders on matters relating to strategy, governance and Directors’ remuneration. Ensuring that the views of shareholders are communicated to the Board as a whole.

The main features of the role of chairman are as follows:

→ Being chairman of the board, he/she is expected to act as the company’s leading representative which will involve the presentation of the company’s aims and policies to the outside world;

→ to take the chair at general meetings and at board meetings. With regard to the latter this will involve:

→ the determination of the order of the agenda;

→ ensuring that the board receives proper information;

→ keeping track of the contribution of individual directors and ensuring that they are all involved in discussions and decision making. At all meetings the chairman should direct discussions towards the emergence of a consensus view and sum up discussions so that everyone understands what has been agreed;

→ to take a leading role in determining the composition and structure of the board. This will involve regular reviews of the overall size of the board, the balance between executive and non-executive directors and the balance of age, experience and personality of the directors.

The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

First proviso to Section 203 of the Companies Act, 2013 provides for the separation of role of Chairman and Chief Executive Officer subject to conditions thereunder.

Clause 49 further provides that in case the Chairman of the board in a non –executive director, at least one-third of the Board should comprise independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.
As per the Institute of Directors (IOD) (UK), the following are the responsibilities of a chairman

The chairman’s primary role is to ensure that the board is effective in its tasks of setting and implementing the company’s direction and strategy.

The chairman is appointed by the board and the position may be full-time or part-time. The role is often combined with that of managing director or chief executive in smaller companies. However, the joint role is considered to be less appropriate for public companies listed on the Stock Exchange.

10. Chief Executive Officer (CEO)

The Board appoints the CEO based on the criterion of his capability and competence to manage the company effectively. His main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, and acting as the main point of communication between the board of directors and the corporate operations. He is involved with every aspect of the company's performance. The CEO is supported and advised by a skilled board and CEO is ultimately accountable to the board for his actions. The most important skill of a CEO is to think strategically. His key role is leading the long term strategy and its implementation, it further includes:

→ Developing implementation plan of action to meet the competition and keeping in mind the long term existence of the company
→ Adequate control systems
→ Monitoring the operating and financial outcomes against the set plan
→ Remedial action
→ Keeping the Board informed

CEO should be able to, by the virtue of his ability, expertise, resources and authority keep the company prepared to avail the benefit of any change whether external or internal.

Separation of role of Chairman and Chief Executive Officer

It is perceived that separating the roles of chairman and chief executive officer (CEO) increases the effectiveness of a company’s board. This is also provided in the Section 203 of the Companies Act, 2013.

It is the board's and chairman's job to monitor and evaluate a company's performance. A CEO, on the other hand, represents the management team. If the two roles are performed by the same person, then it's an individual evaluating himself. When the roles are separate, a CEO is far more accountable.

A clear demarcation of the roles and responsibilities of the Chairman of the Board and that of the Managing Director/CEO promotes balance of power. The benefits of separation of roles of Chairman and CEO can be:

1. **Director Communication**: A separate chairman provides a more effective channel for the board to express its views on management
2. **Guidance**: A separate chairman can provide the CEO with guidance and feedback on his/her performance
3. **Shareholders’ interest**: The chairman can focus on shareholder interests, while the CEO manages the company
4. **Governance**: a separate chairman allows the board to more effectively fulfill its regulatory requirements

5. **Long-Term Outlook**: separating the position allows the chairman to focus on the long-term strategy while the CEO focuses on short-term profitability

6. **Succession Planning**: a separate chairman can more effectively concentrate on corporate succession plans.

11. **Company Secretary**

As per Section 2(24) of the Companies Act, 2013, “company secretary” or “secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

Under Section 2(60) of the Companies Act, the company secretary has also been included in the category of the officer of the company and shall be considered to be in default in complying with any provisions of the Companies Act, 2013

A Company Secretary, being a close confidante of the board will also be able to command confidence of individual directors so as to ensure that the culture of independence is promoted at the board and committee meetings and at the level of individual directors. Company Secretary:

- acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities
- plays a key role in ensuring that the Board procedures are followed and regularly reviewed
- provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations
- acts as a compliance officer as well as an in-house legal counsel to advise the Board and the functional departments of the company on various corporates, business, economic and tax laws
- is an important member of the corporate management team and acts as conscience seeker of the company

Section 2(51) of the Companies Act, 2013 defines KMP as “Key managerial personnel”, in relation to a company, means —

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer; and

(v) such other officer as may be prescribed.

In the light of provisions of Section 2(60) of Companies Act, 2013 Company Secretary is also an officer in default.

**Functions and Duties of a Company Secretary**

Section 205 of the Companies Act, 2013 prescribed that the functions of the company secretary shall include,—
(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;
(b) to ensure that the company complies with the applicable secretarial standards;
(c) to discharge such other duties as may be prescribed.

Explanation—For the purpose of this clause, the expression "secretarial standards" means secretarial standards issued by the Institute of Company Secretaries of India and approved by the Central Government.

Further, Rule 10 of the Companies (Appointment and Remuneration of managerial Personnel) Rules, 2014:-

- To guide the directors of the company regarding their duties, responsibilities and powers
- To facilitate the convening of meetings
- To attend Board Meetings, Committee Meetings and General Meetings
- To maintain minutes of the meetings
- To obtain the approvals from Board, General Meeting, Government and other authorities as required
- To represent before various regulators, and other authorities
- To assist the Board in the conduct of affairs of the company
- To assist and advise the Board in ensuring good corporate governance
- To assist and advise the Board in ensuring the compliance of corporate governance requirements and best practices
- To discharge such other duties as specified under the Act or rules
- To discharge such other duties as may be assigned by the Board from time to time

Appointment of Company Secretary

Section 203 (2) of Companies Act, 2013 provides that every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration. Rule 8 and 8A of companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

Rule 8 – Every listed company and every public company having paid up capital of 10 crore or more rupees shall have whole-time Key Managerial personnel.

Rule 8A – Companies other than covered under rule 8 which has paid up capital of 5 crore or more shall have a whole-time Company Secretary.

The Financial Aspects of Corporate Governance 1992 (Cadbury Report) lays that the company secretary has a key role to play in ensuring that board procedures are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board. It should be standard practice for the company secretary to administer, attend and prepare minutes of board proceedings.

BOARD COMPOSITION

Board composition is one of the most important determinants of board effectiveness. Beyond the legal requirement of minimum directors, a board should have a mix of inside and Independent Directors with a variety of experience and core competence. The potential competitive advantage of a Board structure constituted of executive directors and independent non-executive directors is in its combinations of – the depth of knowledge of the business of the executives and the breadth of experience of the non-executive/independent/outside director. Section 149 of Companies Act 2013, provides following in relation to Board Composition:
Every company shall have a Board of Directors consisting of individuals as directors and shall have—

(a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

(b) a maximum of fifteen directors:

Provided that a company may appoint more than fifteen directors after passing a special resolution:
Provided further that such class or classes of companies as may be prescribed, shall have at least one woman director.

(2) Every company existing on or before the date of commencement of this Act shall within one year from such commencement comply with the requirements of the provisions of sub-section (1).

(3) Every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year.

(4) Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Explanation.—For the purposes of this sub-section, any fraction contained in such one-third number shall be rounded off as one.

(5) Every company existing on or before the date of commencement of this Act shall, within one year from such commencement or from the date of notification of the rules in this regard as may be applicable, comply with the requirements of the provisions of sub-section (4).

Further, as per Section 151 of the Companies Act, 2013, a listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

Explanation- For the purpose of this section “small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes provisions related to appointment of small shareholders’ director

The Board Composition in the Indian context is governed by the Listing Agreement in case of listed companies. Clause 49 of the Listing Agreement mandates as under:

(i) The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive directors.

(ii) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

Provided that where the regular non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

Explanation: For the purpose of the expression “related to any promoter” referred to in sub-clause (2):

i. If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

ii. If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to
be related to it.

An aspect of Board structure which is fundamental but is very less visited is that of the **Board Size**. Board size is also an important determinant of board effectiveness. The size should be large enough to secure sufficient expertise on the board, but not so large that productive discussion is impossible.

**Provisions Regarding Meetings of the Board**

**Meetings of the Board: Section 173 of Companies Act, 2013**

Section 173 of the Act deals with Meetings of the Board

- The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.
- In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be a minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.
- In the case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days.

**Notice of Board Meetings**

The Act requires that not less than seven days’ notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.

In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

**Quorum for Board Meetings: Section 174**

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company. It shall not act for any other purpose.

For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted. If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.

**Requirements and Procedures for Convening and Conducting Board’s Meetings**

Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for the requirements and procedures, in addition to the procedures required for Board meetings in person, for convening and conducting Board meetings through video conferencing or other audio visual means:

1. Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.
(2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:
(a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;
(b) to ensure the availability of proper video conferencing or other audio visual equipment or facilities for
providing transmission of the communications for effective participation of the directors and other
authorized participants at the Board meeting;
(c) to record the proceedings and prepare the minutes of the meeting;
(d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism
as part of the records of the company at least before the time of completion of audit of that particular
year;
(e) to ensure that no person other than the concerned director are attending or have access to the
proceedings of the meeting through video conferencing mode or other audio visual means; and
(f) to ensure that participants attending the meeting through audio visual means are able to hear and
see the other participants clearly during the course of the meeting, but the differently abled persons,
may make request to the Board to allow a person to accompany him.

(3) (a) The notices of the meeting shall be sent to all the directors in accordance with the provisions of sub-
section (3) of section 173 of the Act.
(b) The notice of the meeting shall inform the directors regarding the option available to them to
participate through video conferencing mode or other audio visual means, and shall provide all the
necessary information to enable the directors to participate through video conferencing mode or other
audio visual means.
(c) A director intending to participate through video conferencing mode or audio visual means shall
communicate his intention to the Chairman or the company secretary of the company.
(d) If the director intends to participate through video conferencing or other audio visual means, he shall
give prior intimation to that effect sufficiently in advance so that company is able to make suitable
arrangement in this behalf.
(e) The director, who desire, to participate may intimate his intention of participation through the
electronic mode at the beginning of the calendar year and such declaration shall be valid for one
calendar year.
(f) In the absence of any such intimation from the director, it shall be assumed that the director will
attend the meeting in person.

(4) At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director
participating through video conferencing or other audio visual means shall state, for the record, the
following namely :
(a) name;
(b) the location from where he is participating;
(c) that he can completely and clearly see, hear and communicate with the other participants;
(d) that he has received the agenda and all the relevant material for the meeting; and
(e) that no one other than the concerned director is attending or having access to the proceedings of the
meeting at the location mentioned in (b) above.

(5) (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of
persons other than the directors who are present for the said meeting at the request or with the
permission of the Chairman and confirm that the required quorum is complete.

Explanation: It is clarified that a director participating in a meeting through video conferencing or other audio
visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of
business under any provisions of the Act or the Rules.

(b) The roll call shall also be made at the conclusion of the meeting and at the re-commencement of the
meeting after every break to confirm the presence of a quorum throughout the meeting.

(6) With respect to every meeting conducted through video conferencing or other audio visual means
authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening
the meeting, which shall be in India, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

(7) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

(8) (a) Every participant shall identify himself for the record before speaking on any item of business on the agenda.
(b) If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or company secretary shall request for a repeat or reiteration by the director.

(9) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.

(10) From the commencement of the meeting until the conclusion of such meeting, no person other than the Chairperson, directors, Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

(11) (a) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, dissented from the decision taken by majority.
(b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.

(12) (a) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.
(b) Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.
(c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

Explanation - For the purposes of this rule, ‘video conferencing or other audio visual means’ means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Matters not to be dealt with in a Meeting through Video Conferencing or other Audio Visual Means
Rule 4 prescribe restriction on following matters which shall not be dealt with in any meeting held through video conferencing or other audio visual means:

(i) the approval of the annual financial statements;
(ii) the approval of the Board’s report;
(iii) the approval of the prospectus;
(iv) the Audit Committee Meetings for consideration of accounts; and
(v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Penalty
Every officer of the company who is duty bound to give notice under this section if fails to do so shall be liable to a penalty of twenty five thousand rupees.
Compliance with Secretarial Standards relating to Board Meetings
For the first time in the history of Company Law in India, the Companies Act, 2013 has given statutory recognition to the Secretarial Standards issued by the Institute of Company Secretaries of India.

Section 118(10) of the Act reads as under:
Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

In the context of this provision, observance of Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI) assumes special relevance and companies will have to ensure that there is compliance with these standards on their part. The ICSI is in process to bring out the Secretarial Standards in line with Companies Act, 2013 and has already issued the exposure draft of Secretarial Standard related to Board and General Meeting.

Minutes of the Meeting
Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes.

Minutes kept shall be evidence of the proceedings recorded in a meeting.

Rule 25 of the Companies (Management and Administration) Rules, 2014 contains provisions with regards to minutes of meetings.

A distinct minute book shall be maintained for each type of meeting namely:
(i) general meetings of the members;
(ii) meetings of the creditors;
(iii) meetings of the Board; and
(iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer’s report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting. Each page of every such book shall be initialed or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting
within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the members may decide by passing special resolution pursuant to requirement of section 88 read with section 94 of the Act.

### Separate Meetings
Boards shall consider organizing separate meetings with independent directors to update them on all business-related issues and new initiatives. These meetings give an opportunity for independent directors for exchanging valuable views on the issues to be raised at the Board meetings. Such meetings are chaired by the independent non-executive Director or by senior/lead independent director. The outcome of the meeting is put forward at the Board meeting.

Schedule IV of the Companies Act, 2013 provides the following regarding separate meeting of the Independent Directors:

1. The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;
2. All the independent directors of the company shall strive to be present at such meeting;
3. The meeting shall:
   - review the performance of non-independent directors and the Board as a whole;
   - review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
   - assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Further, Clause 49 also mandates the separate meeting of independent directors for all the listed companies. The provisions given in the Companies Act and that in the Clause 49 regarding separate meeting are same.

### Directors Development Programme

<table>
<thead>
<tr>
<th>Training of Independent Directors – Revised Clause 49 of Listing Agreement</th>
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<tbody>
<tr>
<td>a. The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.</td>
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<tr>
<td>b. The details of such training imparted shall be disclosed in the Annual Report.</td>
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### Performance Review of Board & Individual Director

Proviso 2 to Section 178 of the Companies Act, 2013 provides that the Nomination and Remuneration Committee shall carry out evaluation of every director’s performance. Further, Schedule IV of the Companies Act, 2013 provides for the following evaluation mechanism of independent directors:

1. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.
2. On the basis of the report of performance evaluation, it shall be determined whether to extend or
continue the term of appointment of the independent director.

Section 134(2) (p) provides that in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors shall be included in the report by Board of Directors.

Revised Clause 49 of Listing Agreement provides following for the performance evaluation of independent directors:

a. The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.

b. The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.

c. The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).

d. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.
Lesson 5
BOARD COMMITTEES

LESSON OUTLINE

- Need and advantages of Committees Management
- Enhancing Effectiveness of Committees
- Mandatory committees:
  → Audit Committee
  → Nomination and Remuneration Committee
  → Stakeholders Relationship Committee
  → CSR Committee
3. Non Mandatory Committee
- Corporate Governance Committee
- Regulatory, Compliance and Government Affairs Committee
- Science Technology and Sustainability Committee
- Risk Management Committee
- Other Committees
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the Need and Advantages of management through board committees and the Constitution and scope of various Committees. After this study lesson, students would be able to understand the effective company management through the delegation of power and responsibilities to the board committees.

This study briefs about the Committees to be constituted mandatorily - Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and CSR Committee and non mandatory committees like Corporate Governance Committee, Science Technology and Sustainability Committee, Risk Management Committee, Regulatory, Compliance and Governmental Affairs Committee.

“Committees have become so important nowadays that subcommittees have to be appointed to do the work”

-Laurence J. Peter
INTRODUCTION

With the globalization and the blurring of the borders, the demands on the board have increased tremendously. The regulatory requirements are complex and the onus on the Board is immense. In this scenario the need to delegate oversight of certain areas to a specialist board committee has become imperative. However, it is to be remembered that even though the board delegates some of the responsibilities to a committee, the ultimate responsibility lies with the board.

Board committees with formally established terms of reference, criteria for appointment, life span, role and function constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. Committees enable better management of the board’s time and allow in-depth scrutiny and focused attention.

Since the Board of Directors is ultimately responsible for the acts of the committees, the role and structure of the board committees should be define with due care.

NEED AND ADVANTAGES OF COMMITTEES MANAGEMENT

Committees are a sub-set of the board, deriving their authority from the powers delegated to them by the board. Under section 177 of Companies Act, 2013, Board of Directors may delegate certain matters to the committees set up for the purpose. These committees are usually formed as a means of improving board effectiveness and efficiency in areas where more focused, specialized and technically oriented discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting.

In the present day, the regulatory requirement is such that the composition of the board comprising executive directors and non-executive independent directors is relatively large in number. In such a situation it becomes at times practically difficult to convene board meetings which suit the convenience and other commitments of each director. By having smaller committees this aspect also gets addressed effectively.

Committees allow the board to:

4. Handle a greater number of issues with greater efficiency by having experts focus on specific areas.
5. Develop subject specific expertise on areas such as compliance management, risk management and financial reporting.
6. Enhance the objectivity and independence of the Board’s judgment.

Greater specialization and intricacies of modern board work is one of the reasons for increased use of board committees. The reasons include:

- Responsibilities are shared.
- More members become involved.
- Specialized skills of members can be used to best advantage.
- Inexperienced members gain confidence while serving on the committee.
- Matters may be examined in more detail by a committee.

The committees focus accountability to known groups. While the board as a legal unit always retains responsibility for the work of its Committees, the committee because of its focus on the mandate and the smaller size tend to be more effective. It is important that there is clarity of delegation and it should be
ensured that committees are not put between the Board and the CEO, either by giving committees official instructional authority or by allowing them to evaluate performance using their own criteria.

**Clause 49 of Listing Agreement (Annexure X)** provides that minutes of meetings of audit committee and other committees of the board are to be placed before Board of Directors.

**ENHANCING EFFECTIVENESS OF COMMITTEES**

The following are the manifestations of an effective committee.

→ Committee Charter defining purpose of the committee.

→ Sensitivity to each other’s needs; good communication among all members.

→ Good preparation on part of the chair and members.

→ Access to independent professional advice when necessary.

→ Interested, committed members—Nomination to committees should be done taking into consideration the expertise, time commitment etc.

→ Minutes are complete and concise.

→ Periodic self assessment of committee’s performance.

→ Recognition and appreciation are given to members so that they feel they are really making a contribution.

→ The work of the committee is accepted and makes a valuable contribution to the organization.

**Membership In Committees**

**Clause 49 of Listing Agreement** provides that a director shall not be a member in more than ten 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.

**Explanation:**

1. For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 8 of the Companies Act, 2013 shall be excluded.

2. For the purpose of reckoning the limit under this sub-clause, Chairmanship/membership of the Audit Committee and the Shareholders Grievance Committee alone shall be considered.

**ICSI Recommendations to strengthen Corporate Governance** suggests that the limits reckoned on membership/chairmanship of committees should include all the committees of listed companies on which such director is a member, whether such committees are mandatory or not. This should be on a ‘comply’ or ‘explain’ basis.

**Various Committees of the Board**

The following are some of the important committees of the Board:

- Audit Committee
- Shareholders Grievance Committee
- Nomination and remuneration committee
- Corporate Social Responsibility committee
MANDATORY COMMITTEES
Clause 49 of the Listing Agreement applicable to all listed entities provides for constitution of mandatory committees.

Audit Committee
A key element in the corporate governance process of any organization is its audit committee. The purpose of constitution of this committee is to make it responsible for the oversight of the quality and integrity of the company’s accounting and reporting practices; controls and financial statements; legal and regulatory compliance; the auditor’s qualifications and independence; and the performance of company’s internal function. The committee functions as liaison between the board of directors and the auditors- external & internal.

Regulatory Framework:
The Regulatory Framework with regard to Audit Committee is covered under:
  a. Clause 49 of the Listing Agreement
  b. Section 177 of Companies Act, 2013

Clause 49
The regulatory framework, in terms of Clause 49 covers the following aspects:

- Composition
- Meetings
- Functions
  * Mandatory
  * Normal Role
- Powers
A. Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.

2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (i): The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3. The Chairman of the Audit Committee shall be an independent director;

4. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

5. 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;

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

B. Meeting of Audit Committee

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

C. 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.

D. Role of Audit Committee

The role of the Audit Committee shall include the following:

1. 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;

2. Recommendation for appointment, remuneration and terms of appointment of auditors of the company;

3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors;

4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
   a. Matters required to be included in the Director’s Responsibility Statement to be included in the Board’s report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013
   b. Changes, if any, in accounting policies and practices and reasons for the same
   c. Major accounting entries involving estimates based on the exercise of judgment by management
   d. Significant adjustments made in the financial statements arising out of audit findings
   e. Compliance with listing and other legal requirements relating to financial statements
   f. Disclosure of any related party transactions
   g. Qualifications in the draft audit report

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;

6. 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;

7. Review and monitor the auditor’s independence and performance, and effectiveness of audit process;

8. Approval or any subsequent modification of transactions of the company with related parties;

9. Scrutiny of inter-corporate loans and investments;

10. Valuation of undertakings or assets of the company, wherever it is necessary;

11. Evaluation of internal financial controls and risk management systems;

12. Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems;

13. 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;

14. Discussion with internal auditors of any significant findings and follow up there on;

15. 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;
16. 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;

17. 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;

18. To review the functioning of the Whistle Blower mechanism;

19. Approval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience and background, etc. of the candidate;

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

Explanation (i): The term "related party transactions" shall have the same meaning as provided in Clause 49(VII) of the Listing Agreement.

E. Review of information by Audit Committee

The Audit Committee shall mandatorily review 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.

Section 177 of the Companies Act, 2013

The Act has enlarged the responsibilities of auditors to include monitoring of auditors’ independence, valuation of their performance, approval of modification of related-party transactions, scrutiny of loans and investments, valuation of assets and evaluation of internal controls and risk management. They have to establish a vigil mechanism and protection for any whistle-blower. The members must be able to understand financial statements and have a majority of Independent Directors. Large companies must mandatorily have professional internal auditors.

1. The requirement of constitution of Audit Committee has been limited to:

   (a) Every listed Companies; or

   (b) The following class of companies –

      (i) all public companies with a paid up capital of ten crore rupees or more;

      (ii) all public companies having turnover of one hundred crore rupees or more;

      (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures; or deposits exceeding fifty crore rupees or more.

Explanation - The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into
account for the purposes of this rule.

2. The Committee shall comprise of minimum 3 directors with majority of the directors being Independent Directors. The majority of members of audit committee including its chairperson shall be person with ability to read and understand the financial statement.

3. A transition period of one year from the date on which the new Act comes into effect has been provided to enable companies to reconstitute the Audit Committee.

4. The terms of reference of the Audit Committee have now been specified and inter alia includes, -

   (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

   (ii) review and monitor the auditor’s independence and performance, and effectiveness of audit process;

   (iii) examination of the financial statement and the auditors’ report thereon;

   (iv) approval or any subsequent modification of transactions of the company with related parties;

   (v) scrutiny of inter-corporate loans and investments;

   (vi) valuation of undertakings or assets of the company, wherever it is necessary;

   (vii) evaluation of internal financial controls and risk management systems;

   (viii) monitoring the end use of funds raised through public offers and related matters.

5. The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

6. The audit committee hold the authority to investigate into matters or referred by the Board and have the powers to obtain professional advice from external sources and have full access to records of the company.

7. In addition to the auditor, the KMP shall also have a right to be heard in the meetings of the Audit Committee when it considers the auditor’s report, though they shall not have voting rights.

8. Every listed company and the companies belonging to the following class or classes shall establish a vigil mechanism for their directors and employees to report genuine concerns or grievances (Rule 7):-

   (1) The companies which accept deposits from the public;

   (2) The companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

9. The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee has a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.

10. In case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.
11. This vigil mechanism shall provide for adequate safeguards against victimization of employees and directors who avail of the vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases.

12. In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.

13. The Vigil Mechanism shall operate for directors and employees to enable them to bring to report genuine concerns. Further the said mechanism shall provide safeguards against victimization and provide for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

14. The details of establishment of the Vigil Mechanism is required to be disclosed by the company on its website, if any and in the Board’s report.

Default

If a default is made in complying with the provisions of section 177 of the Companies Act, 2013, the company and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to fifty thousand rupees or with both.

**Comparison between Clause 49 and Section 177 of the Companies Act, 2013**

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<th>Basis of difference</th>
<th>Requirements of Clause 49</th>
<th>Requirements of Section 177 of Companies Act</th>
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<tbody>
<tr>
<td>Applicability</td>
<td>The revised Clause 49 would be applicable to all listed companies with effect from October 01, 2014</td>
<td>The requirement of constitution of Audit Committee has been Limited to: (a) Every listed Companies; or (b) The following class of companies (i) all public companies with a paid up capital of ten crore rupees or more; (ii) all public companies having turnover of one hundred crore rupees or more; (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.</td>
</tr>
<tr>
<td>Composition</td>
<td>Minimum 3 directors as members. 2/3 of the members of audit committee shall be independent directors.</td>
<td>Comprising a minimum of 3 directors, with Independent Directors forming a majority. Majority of members of Audit Committee.</td>
</tr>
<tr>
<td>Qualification of committee members</td>
<td>All members shall be financially literate and at least one member shall have accounting expertise</td>
<td>Majority of members of Audit Committee including its Chairperson must have the ability to read and understand the financial statement.</td>
</tr>
<tr>
<td>Chairman</td>
<td>The Chairman shall be an independent director</td>
<td>Chairperson must have the ability to read and understand the financial statement.</td>
</tr>
<tr>
<td>Invitees</td>
<td>Auditors, internal auditor &amp; director-finance or other executives may be present as invitees</td>
<td>Auditors, internal auditor &amp; the director-finance shall attend &amp; participate at meetings of Audit Committee but shall not vote</td>
</tr>
<tr>
<td>Secretary</td>
<td>Company secretary to be secretary of the Audit Committee</td>
<td>No corresponding requirement</td>
</tr>
<tr>
<td>-----------</td>
<td>--------------------------------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Meeting</td>
<td>At least four times in a year and not more than four months shall elapse between two meetings</td>
<td>Nothing particular, it only states for periodical discussions with the auditors.</td>
</tr>
<tr>
<td>Quorum</td>
<td>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.</td>
<td>No corresponding requirement</td>
</tr>
</tbody>
</table>

**Chairman of audit committee shall be the Chief Executive Officer True or False?**

### Key practical aspects relating to Audit Committee

- Audit Committee to be completely independent – Ideally only independent directors to be part of the audit committee
- Audit Committee charter to be formalized & disclosed to shareholders in the Annual Report
- Private meetings should be held between the members of the Audit Committee
- Annual self appraisal of performance
- Communication with Board

**Audit Committee's primary responsibility**

- Integrity of financial reports and compliance of Internal control systems
- Enterprise risk management
- Compliance with laws
- Whistle-blowing process
- Related party transactions
- Creditor obligation defaults
- Senior management compensation, expense reimbursements and assets use

**Audit Committee's Enabling Responsibilities**

- “Own” the relationship with both auditors- Internal & Statutory
- Determine appointment
- Periodic appraisal
- All commercial relationships
Private meetings
Ensure independence from management influence
Planning & Structure of the audit
Code of conduct quality & enforcement.

**Nomination and Remuneration Committee**

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management’s and personnel’s remuneration and incentive schemes. The responsibilities of the Remuneration and Nomination Committee are defined in its policy document.

**Clause 49 of Listing Agreement**

In terms of the recently amended Clause 49 of the Listing Agreement which will take effect from October 1, 2014, companies are required to constitute Nomination and Remuneration Committee. The provisions with regard Nomination and Remuneration Committee is as under:

A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

B. The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;

2. Formulation of criteria for evaluation of Independent Directors and the Board;

3. Devising a policy on Board diversity;

4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders’ queries. However, it would be up to the Chairman to decide who should answer the queries.

**Section 178 of companies Act, 2013**

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management’s and personnel’s remuneration and incentive schemes.

Except for certain large listed companies, the importance of constitution of the Nomination and remuneration Committee has not been realised fully in India. The Board of directors of following companies shall constitute the Nomination and Remuneration Committee of the Board:

(a) Every listed Companies; or
(b) The following class of companies –

(i) all public companies with a paid up capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The committee shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors. The chairperson of the company may be appointed as member, but shall not chair such committee. The Committee shall identify the person qualified to become directors and may be appointed in senior management and recommend their appointment and removal and also carry out evaluation of every director. The Committee shall formulate the criteria, for determining qualifications, positive attributes and independence of a director and recommend to the Board the policy relating to remuneration for directors, KMPs and other employees.

While formulating its policy, the Nomination and Remuneration Committee shall ensure that

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate the directors

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks and

(c) remuneration to Directors, KMP and senior management involves a balance between fixed and incentive pay reflecting short and long term performance objectives which are suited to the working of the company and its objectives.

The Nomination and Remuneration Committee shall, while formulating the policy under sub-section (3) ensure that—

- the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

- relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

- remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals: Provided that such policy shall be disclosed in the Board’ report. Be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

**Duties of the Nomination and Remuneration Committee**

The duties of the Nomination and Remuneration Committee have now been specified. They include:

a) identifying persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down;

b) recommend to the Board their appointment and removal;

c) carry out evaluation of every Director’s performance;
d) formulate the criteria for determining qualifications, positive attributes and independence of a Director and
e) recommend to the Board a policy, relating to the remuneration for the Directors, KMP and other employees.

**The Stakeholders Relationship Committee**

**The Stakeholders Relationship Committee – Clause 49**
Clause 49 of Listing Agreement mandates a committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

**The Stakeholders Relationship Committee – Under Companies Act, 2013**
Section 178(5) of the Companies Act, 2013 provides for constitution of the Stakeholders Relationship Committee. The Board of a company that has more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is required to constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company. Who can attend the general meeting of the company on behalf of committee constituted under this section? The chairperson of each of the committees constituted under this section or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

**Corporate Social Responsibility Committee**
The evolution of corporate social responsibility in India refers to changes over time in India of the cultural norms of company’s engagement of Corporate Social Responsibility (CSR), with CSR referring to way that businesses are managed to bring about an overall positive impact on the communities, cultures, societies and environments in which they operate. The fundamentals of CSR rest on the fact that not only public policy but even corporate should be responsible enough to address social issues. Thus companies should deal with the challenges and issues looked after to a certain extent by the states.

Among other countries, India has one of the richest traditions of CSR. Much has been done in recent years to make Indian entrepreneurs aware of social responsibility as an important segment of their business activity but CSR in India has yet to receive widespread recognition. If this goal has to be realised then the CSR approach of corporate has to be in line with their attitudes towards mainstream business- companies setting clear objectives, undertaking potential investments, measuring and reporting performance publicly.

As discussed above, CSR is not a new concept in India. Ever since their inception, large corporate houses in India have been involved in serving the community. Through donations and charity events, many other organizations have been doing their part for the society. The basic objective of CSR in these days is to maximize the company’s overall impact on the society and stakeholders. CSR policies, practices and programs are being comprehensively integrated by an increasing number of companies throughout their business operations and processes.

A growing number of corporate feel that CSR is not just another form of indirect expense but is important for protecting the goodwill and reputation, defending attacks and increasing business competitiveness.
Companies have specialised CSR teams that formulate policies, strategies and goals for their CSR programs and set aside budgets to fund them. These programs are often determined by social philosophy which have clear objectives and are well defined and are aligned with the mainstream business.

The programs are put into practice by the employees who are crucial to this process. CSR programs ranges from community development to development in education, environment and healthcare etc. Provision of improved medical and sanitation facilities, building schools and houses, and empowering the villagers and in process making them more self-reliant by providing vocational training and a knowledge of business operations are the facilities that many companies focus on. Also corporate increasingly join hands with NGOs and use their expertise in devising programs which address wider social problems. One of the key changes in the Companies Act, 2013 is the introduction of a Corporate Social Responsibility section making India the first country to mandate CSR through a statutory provision. While CSR is not mandatory for companies, the rules are in line with the ‘Comply or Explain’ principle with penalties applicable only if an explanation is not offered.

The provisions of the Section may be summarized as under:

1. The Section applies to the following classes of companies during any financial year:
   
   (i) Companies having Net Worth of rupees five hundred crore or more;
   
   (ii) Companies having turnover of rupees one thousand crore or more;
   
   (iii) Companies having Net Profit of rupees five crore or more.

2. The companies specified above shall constitute a Corporate Social Responsibility Committee (CSR Committee) of the Board.

3. The CSR Committee shall consist of three or more Directors, out of which at least one Director shall be an Independent Director.

4. After taking into account the recommendations of the CSR Committee, the Board shall approve the CSR Policy for the company.

5. The contents of the Policy shall be disclosed in the Board’s report.

6. It shall also be placed on the Company’s website, if any, in a manner to be prescribed by the Central Government.

7. The Board shall ensure that the activities as are included in the CSR Policy (from the activities as specified in Schedule VII) are undertaken by the Company.

The following additional features of the Section are relevant:

1. While spending the amount earmarked for CSR activities, the company shall give preference to the local area and areas around it where it operates;

2. If the Company fails to spend the amount, the Board shall specify the reasons for not spending the amount in the Board’s Report.

3. The eligible companies are required to spend in every financial year, at least two per cent of the Average Net Profits of the Company made during the three immediately preceding financial years in pursuance of its CSR Policy. For this purpose, “Average Net Profit” shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.
NON-MANDATORY COMMITTEES

A company may have as many non-mandatory companies as it would require for efficient oversight of the company. We will discuss about the committees which are generally constituted by corporate.

In addition to the Committees of the Board mandated by the Companies Act, 2013 viz, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and the CSR Committee, Board of Directors may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives of the company. A few examples of such Committees prevalent in the corporate sector in India and abroad are given below:

Corporate Governance Committee

The Corporate Governance Committee is responsible for considering and making recommendations to the Board concerning the appropriate size, functions and needs of the Board. The Corporate Governance Committee may, at its sole discretion, engage director search firms and has the sole authority to approve the fees and other retention terms with respect to any such firms. The Corporate Governance Committee also has the authority, as necessary and appropriate, to consult with other outside advisors to assist in its duties to the Company.

A company may constitute this Committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company. Many companies give the mandate of corporate governance to nomination committee and are given the nomenclature Nomination and Corporate Governance Committee.

Typically, the committee is responsible for considering matters relating to corporate governance including the composition of board, appointment of new directors, review of strategic human resource decisions, succession planning for the chairman and other key board and executive positions, performance evaluation of the board and its committees and individual directors.

Regulatory, Compliance & Government Affairs Committee

The primary objective of the Compliance Committee is to review, oversee, and monitor:

- the Company’s compliance with applicable legal and regulatory requirements,
- the Company’s policies, programs, and procedures to ensure compliance with relevant laws, the Company’s Code of Conduct, and other relevant standards;
- the Company’s efforts to implement legal obligations arising from settlement agreements and other similar documents; and
- perform any other duties as are directed by the Board of Directors of the company.

It consists of non-employee directors, determined to be “independent” under the listing standards of the New York Stock Exchange:

- Oversees the Company’s non-financial compliance programs and systems with respect to legal and regulatory requirements.
- Oversees compliance with any ongoing Corporate Integrity Agreements or any similar undertakings by the Company with a government agency.
- Reviews the organization, implementation and effectiveness of the Company’s health care compliance &
ethics and quality & compliance programs.
— Oversees the Company’s Policy on Business Conduct and Code of Business Conduct & Ethics for Members of the Board of Directors and Executive Officers.
— Reviews the Company’s governmental affairs policies and priorities and other public policy issues facing the Company.
— Reviews the policies, practices and priorities for the Company’s political expenditure and lobbying activities.

**Science, Technology & Sustainability Committee**

It is composed of non-employee Directors, determined to be “independent” under the listing standards of the New York Stock Exchange. It:

— Monitors and reviews the overall strategy, direction and effectiveness of the Company’s research and development.
— Serves as a resource and provides input, as needed, regarding the scientific and technological aspects of product safety matters.
— Reviews the Company’s policies, programs and practices on environment, health, safety and unsustainability.
— Assists the Board in identifying and comprehending significant emerging science and technology policy and public health issues and trends that may impact the Company’s overall business strategy.
— Assists the Board in its oversight of the Company’s major acquisitions and business development activities as they relate to the acquisition or development of new science or technology.

**Risk Management Committee**

A company needs to have a proactive approach to convert a risk into an opportunity. A business is exposed to various kind of risk such as strategic risk, data security risk, fiduciary risk, credit risk, liquidity risk, reputational risk, environmental risk, competition risk, fraud risk, technological risk etc. It is important for the company to have a structured framework to satisfy that it has sound policies, procedures and practices are in place to manage the key risks under risk framework of the company. A risk management Committee’s role is to assist the Board in establishing risk management policy, overseeing and monitoring its implementation.

The committee shall be constituted with at least three directors, majority being independent directors.

**Major functions include:**

- e. Assisting the Board in fulfilling its corporate governance oversight responsibilities with regard to identification, evaluation and mitigation of operational, strategic and external environment risks.
- f. To ensure that management has instituted adequate process to evaluate major risks faced by the company
- g. Establishing the role and responsibilities of officers/team who shall be responsible for:
  - a. Facilitating the execution of risk management practices in the enterprise
  - b. Reviewing enterprise risks from time to time, initiating mitigation actions, identifying owners and reviewing progress
  - c. Reporting risk events and incidents in a timely manner
- h. Monitoring and reviewing risk management practices of the Company
i. Reviewing and approving risk-related disclosures.

The recently amended Clause 49 of the Listing Agreement requires as under:

A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit. The provisions of (C) above shall be applicable to top 100 listed companies by market capitalization as at the end of the immediate previous financial year

**OTHER COMMITTEES**

Companies depending upon the need may have more committees like:

- Strategies Committee
- Capital Expenditure (Capex) Committee.
- HR Committee
- Project Appraisal Committee
Lesson 6
Legislative Framework of Corporate Governance in India

BOARD STRUCTURE

Size
The Board structure in India is unitary. Section 149 (1) of the Companies Act, 2013 contains provisions regarding the composition of board of directors. It stipulates the minimum number of director as three in case of public company, two in case of private company and one in case of One Person Company. The maximum number of directors stipulated is 15. However, a company may appoint more than 15 directors after passing a special resolution in General Meeting. It may be noted that approval of Central Government is not required. The Listing Agreement does not stipulate on the size of the board.

Composition

Independent Director
Section 149(4) provides that every public listed Company shall have at-least one –third of total number of directors as independent directors and Central Government may further prescribe minimum number of independent directors in any class or classes of company.

With respect to the minimum number of Independent directors, Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes that the following class or classes of companies shall have at least two independent directors:

- Public Companies having paid-up share capital of 10 crore rupees or more; or
- Public Companies having turnover of 100 crore rupees or more; or
- Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

Provided that in case of companies covered under this rule shall appoint a higher number of independent directors as required due to composition of its audit committee. Further, a company belonging to any class of companies for which a higher number of independent directors has been stipulated in a law for the time being in force shall comply with the requirements stipulated in such law.

Woman Director

Proviso 2 to Section 149 provides that such class or classes of companies as may be prescribed in Rules shall have at least one woman director.

With regard to this, Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes that the following class of companies shall have at least one woman director:

- Every Listed Company;
- Every other public Company having:
  - Paid-up capital of 100 crore rupees or more; or
  - Turnover of 300 crore rupees or more

Resident Director

Third proviso to Section 149 provides that every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year.
Detailed provisions related to Directors are discussed in Lesson Board Effectiveness-Issues and Challenges.

Clause 49(II) (A) of the Listing Agreement contains provisions related to the composition Board of Directors. It provides that The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive directors.

Clause 49 further provides that in case the Chairman of the board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

Provided that where the regular non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

### Number of Directorship

Section 165 stipulates that a person cannot hold office at the same time as director (including any alternate directorship) in more than 20 companies. Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten.

For reckoning the limit of public companies in which a person can be appointed as director, directorship in private companies that are either holding or subsidiary company of a public company shall be included.

The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as directors.

Clause 49 of the Listing Agreement provides that a director shall not be a member in more than ten committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore, every director shall inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Clause 49 also provides that a person shall not serve as an independent director in more than seven listed companies. Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

### Separation of Roles of Chairman and Chief Executive

First proviso to Section 203 provides for the separation of role of Chairman and Chief Executive Officer subject to conditions thereunder. It provides that an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless:-

(a) The Articles of such a company provide otherwise; or

(b) The company does not carry multiple business

Separation of roles is instrumental in determining the composition of the Board in terms of Listing Agreement, depending upon executive or non-executive Chairman.

### Meetings of the Board

Section 173 of the Act deals with Meetings of the Board and Section 174 deals with quorum.

1. The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.
2. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

3. In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days.

The Act requires that not less than seven days’ notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means. In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted.

Clause 49 of the Listing Agreement provides that the Board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

**Powers of the Board**

In terms Section 179 of the Companies Act, 2013 the Board of directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorized to exercise and do. The Board shall not exercise any power or do any act or thing which is required, whether by this or any other Act or by the memorandum or articles of the company, to be exercised or done by the company in general meeting.

Section 179 of the Act deals with the powers of the board; all powers to do such acts and things for which the company is authorized is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting. The following (section 179(3) and Rule 8) powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely:-

1. to make calls on shareholders in respect of money unpaid on their shares;
2. to authorise buy-back of securities under section 68;
3. to issue securities, including debentures, whether in or outside India;
4. to borrow monies;
5. to invest the funds of the company;
6. to grant loans or give guarantee or provide security in respect of loans;
7. to approve financial statement and the Board’s report;
8. to diversify the business of the company;
9. to approve amalgamation, merger or reconstruction;
10. to take over a company or acquire a controlling or substantial stake in another company;
(11) to make political contributions;
(12) to appoint or remove key managerial personnel (KMP);
(13) to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;
(14) to appoint internal auditors and secretarial auditor;
(15) to take note of the disclosure of director’s interest and shareholding;
(16) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid–up share capital and free reserves of the investee company;
(17) to invite or accept or renew public deposits and related matters;
(18) to review or change the terms and conditions of public deposit;
(19) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify.

The banking company is not covered under the purview of this section. The company may impose restriction and conditions on the powers of the Board.

Section 180 imposes restrictions on the powers of the Board. It provides that the board can exercise the following powers only with the consent of the company by special resolution:–

(a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings;

(b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company’s bankers in the ordinary course of business;

(d) to remit, or give time for the repayment of, any debt due from a director. The special resolution relating to borrowing money exceeding paid up capital and free reserves specify the total amount up to which the money may be borrowed by Board. The title of buyer or the person who takes on leases any property, investment or undertaking on good faith cannot be affected and also in case if such sale or lease covered in the ordinary business of such company. The resolution may also stipulate the conditions of such sale and lease, but this doesn’t authorise the company to reduce its capital except the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital and free reserves is not valid and effectual, unless the lender proves that the loan was advanced on good faith and also having no knowledge of limit imposed had been exceeded Powers of the Board are not spelt out in Listing Agreement. However, it provides for the responsibilities and functions of the board.
BOARD COMMITTEES

**Audit Committees**
Section 177 of the Companies Act, 2013 has enlarged the responsibilities of auditors to include monitoring of auditors’ independence, evaluation of their performance, approval of modification of related-party transactions, scrutiny of loans and investments, valuation of assets and evaluation of internal controls and risk management. The members must be able to understand financial statements and have a majority of Independent Directors. Large companies must mandatorily have professional internal auditors. Further, in case of Listed Companies, their compliance shall be in accordance with the Corporate Governance provisions enshrined in Clause 49 of the Listing Agreement.

**Nomination and Remuneration Committees:**
The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, to management’s and personnel’s remuneration and incentive schemes. The responsibilities of the Remuneration and Nomination Committee are defined in its policy document. Section 178 of the Act deals with provisions related to the aforementioned committee. Clause 49 of the Listing agreement also provides for mandatory constitution of Nomination and Remuneration Committee.

**Stakeholders Relationship Committee**
Section 178(5) of the Companies Act, 2013 provides for constitution of the Stakeholders Relationship Committee. Further, under Listing Agreement, a committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends. Clause 49 (VIII) (E) of the Listing Agreement provides that Stakeholders Relationship Committee, under the Chairmanship of non-executive director shall be constituted to look into and redress the grievances of shareholders, debenture holders and other security holders.

**Corporate Social Responsibility Committee**
Section 135 of the Companies Act, 2013 provides that companies specified in the said section shall constitute a Corporate Social Responsibility Committee (CSR Committee) of the Board. Further Listing Agreement also mandates the constitution of CSR committees for certain companies.

Apart from the above mandatory committees, Board of Directors may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives of the company. The detailed provisions regarding various committees under Companies Act and Listing Agreement are dealt in detail in Lesson Board Committees.

DISCLOSURE AND TRANSPARENCY

1. **IN TERMS OF COMPANIES ACT, 2013**
In terms of Companies Act, 2013 the aspect of disclosure and transparency spans over several sections.

   A. **Disclosures Under Section 134 of Companies Act 2013**
Section 134(3) Provides that there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—

- the extract of the annual return as provided under Section 92(3)
- (b) number of meetings of the Board;
- (c) Directors’ Responsibility Statement
- (d) a statement on declaration given by independent directors under section 149(6)
- (e) in case of a company covered under sub-section (1) of section 178, company’s policy on directors’ appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters as given under sub-section (3) of section 178.
- (f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—
  - (i) by the auditor in his report; and
  - (ii) by the company secretary in practice in his secretarial audit report.
- (g) particulars of loans, guarantees or investments under section 186.
- (h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form.
- (i) the state of the company’s affairs.
- (j) the amounts, if any, which it proposes to carry to any reserves.
- (k) the amount, if any, which it recommends should be paid by way of dividend.
- (l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report.
- (m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed.
- (n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.
- (o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year.
- (p) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;
- (q) such other matters as may be prescribed.

Section 134(5) referred to in clause (c) section 134(3) shall state that—

- (a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- (b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;
- (c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- (d) the directors had prepared the annual accounts on a going concern basis; and
- (e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation to clause (e) defines the term “internal financial controls as the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

- (f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.
B. Disclosures Under other Sections of Companies Act 2013

Provison to section 178(4) states that the board’s Report shall disclose the policy according to which The Nomination and Remuneration Committee ensure that:

a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully.
b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
c) Remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its

As per section 149(10) an independent director shall be eligible to reappointment on passing of a special resolution and disclosure of such appointment in the board's report. [Subject to the provision of 152]

Under section 177(8), Board’s Report shall disclose the composition of audit committee and also discloses the recommendation of the audit committee which is not accepted by the board along with reason thereof.

Proviso to section 177(10) prescribes that the disclosure in board’s report includes the detail of establishment of vigil mechanism under section 177(9).

With the e-filing of forms with the Registrar of Companies, The Ministry of Corporate Affairs has put in place a mechanism that is imaginative, technologically savvy and stakeholder friendly. Through the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance, the MCA aims at moving from paper based to nearly paperless environment.

As per section 204(1) every listed company and other prescribed companies in Rule 9 Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 shall annex the secretarial audit report given by a Company Secretary in practice with Board’s Report. Board in its report shall explain any qualification or other remarks made by the Company Secretary in Practice.

Section 135(2) provides that the Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

Section 134(8) states that if a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakhs rupees. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees, or with both

2. IN TERMS OF VARIOUS RULES MADE UNDER COMPANIES ACT, 2013

A. Companies (Accounts) Rules, 2014

As per Rule 8 of Companies (Accounts) Rules 2014 following matters to be disclose in the Board’s Report:-

(1) The Board’s Report shall be prepared based on the stand alone financial statements of the company and the report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented.

(2) The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2.
(3) The report of the Board shall contain the following information and details, namely:

(A) Conservation of energy- the capital investment on energy conservation equipments, the steps taken for conservation of energy and utilising alternate sources of energy and the impact thereon

(B) Technology absorption- the efforts made towards technology absorption, expenditure incurred on R&D, the benefits derived, in case of imported technology; the details about year of import, absorption of technology imported.

(C) Foreign exchange earnings and Outgo- actual inflows and outgo during the year.

(4) Every listed company and every other public company having a paid up share capital of twenty five crore rupees or more calculated at the end of the preceding financial year shall include, in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.

(5) In addition to the information and details specified in sub-rule (4), the report of the Board shall also contain –

(i) the financial summary or highlights;
(ii) the change in the nature of business, if any;
(iii) the details of directors or key managerial personnel who were appointed or have resigned during the year;
(iv) the names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;
(v) the details relating to deposits, covered under Chapter V of the Act
(vi) the details relating to deposits, not in compliance with Chapter V of the Act.
(vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company’s operations in future.
(viii) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

B. Companies( Share Capital and Debenture) Rules, 2014

The Board of Directors shall, *inter alia*, disclose details regarding issue of shares with differential rights in the Board’s Report for the financial year in which the issue of equity shares with differential rights was completed.

As per sub rule (13) of rule 8 the Board of Directors shall, *inter alia*, disclose details about the issue of sweat equity shares in the Directors’ Report for the year in which such shares are issued.

As per the rule 12(9) of Companies (Share Capital and Debenture) Rules 2014, the Board of directors, shall, *inter alia*, disclose details of the Employees Stock Option Scheme in the Directors’ Report for the year.

When the voting rights are not exercised directly by the employees in respect of shares to which the scheme relates, the Board of Directors shall, inter alia, disclose in the Board’s report for the relevant financial year Disclosures shall be made in terms of Rule 16(4) Companies (Share Capital and Debentures) Rules, 2014

C. Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014

Rule 5(1) of Companies (Appointment & Remuneration) Rules, 2014 made under Chapter IV provides the following disclosure by the listed companies in the Board’s Report:-
(i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;
(ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;
(iii) the percentage increase in the median remuneration of employees in the financial year;
(iv) the number of permanent employees on the rolls of company;
(v) the explanation on the relationship between average increase in remuneration and company performance;
(vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;
(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;
(viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;
(ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of the company;
(x) the key parameters for any variable component of remuneration availed by the directors;
(xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and
(xii) affirmation that the remuneration is as per the remuneration policy of the company.

Rule 5(2) of Companies (Appointment and Remuneration) Rules, 2014 made under Chapter IV provides the following disclosure on particulars of employees:-

The board’s report shall include a statement showing the name of every employee of the company, who-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty lakh rupees;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than five lakh rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

The statement referred to in sub-rule (2) shall also indicate -

(i) designation of the employee;

(ii) remuneration received;

(iii) nature of employment, whether contractual or otherwise;

(iv) qualifications and experience of the employee;

(v) date of commencement of employment;

(vi) the age of such employee;
(vii) the last employment held by such employee before joining the company;
(viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and
(ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Proviso (i) says that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board’s report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Proviso (ii) says that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Proviso (iii) says that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

D. Companies (Corporate Social Responsibility) Rules, 2014

Rule 8 of Companies (Corporate Social Responsibility) Rules, 2014 prescribes that the following CSR reporting:

- The Board’s Report of a company under these rules pertaining to a financial year commencing on or after 1st day of April, 2014 shall include an Annual Report on CSR containing particulars specified in Annexure.
- In case of a foreign company, the balance sheet filed under section 381(1) (a) shall contain an Annexure regarding report on CSR.

Disclosures: Under Companies Act, 2013, the companies are required to make certain disclosures in the annual return and director’s report.

3. IN TERMS OF LISTING AGREEMENT

Clause 35B
- The issuer (company) shall provide e-voting facility to its shareholders, in respect of all shareholders’ resolutions, to be passed at General Meetings or through postal ballot. Such e-voting facility shall be kept open for such period specified under the Companies (Management and Administration) Rules, 2014 for shareholders to send their assent or dissent.
- Issuer shall continue to enable those shareholders, who do not have access to e-voting facility, to send their assent or dissent in writing on a postal ballot as per the provisions of the Companies (Management and Administration) Rules, 2014 or amendments made thereto.
- Issuer shall utilize the service of any one of the agencies providing e-voting platform, which is in compliance with conditions specified by the Ministry of Corporate Affairs, Government of India, from time to time.
- Issuer shall mention the Internet link of such e-voting platform in the notice to their shareholders.
Clause 49
SEBI requires the Listed companies to include a separate report on Corporate Governance in their Annual Report by including Clause 49 in the Listing Agreement (Text of Clause 49 is placed as Annexure). The disclosures about Corporate Governance to be made in the Annual Report are as under:

1. Disclosures on mandatory requirements
2. Disclosure on non-mandatory requirements

Disclosures on mandatory requirements

Clause 49 (I) (C) of the Listing agreement provides for the Disclosure and Transparency
1. The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.

a. Information should be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

b. Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.

c. The company should maintain minutes of the meeting explicitly recording dissenting opinions, if any.

d. The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

A. Related Party Transactions

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.

2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

B. Disclosure of Accounting Treatment

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

C. Remuneration of Directors

1. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.

2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:

- All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
- Details of fixed component and performance linked incentives, along with the performance criteria.
- Service contracts, notice period, severance fees.
Stock option details, if any - and whether issued at a discount as well as the period over which accrued and over which exercisable.

3. The company shall publish 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.

4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.

5. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

D. Management

1. As part of the directors’ report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company’s competitive position:
   
   a. Industry structure and developments.
   b. Opportunities and Threats.
   d. Outlook
   e. Risks and concerns.
   f. Internal control systems and their adequacy.
   g. Discussion on financial performance with respect to operational performance.
   h. Material developments in Human Resources / Industrial Relations front, including number of people employed.

2. Senior management shall make 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.)

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding the Board of Directors). This would also include all members of management one level below the executive directors including all functional heads.

3. The Code of Conduct for the Board of Directors and the senior management shall be disclosed on the website of the company.

E. Shareholders

1. In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:
   
   a. A brief resume of the director;
(b) Nature of his expertise in specific functional areas;

c. Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and

d. Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v) above

2. Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.

3. Quarterly results and presentations made by the company to analysts shall be 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 web-site.

4. A committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

5. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

F. Disclosure of resignation of directors

1. The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation.

2. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.

G. Disclosure of formal letter of appointment

1. The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.

H. Disclosures in Annual report

1. The details of training imparted to Independent Directors shall be disclosed in the Annual Report.

2. The details of establishment of vigil mechanism shall be disclosed by the company on its website and in the Board’s report.

3. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

I. Proceeds from public issues, rights issue, preferential issues, etc.

When money is raised through an issue (public issues, rights issues, preferential issues etc.), the company
shall disclose the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results to the Audit Committee. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

As per Clause 54 of the listing agreement the company shall maintain a functional website containing basic information about the company e.g. details of its business, financial information, shareholding pattern, compliance with corporate governance, contact information of the designated officials of the company who are responsible for assisting and handling investor grievances, details of agreements entered into with the media companies and/or their associates, etc. The company also ensures that the contents of the said website are updated at any given point of time.

**Report on Corporate Governance**

Clause 49(X) of the Listing agreement provides that 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 companies shall submit a quarterly compliance report in prescribed format to the stock exchanges within 15 days from the close of quarter. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

**Disclosures on non-mandatory requirements**

These requirements may be implemented at the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance)/non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

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.

2. **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.

- **Audit qualifications** - Company may move towards a regime of unqualified financial statements.

4. **Separate posts of Chairman and CEO** - The company may appoint separate persons to the post of Chairman and Managing Director/CEO.

5. **Reporting of Internal Auditor** - The Internal auditor may report directly to the Audit Committee.

**Clause 52**

Corporate Filing and Dissemination System (CFDS), viz., www.corpfiling.co.in to file on the CDFS, such information, statements and reports as may be specified by the Participating Stock Exchanges in this regard.
within the time limit specified in the respective clause of the listing agreement.

Clause 55

Securities Exchange Board of India (SEBI) vide circular CIR/CFD/DIL/8/2012 dated August 13, 2012 inserted a new Clause 55 in the listing agreement by mandating inclusion of Business Responsibility (BR) Reports as part of the Annual Reports for listed entities. As per the circular the requirement to include BR Reports as part of the Annual Reports shall be mandatory for top 100 listed entities based on market capitalisation at BSE and NSE as on March 31, 2012. Other listed entities may voluntarily disclose BR Reports as part of their Annual Reports.

The Clause 55 prescribed that listed entities shall submit, as part of their Annual Reports, Business Responsibility Reports, describing the initiatives taken by them from an environmental, social and governance perspective, in the prescribed format.

4. DISCLOSURES IN TERMS OF SEBI REGULATIONS

C. Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992

Disclosure of interest or holding by directors and officers and substantial shareholders in listed companies - Initial Disclosure. (Regulation 13)

(1) Any person who holds more than 5% shares or voting rights in any listed company shall disclose to the company in the prescribed form, the number of shares or voting rights held by such person, on becoming such holder, within 2 (two) working days of:—

   (a) the receipt of intimation of allotment of shares; or

   (b) the acquisition of shares or voting rights, as the case may be.

(2) Any person who is a director or officer of a listed company shall disclose to the company in the prescribed form, the number of shares or voting rights held and positions taken in derivatives by such person and his dependents, within 2 working days of becoming a director or officer of the company.

ANNEXURE

Revised Clause 49 of the Listing Agreement

I. The company agrees to comply with the provisions of Clause 49 which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below. In case of any ambiguity, the said provisions shall be interpreted and applied in alignment with the principles.

A. The Rights of Shareholders

1. The company should seek to protect and facilitate the exercise of shareholders’ rights.

   a. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes.

   b. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings.

   c. Shareholders should be informed of the rules, including voting procedures that govern general shareholder meetings.

   d. Shareholders should have the opportunity to ask questions to the board, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
e. Effective shareholder participation in key Corporate Governance decisions, such as the nomination and election of board members, should be facilitated.

f. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

g. The Company should have an adequate mechanism to address the grievances of the shareholders.

h. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

2. The company should provide adequate and timely information to shareholders.

a. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

b. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

c. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase.

3. The company should ensure equitable treatment of all shareholders, including minority and foreign shareholders.

a. All shareholders of the same series of a class should be treated equally.

b. Effective shareholder participation in key Corporate Governance decisions, such as the nomination and election of board members, should be facilitated.

c. Exercise of voting rights by foreign shareholders should be facilitated.

d. The company should devise a framework to avoid Insider trading and abusive self-dealing.

e. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders.

f. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Role of stakeholders in Corporate Governance

1. The company should recognise the rights of stakeholders and encourage co-operation between company and the stakeholders.

a. The rights of stakeholders that are established by law or through mutual agreements are to be respected.

b. Stakeholders should have the opportunity to obtain effective redress for violation of their rights.

c. Company should encourage mechanisms for employee participation.

d. Stakeholders should have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in Corporate Governance process.

e. The company should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

C. Disclosure and transparency

1. The company should ensure timely and accurate disclosure on all material matters including the
financial situation, performance, ownership, and governance of the company.

a. Information should be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

b. Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.

c. The company should maintain minutes of the meeting explicitly recording dissenting opinions, if any.

d. The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

D. Responsibilities of the Board

1. Disclosure of Information

a. Members of the Board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the company.

b. The Board and top management should conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture for good decision-making.

2. Key functions of the Board

The board should fulfill certain key functions, including:

a. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestments.

b. Monitoring the effectiveness of the company’s governance practices and making changes as needed.

c. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

d. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.

e. Ensuring a transparent board nomination process with the diversity of thought, experience, knowledge, perspective and gender in the Board.

f. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

g. Ensuring the integrity of the company’s accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

h. Overseeing the process of disclosure and communications.

i. Monitoring and reviewing Board Evaluation framework.

Other responsibilities

a. The Board should provide the strategic guidance to the company, ensure effective monitoring of the management and should be accountable to the company and the shareholders.
b. The Board should set a corporate culture and the values by which executives throughout a group will behave.

c. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

d. The Board should encourage continuing directors training to ensure that the Board members are kept up to date.

e. Where Board decisions may affect different shareholder groups differently, the Board should treat all shareholders fairly.

f. The Board should apply high ethical standards. It should take into account the interests of stakeholders.

g. The Board should be able to exercise objective independent judgment on corporate affairs.

h. Boards should consider assigning a sufficient number of non-executive Board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest.

i. The Board should ensure that, while rightly encouraging positive thinking, these do not result in over-optimism that either leads to significant risks not being recognised or exposes the company to excessive risk.

j. The Board should have ability to ‘step back’ to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the company's focus.

k. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

l. Board members should be able to commit themselves effectively to their responsibilities.

m. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

n. The Board and senior management should facilitate the Independent Directors to perform their role effectively as a Board member and also a member of a committee.

II. Board of Directors

A. Composition of Board

1. The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive directors.

2. Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

Provided that where the regular non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

Explanation: For the purpose of the expression “related to any promoter” referred to in sub-clause (2):

i. If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

ii. If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.”
B. Independent Directors

1. For the purpose of the clause A, the expression ‘independent director’ shall mean a non-executive director, other than a nominee director of the company:

a. who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

b. (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
   
   (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

c. apart from receiving director's remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

d. none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

e. who, neither himself nor any of his relatives —

   (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

   (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of —

      • a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company;

      (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

   (iii) holds together with his relatives two per cent or more of the total voting power of the company; or

   (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;

   (v) is a material supplier, service provider or customer or a lessor or lessee of the company;

   (vi) who is not less than 21 years of age.

Explanation

For the purposes of the sub-clause (1):

i. "Associate" shall mean a company which is an “associate” as defined in Accounting Standard (AS) 23, “Accounting for Investments in Associates in Consolidated Financial Statements”, issued by the Institute of Chartered Accountants of India.

ii. "Key Managerial Personnel" shall mean "Key Managerial Personnel" as defined in section 2(51) of the Companies Act, 2013.

iii. "Relative" shall mean "relative" as defined in section 2(77) of the Companies Act, 2013 and rules prescribed there under.

2. Limit on number of directorships

a. A person shall not serve as an independent director in more than seven listed companies.
b. Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

3. Maximum tenure of Independent Directors
a. An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

4. Formal letter of appointment to Independent Directors
a. The company shall issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013.

b. The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.

5. Performance evaluation of Independent Directors
a. The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.

b. The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.

c. The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).

d. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

6. Separate meetings of the Independent Directors
a. The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.

b. The independent directors in the meeting shall, inter-alia:
   i. review the performance of non-independent directors and the Board as a whole;
   ii. review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
   iii. assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

7. Training of Independent Directors
a. The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.
b. The details of such training imparted shall be disclosed in the Annual Report.

c. 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 shall require previous approval of shareholders in general meeting. The shareholders’ resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

Provided that the requirement of obtaining 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, 2013 for payment of sitting fees without approval of the Central Government.

Provided further that independent directors shall not be entitled to any stock option.

D. Other provisions as to Board and Committees

1. The Board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings. The minimum information to be made available to the Board is given in Annexure - X to the Listing Agreement.

2. A director shall not be a member in more than ten committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore, every director shall inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Explanation:

i. For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 8 of the Companies Act, 2013 shall be excluded.

ii. For the purpose of reckoning the limit under this sub-clause, Chairmanship / membership of the Audit Committee and the Stakeholders’ Relationship Committee alone shall be considered.

3. The Board shall 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.

4. An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.

5. Provided that where 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 shall not apply.

6. The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.

E. Code of Conduct

1. The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.

2. 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.

3. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the
Companies Act, 2013.

4. An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.

Explanation: For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

F. Whistle Blower Policy

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

2. This mechanism should also provide for adequate safeguards against victimization of director(s) / employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases.

3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board’s report.

III. Audit Committee

A. Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.

2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (i): The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3. The Chairman of the Audit Committee shall be an independent director;

4. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

5. 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;

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

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

C. 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.

D. Role of Audit Committee
The role of the Audit Committee shall include the following:
1. 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;
2. Recommendation for appointment, remuneration and terms of appointment of auditors of the company;
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors;
4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
   a. Matters required to be included in the Director’s Responsibility Statement to be included in the Board’s report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013
   b. Changes, if any, in accounting policies and practices and reasons for the same
   c. Major accounting entries involving estimates based on the exercise of judgment by management
   d. Significant adjustments made in the financial statements arising out of audit findings
   e. Compliance with listing and other legal requirements relating to financial statements
   f. Disclosure of any related party transactions
   g. Qualifications in the draft audit report
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;
6. 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;
7. Review and monitor the auditor’s independence and performance, and effectiveness of audit process;
8. Approval or any subsequent modification of transactions of the company with related parties;
9. Scrutiny of inter-corporate loans and investments;
10. Valuation of undertakings or assets of the company, wherever it is necessary;
11. Evaluation of internal financial controls and risk management systems;
12. Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems;
13. 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;

14. Discussion with internal auditors of any significant findings and follow up there on;

15. 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;

16. 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;

17. 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;

18. To review the functioning of the Whistle Blower mechanism;

19. Approval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience and background, etc. of the candidate;

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

Explanation (i): The term "related party transactions" shall have the same meaning as provided in Clause 49(VII) of the Listing Agreement.

E. Review of information by Audit Committee

The Audit Committee shall mandatorily review 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.

IV. Nomination and Remuneration Committee

A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

B. The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;

2. Formulation of criteria for evaluation of Independent Directors and the Board;

3. Devising a policy on Board diversity;

4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.
C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders' queries. However, it would be up to the Chairman to decide who should answer the queries.

V. Subsidiary Companies

A. 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.

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

C. 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.

D. The company shall formulate a policy for determining ‘material’ subsidiaries and such policy shall be disclosed to Stock Exchanges and in the Annual Report.

E. For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.

F. No company shall dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting.

G. Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary shall require prior approval of shareholders by way of special resolution

Explanation (i): The term “material non-listed Indian subsidiary” shall mean an unlisted subsidiary, incorporated in India, whose income or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated income or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

Explanation (ii): The term “significant transaction or arrangement” shall mean 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.

Explanation (iii): 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.

VI. Risk Management

A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

VII. Related Party Transactions
A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

B. A 'related party' is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:

1. A person or a close member of that person’s family is related to a company if that person:
   a. is a related party under Section 2(76) of the Companies Act, 2013; or
   b. has control or joint control or significant influence over the company; or
   c. is a key management personnel of the company or of a parent of the company; or

2. An entity is related to a company if any of the following conditions applies:
   a. The entity is a related party under Section 2(76) of the Companies Act, 2013; or
   b. The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or
   c. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or
   d. Both entities are joint ventures of the same third party; or
   e. One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or
   f. The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or
   g. The entity is controlled or jointly controlled by a person identified in (1).
   h. A person identified in (1) (b) has significant influence over the entity (or of a parent of the entity); or

Explanation: For the purpose of Clause 49(V) and Clause VII (B), the term “control” shall have the same meaning as defined in SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

C. The company shall formulate a policy on materiality of related party transactions and also on dealing with Related Party Transactions. Provided that a transaction with a related party shall be considered material if the transaction / transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds five percent of the annual turnover or twenty percent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

D. All Related Party Transactions shall require prior approval of the Audit Committee.

E. All material Related Party Transactions shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.

VIII. Disclosures

A. Related Party Transactions

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.

2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.
B. Disclosure of Accounting Treatment

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

C. Remuneration of Directors

1. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.

2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be 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.

3. The company shall publish 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.

4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.

5. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

D. Management

1. As part of the directors’ report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company’s competitive position:
   a. Industry structure and developments.
   b. Opportunities and Threats.
   d. Outlook
   e. Risks and concerns.
   f. Internal control systems and their adequacy.
   g. Discussion on financial performance with respect to operational performance.
   h. Material developments in Human Resources / Industrial Relations front, including number of people employed.

2. Senior management shall make 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.)

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding the Board of Directors). This would also include all members of management one level below the executive directors including all functional heads.

3. The Code of Conduct for the Board of Directors and the senior management shall be disclosed on the website of the company.

E. Shareholders
1. In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:
   a. A brief resume of the director;
   b. Nature of his expertise in specific functional areas;
   c. Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
   d. Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v) above

2. Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.

3. Quarterly results and presentations made by the company to analysts shall be put on company’s web-site, 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 web-site.

4. A committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

5. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

F. Disclosure of resignation of directors
1. The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation.

2. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.

G. Disclosure of formal letter of appointment
1. The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.
H. Disclosures in Annual report

1. The details of training imparted to Independent Directors shall be disclosed in the Annual Report.
2. The details of establishment of vigil mechanism shall be disclosed by the company on its website and in the Board’s report.
3. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

I. Proceeds from public issues, rights issue, preferential issues, etc.

When money is raised through an issue (public issues, rights issues, preferential issues etc.), the company shall disclose the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results to the Audit Committee. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

IX. 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:
   • these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
   • 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. They have indicated to the auditors and the Audit committee:

   j. significant changes in internal control over financial reporting during the year;

   k. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and

   l. 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.
X. Report on Corporate Governance

A. 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 suggested list of items to be included in this report is given in Annexure - XII to the Listing Agreement and list of non-mandatory requirements is given in Annexure - XIII to the Listing Agreement.

B. The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in Annexure - XI to the Listing Agreement. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

XI. Compliance

A. 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.

B. The non-mandatory requirements given in Annexure - XIII to the Listing Agreement may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

Annexure - X to the Listing Agreement
Information to be placed before Board of Directors

1. Annual operating plans and budgets and any updates.

2. Capital budgets and any updates.

3. Quarterly results for the company and its operating divisions or business segments.

4. Minutes of meetings of audit committee and other committees of the board.

5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.

6. Show cause, demand, prosecution notices and penalty notices which are materially important.

7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.

8. Any material default in financial obligations to and by the company, or substantial nonpayment for goods sold by the company.

9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
10. Details of any joint venture or collaboration agreement.

11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.

12. Significant labour problems and their proposed solutions. Any significant development in Human Resources/Industrial Relations front like signing of wage agreement, implementation of Volunta Retirement Scheme etc.

13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.

14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

15. Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Annexure - XI to the Listing Agreement
Format of Quarterly Compliance Report on Corporate Governance

Name of the Company: 

<table>
<thead>
<tr>
<th>Quarter ending on:</th>
<th>Clause of Listing agreement</th>
<th>Compliance Status Yes/No</th>
<th>Remarks</th>
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<tbody>
<tr>
<td>II. Board of Directors</td>
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<tr>
<td>(A) Composition of Board</td>
<td>49 (IIIA)</td>
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<tr>
<td>(B) Independent Directors</td>
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<tr>
<td>(C) Non-executive Directors’ compensation &amp; disclosures</td>
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<tr>
<td>(D) Other provisions as to Board and Committees</td>
<td>49 (IID)</td>
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<tr>
<td>(E) Code of Conduct</td>
<td>49 (IIE)</td>
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<td>(F) Whistle Blower Policy</td>
<td>49 (IIF)</td>
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<td>III. Audit Committee</td>
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<td>VIII. Disclosures</td>
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<tr>
<td>(A) Related party transactions</td>
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<td>(B) Disclosure of Accounting Treatment</td>
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<tr>
<td>(I) Proceeds from public issues, rights</td>
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AUSTRALIA

The ASX Corporate Governance Council issued Corporate Governance Principles and Recommendations in 2003. These were revised in 2007 and came into effect from January 1, 2008. It has been further revised in 2010. Following a comprehensive review in 2012-13, the 21 members of the ASX Corporate Governance Council (“Council”) agreed that it was an appropriate time to issue a third edition of the Principles and Recommendations. The changes in the third edition issued on 27th March, 2014, reflect global developments in corporate governance since the second edition was published. The opportunity has also been taken to simplify the structure of the Principles and Recommendations and to afford greater flexibility to listed entities in terms of where they make their governance disclosures.

The ASX Corporate Governance Council's Recommendations articulates eight core principles. Each Principle is explained in detail, with commentary about implementation in the form of Recommendations. The Principles and Recommendations apply to all ASX listed entities, regardless of the legal form they take, whether they are established in Australia or elsewhere, and whether they are internally or externally managed.

The Principles and Recommendations are structured around, and seek to promote, 8 central principles:

1. Lay solid foundations for management and oversight: A listed entity should establish and disclose the respective roles and responsibilities of its board and management and how their performance is monitored and evaluated.

2. Structure the board to add value: A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively.

3. Act ethically and responsibly: A listed entity should act ethically and responsibly.

4. Safeguard integrity in corporate reporting: A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting.

5. Make timely and balanced disclosure: A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.

6. Respect the rights of security holders: A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.

7. Recognise and manage risk: A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.

8. Remunerate fairly and responsibly: A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders.
These are further explained as under:

Principle 1: Lay solid foundations for management and oversight

- Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.
- The performance of senior executives should be reviewed regularly against appropriate measures. Companies should disclose the process for evaluating the performance of senior executives.
- Directors should clearly understand corporate expectations of them. To that end, formal letters upon appointment of directors should be issued setting out the key terms and conditions to that appointment.

Principle 2: Structure the board to add value

- Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties
- Majority of the board should be independent directors including its Chairman. An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with - or could reasonably be perceived to materially interfere with - the independent exercise of their judgement.
- When determining the independent status of a director the board should consider whether the director:
  - is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company.
  - is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
  - has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
  - is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
  - has a material contractual relationship with the company or another group member other than as a director.

The board should regularly assess whether each non-executive director is independent. Each non-executive director should provide to the board all information that may be relevant to this assessment.

- If the Chairman of the board is not an independent director, it may be beneficial to consider the appointment of a lead independent director.
- The roles of chair and chief executive officer should not be exercised by the same individual.
- The board should establish a nomination committee with the following:
  - At least three members with majority of independent directors
  - independent director to chair the meeting
- Responsibilities of the committee should include recommendations to the board about:
  - the necessary and desirable competencies of directors
• review of board succession plans
• the development of a process for the evaluation of the performance of the board, its committees and directors
• the appointment and re-election of directors.

• Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.

The board and company secretary
• The company secretary plays an important role in supporting the effectiveness of the board by monitoring that board policy and procedures are followed, and coordinating the timely completion and despatch of board agenda and briefing material.
• It is important that all directors have access to the company secretary.
• The appointment and removal of the company secretary should be a matter for decision by the board as a whole.
• The company secretary should be accountable to the board, through the chair, on all governance matters.

Principle 3: Act ethically and responsibly

Companies should:

E. clarify the standards of ethical behavior required of the board, senior executives and all employees and encourage the observance of those standards

F. comply with their legal obligations and have regard to the reasonable expectations of their stakeholders

G. publish their policy concerning diversity, or a summary of that policy, and disclose annually their measurable objectives for achieving gender diversity, their progress toward achieving those objectives and the proportion of women in the whole organisation, in senior management positions and on the board.

H. establish a code of conduct and disclose the code or a summary of the code

I. Companies should disclose in each annual report the measurable objectives for achieving gender diversity set by the board in accordance with the diversity policy and progress towards achieving them.

Principle 4: Corporate Reporting

• Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.
• The board should establish an audit committee with the following structure:
• At least three members and consists only of non-executive directors with a majority of independent Directors
• Chaired by an independent chairman, who is not chairman of the board
• The audit committee should review the integrity of the corporate reporting and oversee the independence of the external auditors.
• The audit committee should have a formal charter and it should report to the board on all matters
relevant to the committee’s role and responsibilities.

**Principle 5: Make timely and balanced disclosure**

- Companies should promote timely and balanced disclosure of all material matters concerning the company.
- Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.
- Companies should include commentary on their financial results to enhance the clarity and balance of reporting. This commentary should include information needed by an investor to make an informed assessment of the entity’s activities and results.

**Principle 6: Respect the rights of security holders**

- Companies should respect the rights of security holders and facilitate the effective exercise of those rights.
- Companies should design a communications policy for promoting effective communication with security holders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.
- All companies should have a website and are encouraged to communicate with security holders via electronic methods. If a company does not have a website it must make relevant information available to security holders by other means, for example, a company may provide the information on request by email, facsimile or post.
- The company should describe in its Annual Report, how it communicate with its security holders publicly, ideally by posting the information on the company’s website in a clearly marked corporate governance section.

**Principle 7: Recognise and manage risk**

- Companies should establish a sound system of risk oversight and management and internal control.
- Companies should establish policies for the oversight and management and management of material business risks and disclose a summary of those policies.
- The board should require management to design and implement the risk management and internal control system to manage the company’s material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company’s management of its material business risks.
- A board committee is an efficient mechanism for focusing the company on appropriate risk oversight, risk management and internal control. Ultimate responsibility for risk oversight and risk management rests with the full board, whether or not a separate risk management committee exists.
- The company should made publicly, ideally by posting it to the Company’s Website a summary of the company’s policies on risk oversight and management of material business risks.

**Principle 8: Remunerate fairly and responsibly**

- Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.
→ A board remuneration committee is an efficient mechanism for focusing the company on appropriate remuneration policies. The board should establish a remuneration committee with the following structure:

→ consists of a majority of independent directors
→ is chaired by an independent director
→ has at least three members.

- The remuneration committee should have a charter that clearly sets out its role and responsibilities, composition, structure and membership requirements and the procedures for inviting non-committee members to attend meetings.
- The company should design its remuneration policy in such a way that it motivates senior executives to pursue the long-term growth and success of the company and demonstrates a clear relationship between senior executives performance and remuneration.
- Companies should clearly distinguish the structure of non-executive directors’ remuneration from that of executive directors and senior executives.

Companies are expected to provide explanation of any departures from aforesaid Principles and Recommendations, which should be included in the corporate governance statement in the annual report.

The Recommendations are not prescriptions, they are guidelines, designed to bring out effective governance structure. The approach is similar to the UK combined code – i.e. 'Comply or Explain'. In Australia it is called “if not, why not approach”. If a company considers that a recommendation is inappropriate to a particular circumstance, it has the flexibility not to adopt it and explain why it has not adopted.

**Malaysia - Malaysian Corporate Governance Code, 2012**

Malaysian Government issued the Malaysian Code on Corporate Governance (Code) in the year 2000 to strengthen corporate governance framework in Malaysia. Subsequently, the Code was revised and securities and companies laws were amended. The Audit Oversight Board was established to provide independent oversight over external auditors of companies. The Securities Industry Dispute Resolution Center was established to facilitate the resolution of small claims by investors. Statutory derivative action was introduced to encourage private enforcement action by shareholders.

The Securities Commission Malaysia’s (SCM) five-year Corporate Governance Blueprint launched on July 8, 2011, providing for action plan to raise the standards of corporate governance in Malaysia by strengthening self and market discipline and promoting greater internalisation of the culture of good governance.

The Malaysian Code on Corporate Governance 2012 effective from December 31, 2012 is the first deliverable of the CG Blueprint and supercedes the Malaysian Code on Corporate Governance. It sets out broad principles and specific recommendations on structures and processes which companies should adopt in making good corporate governance an integral part of their business dealings and culture. The code focuses on clarifying the role of the board in providing leadership, enhancing board effectiveness through strengthening its composition and reinforcing its independence. It also encourages companies to put in place corporate disclosure policies that embody principles of good disclosure.

Companies are encouraged to make public their commitment to respecting shareholder rights. The Malaysian Code on Corporate Governance, 2012 consists of eight principles encapsulating broad concepts underpinning good corporate governance that companies should apply when implementing the recommendations.
The recommendations are standards that companies are expected to adopt as part of their governance structure and processes. Listed companies should explain in their annual reports how they have complied with the recommendations. The companies are allowed to determine the best approach to adopting the principles. Where there is non-observance of a recommendation, companies should explain the reasons. Each recommendation is followed by a commentary which seeks to assist companies in understanding the recommendation. It also provides some guidance to companies in implementing the recommendation. Although some of the commentaries provide examples and suggestions, these should not be taken to be exhaustive.

The Principles and Recommendations as enumerated under the Malaysian Code on Corporate Governance 2012 are as under:

**PRINCIPLE 1: ESTABLISH CLEAR ROLES AND RESPONSIBILITIES**

The responsibilities of the board, which should be set out in a board charter, include management oversight, setting strategic direction premised on sustainability and promoting ethical conduct in business dealings.

**Recommendation 1.1** : The board should establish clear functions reserved for the board and those delegated to management.

**Recommendation 1.2** : The board should establish clear roles and responsibilities in discharging its fiduciary and leadership functions.

**Recommendation 1.3** : The board should formalise ethical standards through a code of conduct and ensure its compliance.

**Recommendation 1.4** : The board should ensure that the company’s strategies promote sustainability.

**Recommendation 1.5** : The board should have procedures to allow its members access to information and advice.

**Recommendation 1.6** : The board should ensure it is supported by a suitably qualified and competent company secretary.

**Recommendation 1.7** : The board should formalise, periodically review and make public its board charter.

**PRINCIPLE 2: STRENGTHEN COMPOSITION**

The board should have transparent policies and procedures that will assist in the selection of board members. The board should comprise members who bring value to board deliberations.

**Recommendation 2.1** : The board should establish a Nominating Committee which should comprise exclusively of non-executive directors, a majority of whom must be independent.

**Recommendation 2.2** : The Nominating Committee should develop, maintain and review the criteria to be used in the recruitment process and annual assessment of directors.

**Recommendation 2.3** : The board should establish formal and transparent remuneration policies and procedures to attract and retain directors.

**PRINCIPLE 3: REINFORCE INDEPENDENCE**

The board should have policies and procedures to ensure effectiveness of independent directors.
Recommendation 3.1: The board should undertake an assessment of its independent directors annually.

Recommendation 3.2: The tenure of an independent director should not exceed a cumulative term of nine years. Upon completion of the nine years, an independent director may continue to serve on the board subject to the director's re-designation as a non-independent director.

Recommendation 3.3: The board must justify and seek shareholders’ approval in the event it retains as an independent director, a person who has served in that capacity for more than nine years.

Recommendation 3.4: The positions of chairman and CEO should be held by different individuals, and the chairman must be a non-executive member of the board.

Recommendation 3.5: The board must comprise a majority of independent directors where the chairman of the board is not an independent director.

PRINCIPLE 4: FOSTER COMMITMENT

Directors should devote sufficient time to carry out their responsibilities, regularly update their knowledge and enhance their skills.

Recommendation 4.1: The board should set out expectations on time commitment for its members and protocols for accepting new directorships.

Recommendation 4.2: The board should ensure its members have access to appropriate continuing education programmes.

PRINCIPLE 5: UPHOLD INTEGRITY IN FINANCIAL REPORTING

The board should ensure financial statements are a reliable source of information.

Recommendation 5.1: The Audit Committee should ensure financial statements comply with applicable financial reporting standards.

Recommendation 5.2: The Audit Committee should have policies and procedures to assess the suitability and independence of external auditors.

PRINCIPLE 6: RECOGNISE AND MANAGE RISKS

The board should establish a sound risk management framework and internal controls system.

Recommendation 6.1: The board should establish a sound framework to manage risks.

Recommendation 6.2: The board should establish an internal audit function which reports directly to the Audit Committee.

PRINCIPLE 7: ENSURE TIMELY AND HIGH QUALITY DISCLOSURE

Companies should establish corporate disclosure policies and procedures to ensure comprehensive, accurate and timely disclosures.

Recommendation 7.1: The board should ensure the company has appropriate corporate disclosure policies and procedures.

Recommendation 7.2: The board should encourage the company to leverage on information technology for effective dissemination of information.
PRINCIPLE 8: STRENGTHEN RELATIONSHIP BETWEEN COMPANY AND SHAREHOLDERS

The board should facilitate the exercise of ownership rights by shareholders.

Recommendation 8.1: The board should take reasonable steps to encourage shareholder participation at general meetings.

Recommendation 8.2: The board should encourage poll voting.

Recommendation 8.3: The board should promote effective communication and proactive engagements with shareholders.
Lesson 9
Risk Management and Internal Control

SECRETARIAL AUDIT & COMPANY SECRETARY IN PRACTICE (PCS)
Section 204 of the Companies Act 2013, provides following with respect to Secretarial Audit:

(1) Every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board’s report made in terms of sub-section (3) of section 134, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed.

(2) It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

(3) The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).

(4) If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

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 programs. PCS is a highly specialized professional in matters of statutory, procedural and practical aspects involved in proper compliances under corporate laws. Strong knowledge base makes PCS a competent professional to conduct Secretarial Audit.

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

In order to guide its members with the process of Secretarial Audit, the Institute of Company Secretaries of India has issued a Referencer on Secretarial Audit.

ROLE AND RESPONSIBILITIES WITH REGARD TO INTERNAL CONTROL

Management

Sub Clause 49(VI) of the Listing Agreement provides:
A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.
Clause 49 (IX) of Listing Agreement: The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act 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:
   1. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
   2. 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:
   1. significant changes in internal control over financial reporting during the year;
   2. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
   3. 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.

Companies Act 2013 Section 134(5) (e)
The Directors’ Responsibility Statement referred shall state that— the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Internal Auditors
Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often plays a significant monitoring role. Section 138 of Companies Act, 2013 provides that:

(1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

(2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.
Lesson 10
Corporate Governance and Shareholder Rights

Following sections are yet to be notified under companies Act, 2013. Therefore relevant provisions of companies Act, 1950 will be applicable:

- Section 125
- Section 241
- Section 245
- Section 242

**RIGHTS OF SHAREHOLDERS**
The Companies Act, 2013 requires that such businesses be approved by shareholders by special resolution. Further, Section 117 of the Companies Act, 2013 requires a listed public company that resolutions relating to certain businesses should be got passed only by postal ballot. This is to allow all the shareholders to have their say on important matters. The Postal Ballot Rules list out the businesses which may be passed by postal ballot.

**Shareholder rights enshrined in the Companies Act, 2013**
These rights can be categorised as under:

1. Right to receive copies of the following documents from the company:
   - Copies of Audited Financial statements (Section 136).
   - Report of the Cost Auditor, if so directed by the Government.
   - Contract for the appointment of the managing or whole time director (Section 190).
   - Notices of the general meetings of the company (Sections 101).

2. Right to inspect statutory registers/returns and get copies thereof on payment of prescribed fee.
   - Debenture trust deed (Section 71);
   - Register of Charges (Section 87);
   - Register of Members, Debenture holders and Index Registers, Annual Returns (Section 94);
   - Minutes Book of General Meetings (Section 119);
   - Register of Contracts (Section 189);
   - Register of Directors’ (Section 171);
   - Register of Directors’ and Key Managerial Personnel and their Shareholdings (Section 170);
   - Copy of agreement of appointment of the managing or whole time director (Section 190).

The members can also get the copies of the aforesaid registers/returns on payment of prescribed fee except those of Register of Directors and Register of Directors’ Shareholdings. Members can also get copies of memorandum and articles of association on payment of a fee of Re. One (Section 17).

3. Right to attend meetings of the shareholders and exercise voting rights at these meetings either
personally or through proxy (Sections 96, 100, 105 and 107).

(4) Other rights.

Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

a) To receive share certificates as title of their holdings [Section 46 read with the Companies (Issue of Share Certificates) Rules, 1960).

b) To transfer shares (Sections 44 and 56 and Articles).

c) To resist and safeguard against increase in his liability without his written consent.

d) To receive dividend when declared.

e) To have rights shares (Section 62).

f) To appoint directors (Section 152).

g) To share the surplus assets on winding up (Section 320).

h) Right of dissentient shareholders to apply to court (Section 48).

i) Right to make application collectively to the Tribunal for oppression and mismanagement (Sections 241 and 242). Right of Nomination.

j) Section 47 of the Act provides that every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company.

k) Preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital. A resolution for winding up of the company or for the reduction of the share capital, will be deemed to affect directly the rights attached to preference share and so they can vote on such resolutions.

l) Section 48 of the Companies Act, 2013 lays down that the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class. Further, the variation of rights of shareholders can be effected only:

   i. If provision with respect to such variation is contained in the Memorandum or Articles of association of the company; or

   ii. In the absence of any such provision in a Memorandum or Articles of association of the company, if such variation is not prohibited by the terms of issue of the shares of that class.

m) Section 48 of the Companies Act, 2013 confers certain rights upon the dissentient shareholders. According to this section, where the rights of any class of shares are varied, the holders of not less than ten per cent of the shares of that class, being persons who did not consent to or vote in favour of the resolution for the variation, can apply to the Tribunal to have the variation cancelled. Where any such application is made to the Tribunal, the variation will not be effective unless and until it is confirmed by the Tribunal.
Sections regarding Oppression and Mismanagement are yet to be notified under Companies Act 2013; therefore, relevant sections of Companies Act, 1956 are applicable in this regard

Power and duty to acquire shares of shareholders dissenting from the scheme or contract approved by the majority

As per section 235(1) of Companies Act 2013, where a scheme or contract involving the transfer of shares or any class of shares in a company (the transferor company) to another company (the transferee company) has, within four months after making of an offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved, other than shares already held at the date of the offer by, or by a nominee of the transferee company or its subsidiary companies, the transferee company may, at any time within two months after the expiry of the said four months, give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares.

As per section 235 (2), where a notice under sub-section (1) is given, the transferee company shall, unless on an application made by the dissenting shareholder to the Tribunal, within one month from the date on which the notice was given and the Tribunal thinks fit to order otherwise, be entitled to and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company.

Application to Tribunal for relief in case of oppression and mismanagement

As per section 241 of The Companies Act, 2013, any member of a company who complains that—

(a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or

(b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company’s shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members, may apply to the Tribunal, provided such member has a right to apply under section 244.

(2) The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order.

Section 242 provides that if, on any application made under section 241, the Tribunal is of the opinion—

(a) that the company’s affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up, the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.
As per section 244, the following members of a company shall have the right to apply under section 241, namely:

(a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under section 241.

Explanation.—For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

Where any members of a company are entitled to make an application under subsection (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

Section 245 of Companies Act, 2013, provides the following regarding Class Action Suits:
(yet to be notified)

(1) Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:

a) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;

b) to restrain the company from committing breach of any provision of the company’s memorandum or articles;

c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

d) to restrain the company and its directors from acting on such resolution;

e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

f) to restrain the company from taking action contrary to any resolution passed by the members;

b) to claim damages or compensation or demand any other suitable action from or against—

h) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

i) (ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
j) (iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

k) to seek any other remedy as the Tribunal may deem fit.

(2) Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

(3) (i) The requisite number of members provided in sub-section (1) shall be as under:—

(a) in the case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

(ii) The requisite number of deposit ors provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

(4) In considering an application under sub-section (1), the Tribunal shall take into account, in particular—

(a) whether the member or depositor is acting in good faith in making the application for seeking an order;

(b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of subsection (1);

(c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;

(d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;

(e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

(5) If an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely:—

(a) public notice shall be served on admission of the application to all the members or depositors of
the class in such manner as may be prescribed;

(b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;

(c) two class action applications for the same cause of action shall not be allowed;

(d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

(6) Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

(7) Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(8) Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

(9) Nothing contained in this section shall apply to a banking company.

(10) Subject to the compliance of this section, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

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**Investor Education & Protection Fund**

Investor Education and Protection Fund (IEPF) is established under section 205C of Companies Act. Since the relevant provisions under new act are not yet notified. Section 205C is applicable.

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**PROTECTION OF RIGHTS OF MINORITY SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

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**Role of Audit Committee**

The audit committee has an important role in monitoring related party transactions. In most jurisdictions the first level monitoring of the related party transactions is done by the audit committee.

As per Clause 49(VII) of Listing Agreement, provides following with regard to Related Party Transactions:

- A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

- A 'related party' is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions.
C. The company shall formulate a policy on materiality of related party transactions and also on dealing with Related Party Transactions.

Provided that a transaction with a related party shall be considered material if the transaction / transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds five percent of the annual turnover or twenty percent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

D. All Related Party Transactions shall require prior approval of the Audit Committee.

E. All material Related Party Transactions shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.

Further Clause 49(VIII)(A) of Listing Agreement provides for disclosures related to Related Party Transactions in the following manner:

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.

2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

Related party transactions are many times made through complex transactions between the company and its managers, directors, subsidiaries, and major shareholders, it is hard for outsiders to discover questionable or fraudulent transactions, if any. Therefore it becomes imperative for the Internal Control Processes within the company to be robust enough to identify the related party transactions, determine whether they are at arm’s length and that these are not used as a means of manipulation.

The audit committee can ensure that adequate checks and balances are placed to ensure that minimum conflict of interest situation arises. Some of the basic measures that can be adopted is to have clear and well laid down policies with regard to purchases, engagement of vendors, appointments at key levels, open bidding for material contracts and a well functioning whistle-blower mechanism.

**Whistle-blower mechanism**

In India, Clause 49 of the Listing Agreement prescribes as a mandatory requirement that companies shall 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 provides 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. The audit committee is tasked to review the functioning of the Whistle Blower mechanism. Further, in the Corporate Governance Report, the company shall disclose the whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

**Disclosure**

In terms of the Companies Act, 2013 every director of a company must disclose the nature of his concern or interest in any transaction of the company at a meeting of the Board of Directors. In the case of a publicly owned company a directed interested or concerned in any contract or arrangement entered into or to be entered in to by the company is also prohibited from voting on the resolution brought up at the Board meeting for the approval of the contract. He has to abstain himself from the discussion on the resolution [Section
Section 184 of the Companies Act, 2013 imposes a specific duty on every director to disclose his interest to the full Board.

Since the Board may be a varying body, the section requires a fresh notice of disclosure to be given at the end of each financial year. By virtue of section 167(1) (d) of the Companies Act, 2013, if a director fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested; in contravention of the provisions of section 184, his office will _ipso facto_ become vacated. Further, there is also penalty payable. The provisions are founded on the principle that a director is precluded from dealing on behalf of the company as himself and from entering into engagements in which he has a personal interest conflicting or which possibly may conflict with the interest of those with whom he is bound by fiduciary duty. A director occupies a fiduciary position in relation to a company and he must act bona fide in the interest of the company. If a director makes a contract with the company and does not disclose his interest, he will be committing breach of trust, _Yashovardhan Saboo v. Groz-Beckert Saboo Ltd._, (1995) 83 Com Cases 371 at p.413 (CLB).

The section is so worded that any conflict of personal interest of the director with his duties to the company as its director will have to be disclosed. To emphasise this point, the relevant sub-section 299 is reproduced below:

Section 184 provides for “disclosure of interest by director”, according to it:-

- Every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.

- Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:

  (a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or

  (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be, shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting:

Provided that where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

Further, any contract or arrangement entered into by the company without disclosure or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company. Moreover, in case of non compliance to the provisions, director shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both.

Section 188 prohibits company to enter into any contract or arrangement with a related party except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed. These are applicable in case of:
(a) sale, purchase or supply of any goods or materials;
(b) selling or otherwise disposing of, or buying, property of any kind;
(c) leasing of property of any kind;
(d) availing or rendering of any services;
(e) appointment of any agent for purchase or sale of goods, materials, services or property;
(f) such related party’s appointment to any office or place of profit in the company, its subsidiary company or associate company; and
(g) underwriting the subscription of any securities or derivatives thereof, of the company:

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a special resolution:

Provided further that no member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

These provisions are however not applicable to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm’s length basis.

Any director or any other employee of a company, who had entered into or authorized the contract or arrangement in violation of the provisions of this section shall—

- in case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and

- in case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.
Lesson 11
Corporate Governance and Other Stakeholders

Recognition of Stakeholder Concept in Law

The Companies Act, 2013 - Section 166(2)
Director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, the community and the environment.

Listing Agreement - Clause 49 (I) (B)
The Listing agreement provides that the company should recognize the rights of stakeholders and encourage co-operation between company and the stakeholders.

a. The rights of stakeholders that are established by law or through mutual agreements are to be respected.
b. Stakeholders should have the opportunity to obtain effective redress for violation of their rights.
c. Company should encourage mechanisms for employee participation.
d. Stakeholders should have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in Corporate Governance process.
e. The company should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

RECENT DEVELOPMENTS
Companies Act, 2013

The Companies Act, 2013 mandated to establish vigil mechanism which will enable a company to evolve a process to encourage ethical corporate behaviour, while rewarding employees for their integrity and for providing valuable information to the management on deviant practices.

According to Section 177(9) of the Companies Act, 2013 read with rule 7 of Companies (Meetings of Board and its Powers) Rules, 2014, establishment of vigil mechanism is mandatory for all listed companies and Companies that accept deposits from public or companies that have borrowed money from banks and public financial institutions in excess of Rs 50 crore.

The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and in case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

The vigilance mechanism has to be backed with adequate safeguards against victimization of whistleblowers and should provide direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee in exceptional cases.

In addition, Independent directors and the audit committee are mandated to ensure that the vigil mechanism is “adequate” and “functional”. The duty is also cast on the Auditors to report fraud by employees of the company to the central government within a prescribed time.
Revised Clause 49 of Listing Agreement

As per the revised clause 49 of Listing Agreement issued by the Securities and Exchange Board of India, w.e.f. 1\textsuperscript{st} October, 2014 it would be mandatory for every listed company to have a vigil mechanism for directors and employees to report concerns on unethical behavior, actual or suspected fraud or violation of the company’s code of conduct or ethics policy, to management.

Further, the company is required to provide safeguards against victimisation of whistleblowers and direct access to the chairman of audit committee in exceptional cases. The details of whistle blower policy/vigil mechanism should be disclosed by the company on its website and in the Board’s Report as well.

The Whistle Blower Protection Act, 2011

Corruption is a social evil and one of the impediments felt in eliminating corruption in the Government and the public sector undertakings is lack of adequate protection to the complainants reporting the corruption or wilful misuse of power or wilful misuse of discretion which causes demonstrable loss to the Government or commission of a criminal offence by a public servant.

The Whistle Blowers Protection Bill was introduced on August 26, 2010. It was referred to a Parliamentary Standing Committee on September 16, 2010, which had given its report on June 9, 2011. The Bill was passed by the Lok Sabha and Rajya Sabha on December 27, 2011 and February 21, 2014 respectively.

Finally, Whistle Blowers Protection Act, 2011 got the assent of the President of India on 9th May 2014 and a notification in the Official Gazette of India was issued on 12\textsuperscript{th} May, 2014 to make it a complete legislation to provides a system to encourage people to disclose information about corruption or the wilful misuse of power by public servants, including ministers. The law provides safeguards against victimization of the person who makes the complaint. The Act is expected to become effective in course of this year.

Enron employees sued the trustee, the administrative committee, various corporate officers, and the outside directors of Enron, alleging that they had breached their fiduciary duties under ERISA by failing to disclose the company's true financial condition and by continuing to invest plan assets in Enron stock. The court decision allowed most of the fiduciary claims to proceed.

When employees own corporate stock through their retirement plan or a separate employee stock ownership plan (ESOP), their right to participate in decision-making takes on a new dimension. Indeed, employees have an ethical right to participate based on their years of service and retirement investments, both of which are at risk.

The German corporate governance is shaped by a legal tradition that dates back to the 1920s and regards corporations as entities which act not only in the interests of their shareholders, but also serve other stakeholder interests. The German concept of corporate governance reflects the legal rights and arrangements that underlie how decision-making rights are distributed in a company.
Corporate Social Responsibility Under The Companies Act, 2013

The requirement of undertaking Corporate Social Responsibility by companies has been introduced in Section 135 of Companies Act, 2013. This section needs to read along with Companies (Corporate Social Responsibility Policy) Rules, 2014 and Schedule VII to the Act. Section 135 provides that

1. Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

2. The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

3. The Corporate Social Responsibility Committee shall—
   
   a. formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
   
   b. recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
   
   c. monitor the Corporate Social Responsibility Policy of the company from time to time.

4. The Board of every company referred to in sub-section (1) shall,—
   
   a. after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
   
   b. ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

5. The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

Provided that the company shall give preference to the local area and areas where it operates for spending the amount earmarked for Corporate Social Responsibility activities. Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (a) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation—For the purposes of this section “average net profit” shall be calculated in accordance with the provisions of section 198.

Accordingly, every company – private company or public company, beyond the thresholds specified below is required to constitute CSR Committee:

- Net worth of Rs.500 crore or more; or
Turnover of Rs.1000 crore or more; or

Net profit of Rs. 5 crore or more during any financial year.

The Board of every company referred above shall ensure that the company spends, in every financial year, at least two per cent of the net profits of the company made during the three immediately preceding financial years in pursuance of its CSR policy.

Further, the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

If the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

### Composition Of CSR Committee

The CSR committee shall consist of three or more directors, out which one director shall be an independent director. The presence of an Independent Director shall ensure that the Committee is not just a quasi-committee addressing the whims of the Board, but is in fact, taking up an initiative. The composition of such Corporate Social Responsibility Committee shall have to be disclosed in the Board's Report as required under Section 134(4).

An unlisted public company or a private company which is not required to appoint an independent director shall have its CSR Committee without independent director. A private company having only two directors on its Board shall constitute its CSR Committee with two such directors. With respect of foreign company, the CSR Committee shall comprise of at least two persons of which one person resident in India and another person shall be nominated by the foreign company.

The CSR Committee shall Institute a transparent monitoring mechanism for implementation of CSR projects or programs or activities undertaken by the company.

### Functions Of The CSR Committee

The Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII of the Act. The Committee shall also initiate a CSR Policy, which shall stipulate how, where, and when they want to invest their funds with respect to this requirement.

The Committee shall recommend the amount of expenditure to be incurred on the activities referred to above. Further, the CSR Committee is under an obligation to monitor the implementation of the CSR policy from time to time.

### CSR Policy

The Rules provide that the CSR Policy of a company shall, inter alia include the following, namely:

- A list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedule for the same; and

- Monitoring process of such projects or programs.

But the activity should not be undertaken in pursuance of normal course of business of a company. The Board shall ensure that the activities included by the company in its CSR Policy are related to the activities mentioned in Schedule VII of the Act.

The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or
activities shall not form part of business profit of a company.

**Companies (Corporate Social Responsibility Policy) Rules, 2014**

The MCA has also notified the Companies (Corporate Social Responsibility Policy) Rules, 2014 (‘the Rules’) to be effective from 1 April 2014. The Rules have just released and as these are evaluated in detail, further areas requiring clarity may emerge. The salient features of the Rules are as follows:

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(1) **Short title and commencement.**—(1) These rules may be called the Companies (Corporate Social Responsibility Policy) Rules, 2014

(2) they shall come into force on the 1\textsuperscript{st} day of April, 2014

(2) **Definitions** — (1) in these rules, unless the context otherwise requires,

(a) “Act ” means the Companies Act, 2013;

(b) “Annexure” means the Annexure appended to these rules;

(c) “Corporate Social Responsibility (CSR)” means and include but is not limited to:-

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or

(ii) Projects or programs relating to activities undertaken by the board of directors of the company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

(d) “CSR Committee” means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act.

(e) “CSR Policy” relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company;

(f) “Net Profit” means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following namely:-

(i) any profit arising from any overseas branch or branches of the company or otherwise; and

(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that the net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to
be re-calculated in accordance with the provisions of the Act.

Provided further, that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act. Further, words and expressions used and not defined in these rules but defined in the Act shall have the same meaning respectively assigned to them in the Act.

(3) Corporate Social Responsibility—

(1) Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub section (1) of section 381 and section 198 of the Act.

(2) Every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years shall not be required to-

(a) constitute a CSR Committee; and

(b) comply with the provisions contained in sub-section (2) to (5) of the said section,

till such time it meets the criteria specified in sub-section (1) of section 135

(4) CSR Activities—

(1) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise:

Provided that----

(i) If such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects:

(ii) the company has specified the projects or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

(3) A company ,may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committee of respective companies are in a positions to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions of sub-section (5) of section 135 of the Act, the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.
(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

(6) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through institutions with established track records of atleast three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

Schedule VII of Companies Act, 2013 describes activities to be undertaken as CSR:

- eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
- promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
- promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water;
- protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
- measures for the benefit of armed forces veterans, war widows and their dependents;
- training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;
- contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- contributions or funds provided to technology incubators located within academic institutions
- which are approved by the Central Government
- rural development projects

As per Clarification issued by MCA on 18th June, 2014; following may be noted with regard to provisions mentioned under section 135:

- One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. do not be qualified as part of CSR expenditure.

- Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) are not count as CSR expenditure under the Companies Act.

- Salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.

- Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

(5) CSR Committees—

(1) The companies mentioned in the rule 3 shall constitute CSR Committee as under:-
(i) an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director pursuant to sub-section (1) of section 135 which is not required to appoint an independent director pursuant to sub-section 4 of section 149 of the Act, shall have its CSR Committee without such director;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be a specified under clause (d) of sub-section 1 of section 380 of the Act and another person shall be nominated by the foreign company.

(2) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

(6) CSR Policy—

(1) The CSR Policy of the company shall, inter-alia, include the following namely:-

   (a) a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

   (b) monitoring process of such projects or programs;

Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Provided further that the Board of Directors shall ensure that activities include by a company and its Corporate Social Responsibility Policy are related to the activities include in the Schedule VII of the Act.

(2) The CSR Policy of the company shall specify that the surplus arising out of the CSR Projects or programs or activities shall not form part of the business profit of a company.

(7) CSR Expenditure—

CSR expenditure shall include all expenditure including contribution to corpus for projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which falls within the purview of Schedule VII of the Act.

(8) CSR Reporting—

(1) The Board’s Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure.

(2) In case of a foreign company, the balance sheet filed under sub-clause (1) of sub-section 1 of section 381 shall contain an Annexure regarding report on CSR.

(9) Display of CSR activities in its website—

The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy of the company and disclose contents of such policy in its report and the
same shall be displayed on the company’s website, if any, as per the particulars specified in the **Annexure**.

### Annexure

**FORMAT FOR THE ANNUAL REPORT ON CSR ACTIVITIES TO BE INCLUDED IN THE BOARD REPORT**

1. A brief outline of the company’s CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.

2. The Composition of the CSR Committee.

3. Average net profit of the company for last three financial years.

4. Prescribed CSR Expenditure (two percent of the amount as in item 3 above)

5. Details of CSR spent during the financial year.
   - (a) Total amount to be spent for the financial year;
   - (b) Amount unspent, if any;
   - (c) Manner in which the amount spent during the financial year is detailed below:

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<th>(5)</th>
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<th>(7)</th>
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<tbody>
<tr>
<td>S No</td>
<td>CSR project or activity identified</td>
<td>Sector in which the project is covered</td>
<td>Projects or programs</td>
<td>Amount outlay (budget) project or programs wise</td>
<td>Amount spent on the projects or programs Sub-heads:</td>
<td>Cumulative expenditure upto the reporting period.</td>
<td>Amount spent: Direct or through implementing agency</td>
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* Give details of implementing agency

6. In case the company has failed to spend the two percent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board
7. A responsibility statement of the CSR committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and policy of the company.

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<th>Sd/-</th>
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<tr>
<td>(Chief Executive Officer or Managing Director or Director)</td>
<td>(Chairman CSR Committee)</td>
<td>(Person specified under clause (d) of sub section (1) of section 380 of the Act)</td>
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<td>(wherever applicable)</td>
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PROFESSIONAL PROGRAMME

ADVANCED TAX LAWS AND PRACTICE

MODULE 3 - PAPER 7
Students appearing in December 2014 Examination shall note that all changes made by Finance Act, 2013 in Service Tax Laws, Central Excise Laws and Customs Laws, and all the relevant Circulars, Clarifications/Notifications issued by CBEC / Central Government effective six months prior to the date of examination are applicable.

These notifications and circulars are for Service tax and Central Excise which are updated upto 30th June, 2014.
Notifications in Service Tax

1. Notification No. 01/2014 - Service Tax, dated 10.01.2014: amendment of notification no. 25/2012-Service Tax (Mega Exemption Notification), Dated the 20.06.2012

In the said notification, in the opening paragraph, in entry 11, in item (a), for the words “district, State or zone”, the words “district, State, zone or Country” shall be substituted.


In the said notification, in the paragraph 2, for clause (s), the following shall be substituted, namely:-

‘(s) “governmental authority” means an authority or a board or any other body;
(i) set up by an Act of Parliament or a State Legislature; or
(ii) established by Government,
with 90% or more participation by way of equity or control, to carry out any function entrusted to a municipality under article 243W of the Constitution;’.

3. Notification No. 03/2014-Service Tax, dated 3.02.2014: Regarding levy of service tax on services provided by an authorised person or sub-brokers to the member of a commodity exchange.

G.S.R….(E).- Whereas, the Central Government is satisfied that a practice was generally prevalent regarding levy of service tax (including non-levy thereof), under section 66 of the Finance Act, 1994 (32 of 1994) (hereinafter referred to as ‘the Finance Act’), on services provided by an authorised person or sub-broker to the member of a recognised association or a registered association, in relation to a forward contract, and that such services were liable to service tax under the Finance Act, which was not being levied according to the said practice during the period commencing from the 10th day of September 2004 and ending with the 30th day of June 2012;

Now, therefore, in exercise of the powers conferred by section 11C of the Central Excise Act, 1944 (1 of 1944), read with section 83 of the Finance Act, the Central Government hereby directs that the service tax payable on the services provided by an authorised person or sub-broker to the member of a recognised association or a registered association, in relation to a forward contract, shall not be required to be paid in respect of such taxable service on which the service tax was not being levied during the aforesaid period in accordance with the said practice.


In the said notification, in the opening paragraph,-

(i) after entry 2, the following entry shall be inserted, namely:-

...
“2A. Services provided by cord blood banks by way of preservation of stem cells or any other service in relation to such preservation;”;

(ii) after entry 39, the following entry shall be inserted, namely:-

“40. Services by way of loading, unloading, packing, storage or warehousing of rice.”.

**Circulars**

1. Circular No.175 /01 /2014 – ST, dated 10.01. 2014: Regarding Levy of service tax on services provided by a Resident Welfare Association (RWA) to its own members

Service tax on ‘club or association service’ which covers Resident Welfare Association (RWA) was introduced with effect from 16.06.2005, vide section 65(105)(zzze) read with section 65(25a)[(25a) was later renumbered as (25aa)]. Under the positive list approach which was followed prior to 1st July 2012, exemption was available under notification No. 8/2007-ST dated 01.03.2007, if the total consideration received from an individual member by the RWA for the services does not exceed three thousand rupees per month. This notification was rescinded vide notification No. 34/2012-ST dated 20th June 2012, with effect from 1st July, 2012.

Under the negative list approach, with effect from 1st July, 2012, notification No.25/2012-ST [sl.no.28 (c)] provides for exemption to service by a RWA to its own members by way of reimbursement of charges or share of contribution up to five thousand rupees per month per member for sourcing of goods or services from a third person for the common use of its members.

Certain doubts have been raised regarding the scope of the present exemption extended to RWAs under the negative list approach. These doubts have been examined and clarifications are given below:

<table>
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<tr>
<th>Sl. No.</th>
<th>Doubt</th>
<th>Clarification</th>
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<tr>
<td>1.</td>
<td>(i) In a residential complex, monthly contribution collected from members is used by the RWA for the purpose of making payments to the third parties, in respect of commonly used services or goods [Example: for providing security service for the residential complex, maintenance or upkeep of common area and common facilities like lift, water sump, health and fitness centre, swimming pool, payment of electricity Bill for the common area and lift, etc.]. Is Exemption at Sl. No. 28 (c) in notification No. 25/2012-ST is provided specifically with reference to service provided by an unincorporated body or a non-profit entity registered under any law for the time being in force such as RWAs, to its own members. However, a monetary ceiling has been prescribed for this exemption, calculated in the form of five thousand rupees per month per member contribution to the RWA, for sourcing of goods or services from third person for the common use of</td>
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<td>service tax leviable?</td>
<td>its members.</td>
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<td>(ii) If the contribution of a member/s of a RWA exceeds five thousand rupees per month, how should the service tax liability be calculated?</td>
<td>If per month per member contribution of any or some members of a RWA exceeds five thousand rupees, the entire contribution of such members whose per month contribution exceeds five thousand rupees would be ineligible for the exemption under the said notification. Service tax would then be leviable on the aggregate amount of monthly contribution of such members.</td>
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<tr>
<td>2.</td>
<td>(i) Is threshold exemption under notification No. 33/2012-ST available to RWA?</td>
<td>Threshold exemption available under notification No. 33/2012-ST is applicable to a RWA, subject to conditions prescribed in the notification. Under this notification, taxable services of aggregate value not exceeding ten lakh rupees in any financial year is exempted from service tax. As per the definition of ‘aggregate value’ provided in Explanation B of the notification, aggregate value does not include the value of services which are exempt from service tax.</td>
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<td>(ii) Does ‘aggregate value’ for the purpose of threshold exemption, include the value of exempt service?</td>
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<td>3.</td>
<td>If a RWA provides certain services such as payment of electricity or water bill issued by third person, in the name of its members, acting as a ‘pure agent’ of its members, is exclusion from value of taxable service available for the purposes of exemptions provided in Notification 33/2012-ST or 25/2012-ST?</td>
<td>In Rule 5(2) of the Service Tax (Determination of Value) Rules, 2006, it is provided that expenditure or costs incurred by a service provider as a pure agent of the recipient of service shall be excluded from the value of taxable service, subject to the conditions specified in the Rule. For illustration, where the payment for an electricity bill raised by an electricity transmission or distribution utility in the name of the owner of an apartment in respect of electricity consumed thereon, is collected and paid by the RWA to the utility, without charging any commission or a consideration by any other name, the RWA is acting as a pure agent and hence exclusion from the value of taxable service would be available. However, in the case of electricity bills issued in the name of RWA, in respect of electricity consumed for common use of lifts, motor pumps for water supply, lights in common area, etc., since there is no agent involved in these</td>
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<td>No.</td>
<td>Question</td>
<td>Answer</td>
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<tr>
<td>4.</td>
<td>Is CENVAT credit available to RWA for payment of service tax?</td>
<td>RWA may avail cenvat credit and use the same for payment of service tax, in accordance with the Cenvat Credit Rules.</td>
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</tbody>
</table>

2. **Circular No.177/03/2014 – ST, dated 17.02. 2014: Regarding Rice– exemptions from service tax**

   Doubts have been raised regarding the scope and applicability of various exemptions available to various activities in relation to rice, under the negative list approach. These doubts have been examined and clarifications are given below:

2. These doubts have arisen in the context of definition of ‘agricultural produce’ available in section 65B(5) of the Finance Act, 1994. The said definition covers ‘paddy’; but excludes ‘rice’. However, many benefits available to agricultural produce in the negative list [section 66D(d)] have been extended to rice, by way of appropriate entries in the exemption notification.

3. **Transportation of rice:**

   3.1 by a rail or a vessel: Services by way of transportation of food stuff by rail or a vessel from one place in India to another is exempt from service tax vide exemption notification 25/2012-ST dated 20th June, 2012 [entry sl.no.20(i)]; food stuff includes rice.

   3.2 by a goods transport agency: Transportation of food stuff by a goods transport agency is exempt from levy of service tax [exemption notification 25/2012-ST dated 20th June, 2012 [entry sl.no.21(d)]; amending notification 3/2013-ST dated 1st March 2013]. Food stuff includes rice.

4. **Loading, unloading, packing, storage and warehousing of rice:** Exemption has been inserted in the exemption notification 25/2012-ST dated 20th June, 2012 [entry sl.no.40]; amending notification 4/2014-ST dated 17th February 2014 may be referred.

5. **Milling of paddy into rice:** When paddy is milled into rice, on job work basis, service tax is exempt under sl.no.30 (a) of exemption notification 25/2012-ST dated 20th June, 2012, since such milling of paddy is an intermediate production process in relation to agriculture.
Notifications regarding Central Excise

1. Notification No. 01/2014-Central Excise (N.T.), dated 8.01.2014- CENVAT Credit Rules, 2004

In rule 3 of the CENVAT Credit Rules, 2004, -
(i) the Explanation occurring after the proviso to sub-rule (5B) shall be omitted;
(ii) in sub-rule (5C), after the words “production of said goods”, the words “and the CENVAT credit taken on input services used in or in relation to the manufacture or production of said goods” shall be inserted;
(iii) after sub-rule (5C), the following explanations shall be inserted, namely: -

“Explanation 1.- The amount payable under sub-rules (5), (5A), (5B) and (5C), unless specified otherwise, shall be paid by the manufacturer of goods or the provider of output service by debiting the CENVAT credit or otherwise on or before the 5th day of the following month except for the month of March, where such payment shall be made on or before the 31st day of the month of March.

Explanation 2.- If the manufacturer of goods or the provider of output service fails to pay the amount payable under sub-rules (5), (5A), (5B) and (5C), it shall be recovered, in the manner as provided in rule 14, for recovery of CENVAT credit wrongly taken and utilised.”

2. Notification No. 05/2014 – Central Excise (N.T.), dated 24.02.2014 - CENVAT Credit Rules, 2004

In rule 7 of the CENVAT Credit Rules, 2004, -
(i) in clause (b) for the words, “used in a unit”, the words “used by one or more units” shall be substituted;
(ii) in clause (c) for the words, “used wholly in a unit”, the words “used wholly by a unit” shall be substituted;
(iii) for clause (d), the following clause shall be substituted, namely:-

“(d) credit of service tax attributable to service used by more than one unit shall be distributed pro rata on the basis of the turnover of such units during the relevant period to the total turnover of all its units, which are operational in the current year, during the said relevant period.”;

(iv) for Explanation 3, the following shall be substituted, namely:-

“Explanation 3.- For the purposes of this rule, the ‘relevant period’ shall be,-

(a) If the asessees have turnover in the ‘financial year’ preceding to the year during which credit is to be distributed for month or quarter, as the case may be, the said financial year; or

(b) If the asessees does not have turnover for some or all the units in the preceding financial year, the last quarter for which details of turnover of all the units are available, previous to the month or quarter for which credit is to be distributed.”

In the Central Excise Rules, 2002, in rule 9, in sub-rule (1), after the words “uses excisable goods”, the words “or an importer who issues an invoice on which CENVAT Credit can be taken” shall be inserted.

4. Notification No.12/2014 – Central Excise (N.T.), dated the 3.03.2014- notification regarding procedures, safeguards, conditions and limitations for grant of refund of CENVAT Credit under rule 5B of CENVAT Credit Rules, 2004

The refund of CENVAT credit shall be allowed to a provider of services notified under sub-section (2) of section 68 of the Finance Act,1994, subject to the procedures, safeguards, conditions and limitations, as specified below, namely:-

1. Safeguards, conditions and limitations. –

(a) the refund shall be claimed of unutilised CENVAT credit taken on inputs and input services during the half year for which refund is claimed, for providing following output services namely:-

   (i) renting of a motor vehicle designed to carry passengers on non abated value, to any person who is not engaged in a similar business;

   (ii) supply of manpower for any purpose or security services; or

   (iii) service portion in the execution of a works contract;

Explanation:- For the purpose of this notification,-

Unutilised CENVAT credit taken on inputs and input services during the half year for providing = (A) – (B)

partial reverse charge services

Where,

\[
A = \frac{\text{CENVAT credit taken on inputs and input services during the half year}}{\text{turnover of output service under partial reverse charge during the half year (\*)}} \times \frac{\text{total turnover of goods and services during the half year}}{\text{total turnover of goods and services during the half year}}
\]

\[
B = \text{Service tax paid by the service provider for such partial reverse charge services during the half year;}
\]
(b) the refund of unutilised CENVAT credit shall not exceed an amount of service tax liability paid or payable by the recipient of service with respect to the partial reverse charge services provided during the period of half year for which refund is claimed;

(c) the amount claimed as refund shall be debited by the claimant from his CENVAT credit account at the time of making the claim;
(d) in case the amount of refund sanctioned is less than the amount of refund claimed, then the claimant may take back the credit of the difference between the amount claimed and the amount sanctioned;
(e) the claimant shall submit not more than one claim of refund under this notification for every half year;
(f) the refund claim shall be filed after filing of service tax return as prescribed under rule 7 of the Service Tax Rules for the period for which refund is claimed;
(g) no refund shall be admissible for the CENVAT credit taken on input or input services received prior to the 1st day of July,2012;

Explanation. – For the purposes of this notification, half year means a period of six consecutive months with the first half year beginning from the 1st day of April every year and second half year from the 1st day of October of every year.

Procedure for filing the refund claim

(a) the provider of output service, shall submit an application in Form A annexed hereto, along with the documents and enclosures specified therein, to the jurisdictional Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise, as the case may be, before the expiry of one year from the due date of filing of return for the half year:

Provided that the last date of filing of application in Form A, for the period starting from the 1st day of July,2012 to the 30th day of September,2012, shall be the 30th day of June,2014;

(b) if more than one return is required to be filed for the half year, then the time limit of one year shall be calculated from the due date of filing of the return for the later period;

(c) the applicant shall file the refund claim along with copies of the return(s) filed for the half year for which the refund is claimed;

(d) the Assistant Commissioner or Deputy Commissioner to whom the application for refund is made may call for any document in case he has reason to believe that information provided in the refund claim is incorrect or insufficient and further enquiry needs to be caused before the sanction of refund claim;

(e) at the time of sanctioning the refund claim, the Assistant Commissioner or Deputy Commissioner shall satisfy himself or herself in respect of the correctness of the refund claim and that the refund claim is complete in every respect;

For rule 12CCC of the Central Excise Rules, 2002, the following shall be substituted, namely:—

“12CCC. Power to impose restrictions in certain types of cases.— Notwithstanding anything contained in these rules, where the Central Government, having regard to the extent of evasion of duty, nature and type of offences or such other factors as may be relevant, is of the opinion that in order to prevent evasion of, or default in payment of duty of excise, it is necessary in the public interest to provide for certain measures including restrictions on a manufacturer, first stage and second stage dealer or an exporter may, by notification in the Official Gazette, specify the nature of restrictions including suspension of registration in case of a dealer, types of facilities to be withdrawn and procedure for issue of such order by the Chief Commissioner of Central Excise.

Explanation.- For the purposes of this rule, it is hereby clarified that every proposal initiated in terms of the procedure specified under notification no. 05/2012-CE (N.T.) dated the 12th March, 2012 published in the Gazette of India, Part II, Section 3, Sub-section (i) vide number G.S.R. 140(E), dated the 12th March, 2012, which is pending, shall be treated as initiated in terms of the procedure specified under this rule and shall be decided accordingly.”


For rule 12AAA of the CENVAT Credit Rules, 2004, the following shall be substituted, namely :—

“12AAA. Power to impose restrictions in certain types of cases.— Notwithstanding anything contained in these rules, where the Central Government, having regard to the extent of misuse of CENVAT credit, nature and type of such misuse and such other factors as may be relevant, is of the opinion that in order to prevent the misuse of the provisions of CENVAT credit as specified in these rules, it is necessary in the public interest to provide for certain measures including restrictions on a manufacturer, first stage and second stage dealer or an exporter, may by notification in the Official Gazette, specify the nature of restrictions including restrictions on utilization of CENVAT credit and suspension of registration in case of a dealer and type of facilities to be withdrawn and procedure for issue of such order by the Chief Commissioner of Central Excise.

Explanation.- For the purposes of this rule, it is hereby clarified that every proposal initiated in terms of the procedure specified under notification no. 05/2012-CE (N.T.) dated the 12th March, 2012 published in the Gazette of India, Part II, Section 3, Sub-section (i) vide number G.S.R. 140(E), dated the 12th March, 2012, which is pending, shall be treated as initiated in terms of the procedure specified under this rule and shall be decided accordingly.”

***************
PROFESSIONAL PROGRAMME

DRAFTING, APPEARANCES AND PLEADINGS

MODULE 3 - PAPER 8
Lesson 7
Drafting of Agreements under the Companies Act

LESSON OUTLINE

- Introduction
- Promoters’ Contract-Pre- Incorporating Contracts
- Memorandum of Association
- Drafting of Memorandum
- Articles of Association
- Drafting of Articles
- Underwriting and Brokerage Agreements
- Underwriting Contract
- Shareholders Agreement
- Contract of Appointment with Managing Director
- Contract of Appointment with Manager
- Contract of Appointment with Secretary
- Deeds of Amalgamation of Companies: Transfer of Undertakings
- Compromise, Arrangements and Settlements
- Slump Sale Agreement
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated, such contracts are called preliminary or pre-incorporation contracts. Memorandum of Association of the company is the fundamental formation document. It is the constitution and charter of the company. Articles are rules and regulations for management of internal affairs of the company.

Corporate professionals like Company Secretaries have to advise the companies in drafting various documents as well as to undertake legal documentation pertaining to a range of other functions.

The objective of this lesson is to make the students appreciate the skills involved and the important requirements to be borne in mind in the drafting of memorandum of association, articles of association, company’s agreements in particular shareholders agreements, agreements for the appointment of managing director & manager etc.
The word ‘Promoter’ has not been defined by the Companies Act, 1956 but a definition of the word promoter has been added in the Companies Act, 2013. As per Section 2(69) of the Companies Act, 2013, Promoter” means a person –

(a) Who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

(b) Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity;

Generally Promoter of a company is a person who does the necessary preliminary work in connection with the formation and the establishing of the company. It is Promoters only who conceives an idea, develops it, formulates a scheme or project and takes all the necessary steps for the formation of a company to implement the project or the scheme.

Before the company is registered by the Registrar promoters continue to be known as promoters. They gather funds for meeting the expenses in connection with the formation of the company and spend them, which are known and designated as “preliminary expenses” and a provision is made in the articles of association of the company authorising the company and its directors to reimburse promoters the preliminary expenses incurred by them, and also a provision for the formalisation of the contracts which the promoters of the company had entered into with third parties prior to the company coming into existence. Promoters usually enter into contracts with the prospective directors, solicitors, bankers, brokers, underwriters, auditors, secretary, manager and with those who offer to sell land, plant, machinery equipment etc. for implementing the proposed project. Such contracts are known as “promoters’ contracts” which are not binding on the company because the company had not come into existence when they were entered into with third parties by the company's promoters. However, as a matter of practice, the company, on its incorporation enters into fresh contracts with the third parties on the lines of the promoters’ contracts, which then become binding on the company.

Companies Act, 2013 does not contain any provisions about Promoter’s Contract. The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated, such contracts are called preliminary or pre-incorporation contracts. The promoters, generally enter into such contracts as agents for the company about to be formed. The legal position is that since presence of two consenting parties is necessary for a contract, and the company before incorporation is a non-entity, the promoters cannot act as agents for the company, which has yet to come into existence. As such, the company is not liable for the acts of the promoters done before its incorporation.

When the company comes into existence, it is not bound by the pre-incorporation contracts even when it takes the benefit of the work done on its behalf. However, specific performance of a contract between a third party and the promoters may be successfully claimed by the third party against the company, when the company enters into possession of the property on the faith of the promoters’ contract.

Similarly, the company, after incorporation, cannot enforce any contract made before its incorporation, which means the company cannot sue the other party to the contract if the other party fails to carry out the contract.
Promoters remain personally liable on the contract.

A company also cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purporting to have been made on its behalf before it came into existence, as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of the contract by the agent. Where a contract is made on behalf of principal known to both parties to be non-existent, the contract is deemed to have been entered into personally by the actual maker, i.e. the agent. A company may, if it desires, enter into a new contract, after its incorporation, with the other party which is known as novation of promoter’s contracts; and if it makes a fresh contract in terms of the preliminary contract, the liability of the promoters comes to an end and if it does not make a fresh contract within a limited period of time, either of the parties may rescind the contract.

The essential feature of novation is that the right under the original contract is relinquished and a new right referable to a new contract is created. The substituted contract must, in order to effect a novation, be enforceable one.

The pre-incorporation agreements entered into by the promoters acting on behalf of the intended company with third party cannot always be avoided for various reasons. These agreements affect the operations of the incorporated company.

**A Specimen of Promoters’ Contract for the Purchase of an Industrial Plot for setting up Industrial Unit of the Proposed Company ABC Ltd.**

THE AGREEMENT made on..................... day of..................... between Mr. A, son of Mr..................... resident of....................., Mr. B, son of Mr..................... resident of....................., and Mr. C, son of Mr..................... resident of.....................’ (hereinafter referred to as “promoters”) of the one part which expression shall, unless repugnant to the context include their heirs, legal representatives and assigns and Mr. “V” son of Mr..................... resident..................... (hereinafter referred as “Vendor”) of the other part, which expression shall, unless repugnant to the context, include his heirs, legal representatives and assigns.

WHEREAS the promoters have been engaged for quite sometime in the past in promoting and forming a company to be known as ABC Ltd., which name has been made available to the promoters by the Registrar of Companies....................., consequent upon which they have filed with the Registrar memorandum of association and articles of association for registration of the company;

AND WHEREAS the memorandum and articles of association of the proposed ABC Ltd., empower the company and its directors to enter into agreements on its incorporation on the lines of the agreement entered into by the promoters for the purchase of land, plant, machinery, equipment and for hiring the services of persons required for and in connection with the formation and incorporation of the company;

AND WHEREAS the Vendor is the absolute owner of industrial plot of land measuring..................... and situated at..................... and is desirous of selling the same;

AND WHEREAS the promoters and desirous to buy the said plot of land for the proposed company ABC Ltd. to set up an industrial unit on its incorporation.

NOW IT IS AGREED AND DECLARED BETWEEN AND BY THE PARTIES AS FOLLOWS:

That the said vendor shall sell and the promoters shall purchase the industrial Plot No..................... situated in the..................... Industrial Area, .....................bounded on North by....................., on South by....................., on East by....................., and on West by..................... in consideration of the payment, by the promoters on the date of this agreement, of the sum of Rs..................... and the balance of Rs..................... on the date of the appearance of the vendor and the promoters before the Sub-Registrar..................... at the time of registration of the deed of sale to this agreement.

2. The vendor shall satisfy the promoters or ABC Ltd., if incorporated by then, about the title of the vendor to the
aforesaid piece of land within one month of the execution of this agreement and the promoters or their attorney
shall be entitled to ask for such information as may be necessary to ascertain the title of the vendor and the vendor
shall be bound to allow inspection of the title deeds relating to the plot of land at his place within two months of the
date of this agreement. On the satisfaction of the promoters as to the title of the vendor in respect of the said plot
of land, the parties shall complete the transaction of the sale within six months of the date of this agreement.

3. The parties shall bear the expenses of sale equally. The purchaser shall pay to the vendor the expenses for
purchase of stamp, a fortnight before the expiry of the period fixed for this agreement for completion of the sale
and the promoters shall also at the same time deliver to the vendor a draft of the deed of sale which the vendor
shall, if in proper form, execute at his expense in favour of the purchasers and present the same for registration
on or before the date fixed for the completion of the sale transaction.

4. The vendor shall deliver actual possession of the plot of land to the promoters or the company on the date of
payment of the balance of the price aforementioned and shall do all other acts that may be necessary or
requisite to effectually put the promoters or ABC Ltd., as the case may be, in such possession.

5. In case there found to be any error or misdescription in area or the boundaries or the other specifications of
the plot of land agreed to be conveyed to the promoters of ABC Ltd. or ABC Ltd., as the case may be, corresponding
decrease or increase in price relating to the area and rectification of misdescription of the specification relating
to boundaries etc. shall be permissible, and shall not form any ground for avoiding this agreement for sale of the
plot of land.

IN WITNESS WHEREOF the parties aforementioned have signed this deed of acceptance of the terms thereof.

1. Witness Vendor
2. Witness Purchasers/Promoters of the Company
    ABC Limited, under incorporation.
3. Witness A
4. Witness B
    C

(Schedule of Land)

A Specimen of Agreement entered into by and between ABC Ltd. on its Incorporation and Mr.
......................... Vendor of Industrial Plot No......................... Situated......................... who had
earlier entered into an Agreement dated......................... for the Sale of the said Plot of land to
the Promoters of the Company.

THIS AGREEMENT made and entered into the......................... day of......................... between Mr. 'V' son of
Mr......................... resident of......................... (hereinafter called “the vendor”) which expression shall, unless,
repugnant to the context, include his heirs, legal representatives and assigns of the one part and ABC Ltd., a
company incorporated under the Companies Act, 2013 and having its Registered Office at.........................
(hereinafter known as “the company”) which expression shall, unless repugnant to the context, include its legal
representatives, of the other part.

WHEREAS the company was incorporated on......................... under the Companies Act, 2013 as a public
limited company with a nominal share capital of Rs......................... divided into......................... equity share of
Rs......................... each;

AND WHEREAS Mr. A, Mr. B and Mr. C have been engaged for quite sometime in the past in promoting and
forming this company;

AND WHEREAS the said promoters of the company, Mr. A, Mr. B and Mr. C had entered into agreement with the
vendor on the…………………., for the purchase of industrial plot of land No…………………. situate at…………………., a copy of the plan whereof is annexed hereto as Annexure-I;

AND WHEREAS the memorandum and articles of association of the company empower the company and its directors to enter into agreements with third parties on the terms and conditions of the agreements entered into by and between the promoters and the third parties for the purchase of land, plant, machinery, equipment etc. for the company;

NOW IT IS HEREBY AGREED BY AND BETWEEN THE PARTIES OF ONE PART AND PARTY OF THE OTHER PART:

That the said vendor shall sell and the company shall purchase the industrial plot No………..…………………. situate in the……...……..…………………. Industrial Area, ………………….more precisely described in the Schedule hereto in consideration of payment by the company on the date of this agreement of the sum of Rs…………………. and the balance of Rs…………………. on the date of the appearance of the vendor and the company before the Sub-Register, ………………….at the time of registration of the deed of sale pursuant to this agreement.

2. The company has already satisfied itself with regard to absolute title of the vendor in the said plot of land and has already given to the vendor a draft of the deed of conveyance and the vendor hereby agrees and undertakes to execute the same in favour of the company within a period of a fortnight of the date of execution hereof and present the same for registration within the said period of fort-night.

3. The vendor shall deliver actual possession of the plot of land to the company on the date of payment of price aforementioned and shall do all other acts that may be necessary or requisite to effec-tually put the company in such possession.

Signed and delivered by within named vendor in presence of:

Witness - 1………………….
Witness - 2………………….
Signature of Vendor

Signed, sealed and delivered by within named company (purchaser)

(Name of the Company)

Through its Director

Shri………………….
Signature………………….

In presence of:

Witness - 1………………….
Witness - 2………………….

Agreement by Company Adopting Contract made on its behalf before its Incorporation

This Agreement made at New Delhi on this………………... day of………………... 2014 between Shri A of the 1st part, Shri B of the Second part and AB & Co. Ltd. (hereinafter referred to as ‘the company’) of the third part.

Whereas after the execution of the contract on 10th July, 2014 (hereinafter referred to as “the said contract”) between Shri A, the vendor, and Shri B, on behalf of the company, the said company AB & Co. Ltd. has been incorporated under the Companies Act, 2013.

Now it is hereby agreed by and between the parties hereto as under:
1. The said contract dated 10th July, 2014 is hereby adopted by the company and shall be binding on the said Shri A and on the company in the same manner and shall take effect in all respects as if the company had been in existence at the date of the agreement.

2. Shri B who actually signed on behalf of the proposed company shall be discharged from all liability under the said contract as the company had adopted and ratified the said contracts.

In witness whereof the parties hereunto have put their hands and signatures and the company has caused its common seal affixed in the presence of Shri……………. and Shri……………. two directors who have set their respective hands and signatures the day and year first herein above written in terms of the Resolution passed in its Board of Directors in their meeting held on…………….

Common Seal

Witnesses:

……………………………..
(Signature)

1……………………………..
Director

……………………………..
(Signature)

2……………………………..
Director

Signatures of A ……………………..
B……………………………..

MEMORANDUM OF ASSOCIATION

Memorandum of association of the company is the fundamental formation document. It is the constitution and charter of the company. It contains the basic conditions on the strength of which the company is incorporated. Thus, it defines and confines the area of operation of the company. It lays down the area, beyond which the action of the company cannot go. Sections 4 of the Companies Act, 2013 and Table A, B, C, D and E in Schedule I as may be applicable to such company deal with contents, form and printing and signature of memorandum of association. Students are advised to be conversant with the above sections, as they are very relevant to drafting.

Drafting of Memorandum

It is pertinent to note that memorandum is the main edifice upon which the whole structure of the company is erected. It is the basic document fundamental to its existence. Further, it is also to be noted that as it is the charter of the company defining scope of its activity and extent of power it could exercise, so that its shareholders, creditors, bankers and other third parties who deal with the company could know the range of the company’s enterprise. Based on the provisions of Section 4 of the Companies Act, 2013, the main drafting requirements of contents of a Memorandum are summarized below:

1. Name of the company

As per Section 4(1) (a) of the Companies Act, 2013, in the case of a public limited company the name of the company should last with the word “Limited”, or in the case of a private limited company, the name of the company should last with the words “Private Limited. In case of Companies Registered under Section 8 of the Companies Act, 2013 these provisions does not apply.
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As per Section 4(2) of the Companies Act, 2013, the name stated in the memorandum shall not—

(a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or

(b) be such that its use by the company –

(i) will constitute an offence under any law for the time being in force; or

(ii) is undesirable in the opinion of the Central Government.

2. Registered Office of the Company

As per Section 4(1) (b) the memorandum of the company should mention the State in which the registered office of the company is to be situated;

3. Objects of the Company

The memorandum of the company should state the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

The objectives of the company may be categorized as

(i) the main objects to be pursued by the company on its incorporation;

(ii) subjects incidental and ancillary to the attainment of the main objects; and (iii)

(iii) Other objects not included in (i) and (ii) above.

An act beyond the objects mentioned in the memorandum is *ultra vires* and void and cannot be ratified even by all members of the company. There is no restriction on objects except it should be legal and lawful. While drafting the objects, care should be taken to see that:

(i) The objects are stated in a precise and clear manner so that there is no ambiguity in their interpretation;

(ii) Each object is stated independently;

(iii) There is no inconsistency or contradiction between the objects;

(iv) The same objects are not repeated in other clauses of objects in different words and phraseology;

(v) No object is illegal, immoral or against public policy;

(vi) Objects are properly arranged and divided and set in short sentences.

Prior approval of the competent authority is obtained wherever necessary for carrying out any objective.

**Main objects**

The objects which are intended to be pursued by the company on its incorporation and in the immediate foreseeable future are its main objects. The objects clause should be widest possible coverage in precise and clear expression. This will save the company from litigation on the ground that the object pursued by the company fall outside the permitted range of its activity. No hard and fast rule could be devised for drafting main objects of the company. But a successful drafting could be done with caution and planning. Further, it may be brought to the notice that alteration of the objects clause will entail, passing of special Resolution and approval of central government which is a time consuming, cumbersome and costly. Normally not more than four objects are permitted by ROC. Hence one has to make himself very clear about the company’s main objects and not to mistake ancillary object as main one. In short, the principal objects i.e. main objects, the company has finally decided upon and for which the company plans to undertake immediately or in the near future, are included in the Main Objects.
Objects incidental or ancilliary

The objects under this category are not independent objects and cannot be entered upon by the company independent of its main objects. These objects are pursued only to the extent they are necessary for attainment of the main objects. Some of the clauses which are commonly included in the objects incidental and ancilliary to the main objects are enumerated below (Palmer’s Co. Law 90-91 21st Edn.):

(i) A clause authorising the company to carry on the particular business which it proposes to carry on, and also to carry on various other business which it may probably or possibly be desirable to carry on;

(ii) A clause empowering the company to acquire any other business similar to its own;

(iii) A clause empowering the company to enter into any agreement for sharing profits, joint venture or other arrangement of a like nature with other persons or companies carrying on any similar business;

(iv) A clause empowering the company to take shares in other companies having similar objects, etc. such a power is commonly wanted, and not easily implied but may be implied, e.g. from a clause allowing amalgamation;

(v) A clause empowering the company to promote other companies for any purpose calculated to benefit the company;

(vi) A power generally to acquire property and rights which the company may think necessary or convenient for the purpose of its business. In dealing with outsiders, it is found useful to have an express power like this, and so preclude any question of capacity;

(vii) A power to lend money and guarantee the performance of contracts by customers and others;

(viii) A power to borrow or raise money by the issue of debentures, debenture stock, or otherwise;

(ix) A power to draw, make, accept, endorse, discount and issue promissory notes, bills of exchange, debentures and other negotiable or transferable instruments;

(x) A power to sell and dispose of the undertaking of the company for shares, debentures or securities of any other company having objects altogether, or in part, similar to those of this company;

(xi) A power to obtain an Act of Parliament for enabling the company to carry out any purpose which may seem expedient; or to oppose any proceedings or applications which seem to prejudice directly or indirectly the interests of the company;

(xii) A power to sell, improve, manage, develop, exchange, lease, mortgage, dispose of, turn to account, or otherwise deal with, all or any part of the property and rights of the company;

(xiii) A declaration that the objects specified in the sub-clauses of the clause shall be regarded as independent objects, and shall be construed independently of the other sub-clauses of it and that none of the objects mentioned in any sub-clauses shall be deemed to be merely subsidiary to the objects in any other sub-clause (except where otherwise expressed in such sub-clauses).

Further, it may include power to make donations to political or charitable trusts, amalgamations with other companies, extension of its operations abroad etc.

No borderline could be created between the Main Objects and objects incidental and ancilliary to main objects. The attainment of main objects should be facilitated by the objects incidental and ancilliary. This makes it imperative that reasonable nexus or resemblance should exist or to be shown to exist in objects incidental and ancilliary with main objects while drafting these clauses.
**Other Objects**

Third part of the objects clause enumerates the objects which are covered neither by main objects nor by objects ancilliary or incidental thereto, but which are nevertheless necessary to enable the company to undertake all types of business activities which the company may anticipate to pursue. The types of clauses which are commonly included in this part are mentioned below:

(i) a clause empowering the company to deal in machinery, appliances, plants, tools, transport vehicles of all kinds and descriptions, etc.;

(ii) a clause empowering the company to act as insurance agents, financiers, underwriters, commission agents and forwarding and other agents;

(iii) a clause empowering the company to acquire land, buildings, mines, forests, plantation etc.;

(iv) a clause empowering the company to carry on the business of manufacture, import, processing and dealing in industrial chemicals, pharmaceuticals and medical products;

(v) a power to manufacture and deal in fats, fertilisers, fungicides, insecticides, etc.;

(vi) a power to generate or distribute electricity or other motive power;

(vii) a power to undertake, sponsor and carry out programmes of rural development;

(viii) a power to carry on any business capable of being conveniently carried on with the other objects;

(ix) a clause empowering the company to search for, develop or produce minerals and their products and by-products;

(x) a power to undertake, purchase or otherwise acquire and hold and dispose of and to deal in shares, debentures and other securities.

(xi) to undertake, promote, sponsor or assist any activity for the promotion or growth of national economy and for discharging social and moral responsibility of the company towards the public or any section thereof.

Nevertheless, the other objects of the company to be included in objects clause are simple as these need not resemble to either the main objects or the objects incidental and ancilliary. But other objects should not be ambiguous and irrelevant to the main objects of the company. The use of words “and to do all such other acts, as are incidental or conducive or as the company may think conducive to the attainment of the above objects are used at the end of this clause.

**Objects clause to mention the States of operation**

In the case of a company other than a trading company, objects clause must also mention the States to whose territories the objects of the company extend, if the objects of the company are not confined to one State.

4. The Liability of Members

This clause of memorandum should state the liability of members of the company, whether limited or unlimited, and also state, –

(i) In the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and

(ii) In the case of a company limited by guarantee, the amount up to which each member undertakes to contribute –
(A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
(B) To the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

5. Capital Clause

This clause of memorandum of association of company should include in the case of a company having a share capital, –

(i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and
(ii) The number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

6. Name of one person Company’s Subscriber

In the case of One Person Company, the memorandum of association of a company should contain the name of the person who, in the event of death of the subscriber, shall become the member of the company.

The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

Any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

ARTICLE OF ASSOCIATION

The provisions regarding Articles of a company are contained in Section 5 of the Companies Act, 2013 and Table F, G, H, I and J in the Schedule I of the Companies Act, 2013. An article of Association is another equally important document for incorporation of a limited company. Articles are rules and regulations for management of internal affairs of the company. It constitutes a contract between the company and its members and members inter se. It is framed with the object of carrying out aims and objects of the company as contained in Memorandum and if necessary it may clarify anything contained in Memorandum. The article of a company contains the regulations for management of the company and other such matters, as may be prescribed:

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with. However the provisions for entrenchment referred above shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company. Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.

The articles of a company should be in respective forms specified in Tables, F, G, H, I and J in Schedule I which contains the model articles applicable to such company.

Contents of Articles

The articles of association usually contain provisions relating to the following matters:
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(a) Share capital, rights of shareholders, variation of these rights, payment of commission, share certificates:
(b) Lien on shares;
(c) Calls on shares;
(d) Transfer of shares;
(e) Transmission of shares;
(f) Forfeiture of shares;
(g) Alteration of capital;
(h) Capitalisation of Profit
(i) Buy Back of Shares
(j) General Meeting
(k) Voting Rights
(l) Proxy
(m) Board of Directors
(n) Proceeding of the Board
(o) Key Managerial person of the company
(p) Seal of the company
(q) Dividend and Reserve of the company
(r) Accounts
(s) Winding up
(t) Indemnity

Articles of the company can be amended as per Section 14 of the Companies Act, 2013 and any alteration made in the articles should be recorded in all articles of the company.

Drafting of Articles

Utmost care is required to be taken to draft the Articles. It should contain strictly only relevant and necessary matters. In its draft, efforts must be made to incorporate comprehensive provisions so as to cover all statutory requirements and all possible contingencies. Any alteration requires cumbersome procedure to be followed which is expensive and time consuming.

Articles, as a public document of the company, have evidentiary value in matters which involve dealing of the company with its own members or third parties. Any person outsider has constructive notice of the contents of Articles and expected to inspect before entering into any transaction with the company. Articles must be signed by the subscribers of the Memorandum and be registered along with the Memorandum. In case of drafting the articles for a company limited by shares, the draftsman can follow the following alternatives:

(i) Adopt Table F of Schedule 1 in Companies Act, 2013 in full; or
(ii) Exclude Table A wholly and register own Articles suiting its requirements; or
(iii) Register own articles and in addition thereto allows Table A to apply so far as it is not modified or excluded by the articles.
Articles shall be divided into paragraphs numbered consecutively. This will help the company to alter the articles conveniently.

Some important points which a draftsman should bear in mind while drafting the Articles are as follows:

1. Share capital, its kinds rights attached to different kinds of shares or any special privileges attached thereto should be considered and incorporated in Articles.

2. Directors – appointment of directors, their noting rights, resignations, termination etc. should be given due consideration and their rights, powers and privileges should be incorporated in Articles Proportional representations may also be looked into.

3. In Government Companies, Joint Sector Companies, Joint Ventures with foreign companies, joint venture with Government Companies, the main terms of their partnership in Share Capital as well as the management of the affairs of the company with power and authority delegation be relevantly discussed in the Articles with scope and limitations thereto to avoid any misinterpretation.

4. As far as possible, regulation given in Table F may be borrowed, even if it is not made applicable so that Article may conform to the intent and spirit of law.

5. Efforts should be made to make each article self explanatory and self interpretative to avoid misleading conclusions. Coherence and sequence of the contents should be maintained at any costs.

6. Any items which are already mentioned in Memorandum and is to be mentioned in Articles, it is better that it is put in words such as “as mentioned in Memorandum of Association” which will skip the requirement of altering Articles when Memorandum is altered.

7. No provision which a company cannot do either as per Memorandum or Companies Act or any other law, should find a place in articles: e.g. expulsion of members. This is opposed to Company Jurisprudence and is ultra vires of the Act.

8. Where the company would require assistance from financial Institutions, provisions be made for appointment of nominee directors, conversion of loans from financial institutions into equity etc.

After drafting a proper balancing should be done with Memorandum’s contents, as to coverage, inconsistencies with it, contradictions occurred etc. to enable proper modification in time. It is better to have an Article of an existing company in the same field of activity, either to modify it or at least to know the relevant matters which can be included in the Draft. Before printing it is better be shown to ROC and seek his informal approval

**UNDERWRITING AND BROKERAGE AGREEMENTS**

Underwriting is an insurance against risk. When shares or debentures of a company are issued, they are, by and large, underwritten to ensure that all the shares or debentures issued are taken up and thus the required capital is raised. Before entering into an underwriting arrangement with a member of any recognised stock exchange, it is the duty of the directors of the concerned company to ensure that the underwriter has sufficient financial resources to meet any obligation which may devolve upon him in the event of the issue not being fully subscribed by public.

**Power of a Company to Pay Brokerage/Underwriting Commission**

Section 40 of the Companies Act, 2013 permits a company to pay certain commissions and prohibits the payment of all other commissions, discounts etc.

The company may exercise the powers of paying commissions conferred by sub-section (6) of section 40, provided that the rate per cent. or the amount of the commission paid or agreed to be paid shall be disclosed in the manner required by that section and rules made thereunder.
(ii) The rate or amount of the commission shall not exceed the rate or amount prescribed in rules made under sub-section (6) of section 40.

(iii) The commission may be satisfied by the payment of cash or the allotment of fully or partly paid shares or partly in the one way and partly in the other.

As per Rule 13 of the Company (Prospectus and Allotment of Securities) Rules, 2014 A company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions, namely:-

(a) The payment of such commission shall be authorized in the company’s articles of association;

(b) The commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) The rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent of the price at which the debentures are issued, or as specified in the company’s articles, whichever is less;

(d) the prospectus of the company shall disclose –
   (i) the name of the underwriters;
   (ii) the rate and amount of the commission payable to the underwriter; and
   (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

(e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;

(f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Specimen Agreement for Acting as Broker to an Issue

Name and address of the firm of brokers who agree to act as brokers.

Ref. No………………. Date………………

The Board of Directors
(Name and address of the company
for whose public issue the firm
agrees to act as broker)

Dear Sir(s),

Re: Proposed public issue of……………… (type of security) Shares/ Debentures of Rs…………… each for cash at par of………………Ltd.

We, the undersigned, hereby testify and consent to act as Brokers to the Issue of………………. Shares/Debentures of Rs…………… each for cash at par as captioned above by……………… Ltd. and to our name being inserted as Brokers in the prospectus which the company intends to issue in respect of the proposed issue of capital and we hereby authorise the said company to deliver this consent to the Registrar of Companies………….. pursuant to Section 40(6) of the Companies Act, 2013.

As required under Rule 13 of the Company (Prospectors and Allotment of Secretaries) Rules, 2014, we are agreeable to accept one and a half per cent on the issue price as brokerage on allotment made in respect of applications bearing our rubber stamp as brokers.
Dear Sir(s),

Re: Proposed Public Issue of Equity Shares

We, hereby record the terms on which we (hereinafter referred as “underwriters”) have agreed to underwrite……………… Equity Shares of the aggregate nominal value of Rs…………….. out of the total issue of……………… Equity Shares to be offered to the public at Rs……/- each for cash at par.

1. The prospectus as approved by the underwriters will be delivered to the Registrar of Companies …………… on or before……………… for registration in accordance with the provisions of Rule 13 of the Company (Prospectors and Allotment of Secretaries) Rules, 2014. Sufficient number of copies of the prospectus and application forms shall be printed and made available to the underwriters, brokers and members of the public who intend to apply for the Equity Shares as soon as possible thereafter.

2. Underwriters shall be entitled to arrange sub-underwriting with respect to their respective commitments for their own account on terms to be arranged at their discretion with their sub-underwriters.

3. If by the closing date of the subscription list or such earlier date as may be agreed to by the underwriters, the Equity Shares offered to the public are not subscribed in full by the public and the application money payable in respect thereto is not received by you, you will within 14 days or such extended time as may be agreed to by the underwriters, notify the underwriters in writing as to the amount/number of Equity Shares which have not been so subscribed. The underwriters shall within 21 days after the receipt of such intimation apply for and subscribe such unsubscribed amount/number of Equity Shares and pay or procure to be paid the money payable on application in respect of such Equity Shares in proportion that the amount underwritten by each of them bears to the total amount of the issue.

4. In determining the amount/number of Equity Shares to be taken up by the underwriters the following factors shall be taken into consideration:

(a) In no circumstances will the underwriters be liable to take up Equity Shares more than the amount underwritten by them.

(b) All applications made before the closing of the subscription list by the underwriters, or on forms of application bearing the stamp of the underwriters, and not withdrawn in the meantime shall be taken into account in pro tanto reduction of the liability of the underwriters under this underwriting agreement.

(c) After scrutiny of the applications received, the total shortfall shall first be allocated among all persons who have underwritten the issue and who have not fulfilled their quota, in proportion to the amount underwritten by each of them.
(d) Credit shall be given to each underwriter who has not fulfilled his quota in relation to applications made by members of the public independently proportionately to the amount underwritten by each underwriter, any amount or such credit being in excess of the commitment of any underwriter being similarly shared proportionately by the others.

5. Subject to the terms of the prospectus, you will allot Equity Shares for which applications have been received as soon as possible and despatch Equity Share Certificates within six months of such allotment.

6. In consideration of the underwriting you will, within 14 days from the date on which we shall have fulfilled our obligation, pay the underwriters a commission at the rate of two and a half per cent on the issue of the amount/number of Equity Shares underwritten by the underwriters.

7. Notwithstanding anything stated above the underwriters shall have the option to be exercised by them at any time prior to the date fixed finally for publication of the “Announcement” of terminating underwriting arrangement in the event of a complete breakdown or dislocation of business in the financial markets of the cities of Calcutta, Bombay, Madras and Delhi due to war, insurrection, civil commotion or any other serious or sustained or political or industrial disturbances or if the whole present basis of Stock Exchange prices in any such city should undergo substantial change through the occurrences of such catastrophe or similar event at present not foreseen. In the event of underwriters exercising such option they shall be released from all obligations arising out of the underwriting agreement.

8. Our offer is valid subject to your subscription list opening on or before………………

Please acknowledge receipt of this letter and intimate to us your acceptance of the terms and conditions mentioned above.

Thanking you,

Yours faithfully,

For………………

**Underwriting Contract**

An agreement made the………… day of………… 20…… between……………… of………… (hereinafter called the underwriters) of the one part, and ………………”Ltd. whose registered office is situate at……………… (hereinafter called the ‘the company’) of the other part:

Whereas the company is about to offer for public subscription as issue of……………… shares of……………… each in accordance with the terms of the draft prospectus a copy of which is annexed hereto, or with such modifications therein as may be mutually agreed upon bet­ween the company and the underwriters:

Now it Is hereby agreed as follows:

1. If the said……………… shares shall on or before the……………… day of……………… 20……… (or such latter date as shall be mutually agreed upon by the parties hereto not after than the……………… day of……………… 20……..) be offered by the company for subscription by the public at par on the terms of such prospectus as aforesaid, the underwriters shall on or before the closing of the subscription list apply at par for the said……………… shares.

The said prospectus shall be issued in the form already approved by the underwriters or with such modification, if any, as shall mutually agreed between the company and the underwriters.

2. If on the closing of the lists under the said prospectus the said……………… shares shall be allotted in respect of applications from the public the responsibility of the underwriters is to cease and no allotment is to be made under this agreement but if the said……………… shares shall not be allotted to the public but any smaller
number of such shares is so allotted, the undertaking of the underwriters is to stand for the difference between the said................. shares and the number of the shares allotted to the public.

3. The company shall pay to the underwriters in cash within…… days from the allotment of the said................. shares a commission at the rate of p.c. on the nominal value of the shares.

4. This agreement is to be irrevocable on the part of the underwriters and is to be sufficient in itself to authorise the company in the event of the underwriters not applying for the said................. shares to cause application to be made for such shares or any part thereof in the name and on behalf of the underwriters in accordance with the terms of the said prospectus and authorise the directors of the company to allot the said................. shares of the company or any part thereof to the underwriters (but subject to the provisions of this agreement) and in the event of the company causing an application to be made for such shares in the name of the underwriters, the underwriters shall hold the company and the said applicants harmless and indemnified in respect of such application.

Shareholders' agreements

Shareholders' agreements (SHA) are quite common in business. In India shareholder’s agreement have gained popularity and currency only lately with bloom in newer forms of businesses. There are numerous situations where such agreements are entered into – family companies, JV companies, venture capital investments, private equity investments, strategic alliances, and so on. Shareholders’ agreement is a contractual arrangement between the shareholders of a company describing how the company should be operated and the defining inter-se shareholders’ rights and obligations. shareholders’ agreement. SHAs are the result of mutual understanding among the shareholders of a company to which, the company generally becomes a consenting party. Such agreements are specifically drafted to provide specific rights, impose definite restrictions over and above those provided by the Companies Act. A SHA creates personal obligation between the members signing such agreement however, such agreements do not become a regulation of the company in the way the provisions of Articles are.

Enforceability of the Shareholder's Agreement

Though the international view is split but to a large extent courts are inclined towards favouring SHA as long as they are not found to be detrimental to the minority stakeholder’s rights. In the leading case of Russell v. Northern Bank Development Corporation Ltd [1992] BCC 578; [1992] 1 WLR 588, the House of Lords found that though a company cannot deprive itself of its power to alter its constitution, the members of the company could agree in a shareholders’ agreement as to how they will exercise their voting rights on a resolution to alter the articles/constitution. The US Courts have largely accepted shareholder agreements. [Blount v. Taft [246 S.E.2d 763 at 769 (1978)]

While shareholders’ agreements are enforceable in England regardless of whether they have been incorporated in the articles of association of the company, in India courts have either refused to recognize clauses in shareholders agreements or, even when consistent with company legislation, enforced such clauses only if they have been incorporated in the articles of association of the company. There is a series of rulings where the courts have upheld that in case of any conflict between the Articles and the SHA, the former will always prevail. Some of these are:

- V.B. Rangaraj v. V.B. Gopalakrishnan (AIR 1992 SC 453)
- Shanti Prasad Jain v. Kalinga Tubes Ltd., (35 Com. Cas. 351 SC)
- Mafatlal Industries Ltd., v. Gujarat Gas Co. Ltd (97 Comp Cas 301 Guj).
- Pushpa Katoch v. Manu Maharani Hotels Limited ([2006] 131 Comp Cas 42 (Delhi)]

The Supreme Court in V.B. Rangaraj v. V.B. Gopalakrishnan, AIR 1992 SC 453 held that a restriction which is not specified in the articles of association is not binding either on the company or on the shareholders. This decision was reiterated by the Bombay High Court in IL & FS Trust Co. Ltd. v. Birla Perucchini Ltd [2004] 121 Comp Cas 335 (Bom).
However, the Supreme Court in 2003 in its decision in *M.S. Madhusoodhanan v. Kerala Kaumudi Pvt. Ltd.* (2003 117 CompCas 19 SC) not disagreeing with the decision in *V.B Rangaraj* case mentioned above, but distinguishing itself from the facts in that judgment, held that a restriction in relation to identified members on identified shares of a private company did not amount to restriction of transferability of shares per se.

In *Western Maharashtra Development Corporation Ltd. v. Bajaj Auto Ltd* [(2010) 154 Company Cases 593 (Bom)], it was held that such clauses are to hamper the free transferability of shares and in violation of the Companies Act, and hence, are not enforceable. Subsequently in the case of *Messer Madanmohan Ruia and Ors* [(2010) 98 CLA 325] the Division Bench of Bombay High Court overruled its judgment in *Western Maharashtra Development Corporation Ltd* and provided a more liberal interpretation and recognised the rights inter se among shareholders in case of restrictions on transfer of shares.

In Indian context, while the landmark decision of the Supreme Court in *V.B. Rangaraj* case mentioned above is often cited in the context of shareholders’ agreements, most other decisions have been rendered by the High Courts in various states especially the Bombay High Court. The decisions on shareholders’ agreements are not uniformly inclined in a direction. The High Court decisions are limited in their applicability as they are susceptible to disagreements by other High Courts, thereby conferring limited precedential value. It is difficult to come to clear and crisp answers as to enforceability of shareholders’ agreements

**Specimen Shareholders Agreement**

THIS AGREEMENT made the ____ day of ______, 2013 BETWEEN MR. A residing at _____________________ (hereinafter referred to as “A”) (which expression shall, unless repugnant to the context or meaning hereof, mean and include his heirs, executors, administrators and assigns) of the First Part.

And

MR. B residing at __________________________ (hereinafter referred to as “B”) (which expression shall, unless repugnant to the context or meaning hereof, mean and include his heirs executors, administrators and assigns) of the Second Part.

And

________________________ (P) LTD., a Company incorporated under the Companies Act, 2013 and having its registered office at _____________________ herein represented by its ___________ (hereinafter referred to as “XYZ”) which expression shall, unless repugnant to the context or meaning hereof, include its successors and assigns) of the Third Part;

WHEREAS:

(A) A and B hereto have agreed to jointly manage a company in India named “XYZ Pvt Ltd.”;

(B) A and B have agreed to become Equity Partners by investing in the shares of the Company subject to the condition that they shall enter into a Shareholders Agreement in terms of these presents;

(C) The Company “XYZ PVT. LTD. “ has been requested to, and has agreed to, join in the execution of these presents and to take this Agreement on record so that it is aware of the rights and obligations of A AND B, the parties hereto and ensure that they comply with the same;

(D) The parties hereto are desirous of recording the terms and conditions of their Agreement in writing;

NOW IT IS HEREBY AGREED BY AND BETWEEN THE PARTIES HERETO AS FOLLOWS:-

1. (a) A and B shall jointly invest in the Company which is an existing company limited by shares under the Companies Act, 2013 and known as “XYZ PVT LTD”.

(b) The registered office of the Company shall be situate at ______________, or at such other places as may be mutually agreed upon between the parties in writing.
(c) The Company shall carry on the business of running and managing restaurants and (Description of the business and complete address), either by itself or through other agencies or company industries and may carry on any other business as may be decided by B hereto and shall ensure that no other business activity is undertaken by the Company at any time without the consent of A hereto.

2. The authorised share capital of the Company is Rs.________/- (Rupees ___________________ only) consisting of ______________ (________) equity shares of Rs.10/- (Rupees ten) each.

3. The subscription by A hereto to the aforesaid authorised share capital of the Company shall be 1,00,000 (One lakh) equity shares of Rs.10/- (Rupees ten only) and the subscription by B to the aforesaid authorised share capital of the Company shall be 1,00,000 (One lakh) equity shares of Rs.10/- (Rupees ten only).

4. There shall be no further issue of capital without the consent of both the parties hereto, and unless otherwise agreed upon in writing further investment shall be as mutually decided by both parties.

5. (a) The Board of Directors of the Company shall consist of A and B

(b) A shall have the right to nominate two (2) Additional Directors onto the Board and B shall have the right to nominate three or more Additional Directors on the Board. Both parties shall be entitled at any time to remove any of the representatives on the Board by written notice to the other party and to appoint another or other/s in their place.

(c) The day to day management of the Company shall be looked after by a Managing Director to be appointed with the consent of B hereto. Any major acquisition of property, substantial expansion of business activities or diversification or matters of policy shall be with the prior consent of B.

(d) It is agreed as between the parties hereto that the position of Chairperson of the Company shall be held by B or a nominee of B. The Chairman of the Board shall also be the Chairman of all general meetings of the Company.

6. A and B hereto jointly and severally shall vote and act as members of the Company and with respect to the shares of the Company held by them, so as to ensure that Directors of the Company are at all times appointed and maintained in office in conformity with the provisions of this Agreement. If at any time the provisions of this Agreement are not fully complied with, A and B jointly and severally agree to promptly take all necessary steps to ensure that the provisions of this Agreement hereof are fully implemented in letter and spirit.

7. (a) The Auditors of the Company shall be M/s.______________________.

(b) The Auditors of the Company shall not be changed without the prior written consent of both A and B.

8. Any sale or transfer of shares in the Company by either party shall be as provided in Clause 9. If at any time during the continuance of this Agreement either A or B, desire to sell or transfer all or any of their respective shares held by them in the Company, they shall do so strictly in accordance with the provisions hereinafter written.

9. If either A or B desires at any time to sell the whole or part of their shares in the Company, he shall first offer such shares in writing to the other. If the other does not accept in writing the offer within 15 days of receipt of the offer, the first party shall then be at liberty within 30 days thereafter to sell the shares so offered to any other persons of its choice at the same price and on the same terms and conditions as contained in its written offer to the other party hereto in the first instance, failing which the procedure contained in this sub-clause will have to be repeated by a party desiring to sell his shares.

10. B will bring in further working capital to run an F & B Unit(s) at (Address of registered office). _________ Bank had advanced loans of about Rs. 1,10,00,000/- (Rupees One Crore Ten Lakhs Only) to XYZ which loans have to be repaid by them. B will be bringing further moneys upto Rs.___ (Rupees______Only) to repay the loan. The Balance Rs. ____/- has been secured with the collateral security provided B. XYZ have entered into a
Management and Royalty Agreement with ———— (P) Ltd., for the operation and management of the F & B unit(s) of XYZ and are entitled to receive their share of profit. A and B are equally entitled to this share of profit being equal shareholders of XYZ. It is hereby agreed that A shall not be entitled to a percentage of the profit which shall not exceed Rs. ———/- (Rupees ________________ Only) per month from XYZ out of his share of profit subject to the terms contained herein and/or in any other document executed by him on behalf of XYZ. The balance money attributable to A shall be utilized to repay the loans and interest outstanding to ________ Bank, and the amount of Rs. ________ /- brought in by B and interest thereon, and towards the working capital brought in by B and interest thereon and any other loans of the XYZ. This arrangement will continue till the entire sums (liabilities) together with the interest thereon have been repaid. However B will be entitled to withdraw the profit attributable to his share.

11. B will be entitled to interest at the rate of 12% per annum on the sums brought in by him or his Associates / concerns / businesses.

12. A and B agree and undertake not to disclose or divulge directly or indirectly to any third party any trade or business secret or other secret or confidential information pertaining to the business, affairs or transactions of each other or of the Company or of their clients or customers, that may have been disclosed, imparted to or acquired by either of them from the other or from the Company.

13. A and B jointly and severally undertake:-

(a) that they shall ensure that they, their representatives, proxies and agents representing them at general meetings of the shareholders of the Company shall at all times exercise their votes in such manner so as to comply with, and to fully and effectually implement, the provisions of this Agreement.

(b) that if any resolution is proposed contrary to the terms of this Agreement, the parties, their representatives, proxies and agents representing them shall vote against it. If for any reason such a resolution is passed, the parties will, if necessary, join together and convene an extraordinary, general meeting of the Company in pursuance of section 100 of the Companies Act, 2013 for implementing the terms of this Agreement.

14. A and B shall jointly and severally procure and/or ensure that the Director or Directors of its choice on the board of the Company shall at all times fully and effectually implement and comply with (including by exercise of voting rights at meetings of the Board or resolutions by circulation and on resolutions passed at a meeting of any Committee of the Directors) the provisions of this Agreement.

15. If either A or B shall commit a breach of any of the terms or provisions of this Agreement and shall fail to rectify such breach within Sixty (60) days from the receipt of written notice from the party complaining of the breach, then the latter shall be entitled, without prejudice to its other rights and remedies under this Agreement or at law, to terminate the Agreement recorded herein by written notice.

16. No modification of alteration of this Agreement or any of its terms or provisions shall be valid or binding on A and/or B unless made in writing duly signed by both.

17. This Agreement is personal to A and B and shall not be transferred or assigned in whole or in part by either party without the prior written consent of the other.

18. If any dispute or difference shall at any time arise between A and B as to any terms, provisions or matters contained herein on as to their respective rights, claims, duties or liabilities hereunder or otherwise, howsoever in relation to or arising out of or concerning this Agreement, such dispute or difference shall be referred to the arbitration. The venue of such arbitration shall be in Bangalore unless otherwise agreed in writing. Such arbitration shall be held under and in accordance with the provisions of the Arbitration and Conciliation Act, 1996.

19. This Agreement represents the entire agreement between the parties hereto on the subject matter hereof and cancels and supersedes all prior agreements, arrangements or understandings, if any, whether oral or in writing, between the parties hereto on the subject matter hereof.
IN WITNESS WHEREOF the parties hereto have executed these presents the day and year first hereinafter written.

SIGNED AND DELIVERED by MR. A
in the presence of 

SIGNED AND DELIVERED by MR. B
in the presence of 

SIGNED AND DELIVERED for and on behalf of XYZ
By its SHAREHOLDERS AND AUTHORISED DIRECTORS
MR. A
MR. B
in the presence of 

Contract of Appointment with Managing Director

According to Section 2(54) of the Companies Act, 2013, “managing director” means “a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors is entrusted with substantial powers of management of the affairs of the company, and includes a director occupying the position of a managing director, by whatever name called.”

While drafting a contract of appointment, the following points have to be taken care of:

The person who is being appointed as managing director must be a director of the company; and He must be entrusted with substantial powers of management.

Usually the articles of association of companies empower the Board of directors to appoint one or more of the directors as managing director(s) and fix their remuneration subject to the provisions of Sections 196, 197, 198, 199, 200 and other applicable provisions of the Act and Rules make thereunder. The Board of directors while appointing a director as managing director, critically examines the draft agreement prepared by the secretary for the appointment of the managing director and after having approved the same with or without any modification, authorises one of its directors to sign and execute for and on behalf of the company, the agreement for the appointment of the managing director. It should, therefore, be made sure that the person executing the agreement on behalf of the company is duly authorised by the Board of directors in this regard.

Being an agreement, such a contract must have all the other essential ingredients of a contract under the Indian Contract Act, 1872, namely,

(i) free consent of parties;
(ii) competence to contract;
(iii) for a lawful consideration;
(iv) with a lawful object; and
(v) are not expressly declared to be void in the Act (Section 10).
Section 11 of the Contract Act lays down that “every person is competent to contract who is of the age of majority, according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject.”

Section 12 of the said Act provides that a person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgement as to its effect upon his interests. A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind. A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

According to Section 14 of the Contract Act, consent is said to be free when it is not caused by –

- coercion;
- undue influence;
- fraud;
- misrepresentation; or
- mistake.

**Specimen Agreement of Service as a Managing Director of a Company**

THIS AGREEMENT is made on the………….. day of………….. 2013 between………….. Ltd., a company incorporated under the Companies Act, 2013 and having its Registered Office at………….. (hereinafter called “Company” of the one part and Mr………….. son of Mr………….. resident of………….. (hereinafter called “the Managing Director” of the other part).

It is hereby agreed as follows:

1. The company hereby appoints subject to the approval of the Government of India under Section 203 of the Companies Act, 2013, Mr………….. as Managing Director of the company for period of five years with effect from………….. and the Managing Director hereby agrees to serve the company in such capacity for a period of five years with effect from…………..

2. The Managing Director shall exercise and perform such powers and duties as the Board of directors of the company (hereinafter called “the Board”) shall, from time to time, determine, and subject to any directions and restrictions, from time to time, given and imposed by the Board and subject to the restrictions contained hereinafter, he shall have the general control, management and superintendence of the business of the company with power to appoint and dismiss employees (other than officers of the company drawing a basic pay of Rs. 3000/- and above per month) and to enter into contracts on behalf of the company in the ordinary course of business and to do and perform all other acts and things, which in the ordinary course of business he may consider necessary or proper or in the interest of the company.

3. Without prejudice to the generality of the powers vested in the Managing Director under the preceding clause hereof, the Managing Director shall be entitled to exercise the following powers–

   (a) With Board’s approval singly or together with other authorised officer(s) of the company, to open and operate on any banking or other account and to draw, make, accept, execute, endorse, discount, negotiate, retire, pay, satisfy and assign cheques, drafts, bills of exchange, promissory notes, hundis, interest and dividend warrants and other negotiable or transferable instruments or securities;

   (b) Together with other authorised officer(s) of the company to borrow moneys with or without security, but not exceeding Rs. five lakhs at a time from one party;

   (c) To incur capital expenditure up to a sum of Rs. five lakhs during any financial year;
(d) Together with other authorised officer(s) of the company, to invest funds of the company in approved securities (other than in shares of other companies) and on fixed deposit with the company’s bankers provided that such investments in any one financial year shall not exceed Rs. twenty lakhs;

(e) To engage employees and other servants for the company at a basic salary not exceeding Rs. 3000/- per month within the budget sanctioned by the Board;

(f) To increase the salary or the remuneration of any employee or servant of the company whose basic salary does not exceed Rs. 2,000/- per month. General increments must be with the Board’s approval;

(g) Together with other authorised officer(s) of the company, to enter into contracts for the purchase of goods and hiring of services for the company which contracts do not extend over a period of one year or exceed in value the sum of Rs. ten lakhs;

(h) To institute, prosecute, defend, oppose, appear or appeal, to compromise, refer to arbitration, abandon subject to judgment, proceed to judgment and execution or become non-suited in any legal proceedings relating to customs or excise duties, tax on income, profits and capital and taxation generally or otherwise.

4. The Managing Director shall, throughout the said term, devote the whole of his time, attention and abilities to the business of the company, and shall obey the orders, from time to time, of the Board and in all respects conform to and comply with the directions and regulations made by the Board, and shall faithfully serve the company and use his utmost endeavour to promote the interest thereof.

5. The company shall pay to the Managing Director during the continuance of this agreement in consideration of the performance of his duties –

(a) a salary at the rate of Rs………….. per month;

(b) the actual travelling expenses incurred by the Managing Director in or about the business of the company;

(c) the actual entertainment expenses and approved club membership fees reasonably incurred by the Managing Director in or about the business of the company;

(d) the actual hospital and medical expenses which have been incurred by the Managing Director for himself, his wife, dependent parents and his minor children, provided that such expenses during the three consecutive financial years shall not exceed Rs…………

(e) The Managing Director shall be entitled to use the company’s car, all the expenses for maintenance and running of the same including salary of the driver to be borne by the company;

(f) The company shall provide the Managing Director with rent free furnished accommodation and will pay electricity and water charges;

(g) He shall also be entitled to use the company’s telephone at his residence, the charges whereof shall be borne by the company;

(h) The Managing Director shall be entitled to participate in any provident fund and gratuity fund or scheme for the employees which the company may establish;

(i) The Managing Director shall be entitled to such increments from time to time as the Board may in the discretion determine;

(j) The Managing Director shall be entitled to privilege annual leave on full salary for a period of one month, such leave to be taken at such time to be previously approved by the Board; Provided that the Board shall be entitled, at its sole and uncontrolled discretion, to permit the Managing Director to accumulate such leave for not more than three months; provided further that any leave not availed of by the Managing Director shall be encashable.
6. The Managing Director shall not during the period of his employment, and without the previous consent in writing of the Board, engage or interest himself either directly or indirectly in the business or affairs of any other person, firm, company, body corporate or concern or in any undertaking or business of a nature similar to or competing with the company's business and further shall not, in any manner, whether directly or indirectly, use, apply or utilise his knowledge or experience for or in the interest of any such person, firm, company, body corporate or concern as aforesaid or any such competing undertaking or business as aforesaid.

7. The Managing Director shall not, during the continuance of his employment or any time thereafter, divulge or disclose to any person, firm, company, body corporate or concern, whatsoever or make any use whatever for his own or for whatever purpose of any confidential information or knowledge obtained by him during his employment of the business or affairs of the company or of any trade secrets or secret processes of the company and the Managing Director shall, during the continuance of his employment hereunder, also use his best endeavours to prevent any other person, firm, company, body corporate or concern from doing so.

8. Any property of the company or relating to the business of the company, including memoranda, notes, records, reports, plates, sketches, plans, or other documents which may be in the possession or under the control of the Managing Director or to which the Managing Director has at any time access, shall at the time of the termination of his employment be delivered by the Managing Director to the company or as it shall direct and the Managing Director shall not be entitled to the copyright in any such document which he hereby acknowledge to be vested in the company or its assigns and binds himself not to retain copies of any of them.

The Managing Director shall, from time to time, during his employment hereunder, fully disclose to the company the progress of his investigation and any discoveries he may make himself or in conjunction with others and if at any time hereafter he shall make himself or in conjunction with others any improvement, invention or discovery arising out of or in connection with the said employment he shall forthwith disclose to the Company or any patent agent appointed by it a full and complete description of the nature of the said improvement, invention or discovery and the mode of performing the same.

9. The whole interest of the Managing Director in the said improvement, invention or discovery and in all future improvements thereon at any time discovered or invented by the Managing Director alone or in conjunction as aforesaid, shall be the sole and absolute property of the Company and the Managing Director, if and whenever required by the Company during the period of employment or after the termination thereof shall at the expense of the Company, join with the Company in applying for letters patent, design registration or other forms of protection in India and in such other countries as the Company may direct for the said improvement, invention or discovery or any such improvement thereon and shall, on the request by, and at the expense of the Company, execute, sign and do all applications, assignments, instruments and things necessary to vest the whole of his interest in the said improvements, invention or discovery or improvement thereon and any letters patent or other protection that may be obtained in respect thereof, in the Company or person or persons appointed by it.

10. If the Managing Director shall at any time be prevented by ill-health or accident from performing his duties hereunder, he shall inform the Company and if he shall be unable by reason of ill-health or accident for a period of sixty days in any period of twelve consecutive calendar months to perform his duties hereunder, the Company may terminate his employment.

11. The Company shall be entitled to terminate this agreement in the event of the Managing Director being guilty of misconduct or such inattention to or negligence in the discharge of his duties or in the conduct of the Company's business or of any other act of omission or commission inconsistent with his duties as the Managing Director or any breach of his agreement.

12. If before the expiration of this agreement the tenure of office of the Managing Director shall be determined by reason of a reconstruction or amalgamation whether by the winding up of the Company or otherwise, the Managing Director shall have no claim against the Company for damages.
13. The Company shall be at liberty from time to time to appoint a person or persons to be Managing Director(s) jointly with the Managing Director.

The Managing Director hereby agrees that he will not, at any time, after the termination of this agreement, represent himself as being in any way connected with or interested in the business of the company.

IN WITNESS WHEREOF the parties hereto have set their hands the day, month and the year first above written.

Witnesses:

for and on behalf of the company

1.

2. Managing Director

**Contract of Appointment with Manager**

Section 2(53) of the Companies Act, 2013 defines “Manager” as an individual who, subject to the superintendence, control and direction of the Board of directors, has the management of the whole, or substantially the whole, of the affairs of the company, and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not.

The above definition highlights the following points, which must be borne in mind by the secretary while drafting an agreement for the appointment of a manager:

1. a manager has to be an individual only;
2. a manager has the management of the whole, or substantially the whole, of the affairs of the company;
3. a manager functions subject to the superintendence, control and direction of the Board of directors of the company;
4. a manager may be under a contract or not.

If, for the appointment of a manager, an agreement is not drawn and executed, then the secretary must draft a detailed Board resolution approving the appointment of a manager, making it very clear that the manager shall have the management of the whole or substantially the whole of the affairs of the company, and shall function under the superintendence, control and direction of the Board of directors, which means that he shall act under the directions of the Board, his actions shall be subject to the scrutiny and supervision of the Board and finally the Board shall direct the manager in his day-to-day management of the affairs of the company. As against a managing director, who is entrusted by the Board of directors with substantial powers of management, a manager by virtue of his appointment, has the power of management. A managing director after the powers of management have been entrusted to him performs his day-to-day functions independently according to the mandate of the Board, whereas a manager acts under the superintendence, control and direction of the Board. Keeping the above subtleties between the two managerial personnel in view, the secretary shall proceed to draft an agreement for the appointment of a manager.

**Specimen Agreement for the Appointment of a Manager in a Company**

AN AGREEMENT made this………….. day of………….. between………….. Ltd., a company incorporated under the Companies Act, 2013 and having its Registered Office at………….., (hereinafter referred to as the Company, which expression shall, unless repugnant to the context or contrary to the meaning thereof include its legal representatives) of the one part and Mr………….., son of Mr………….., resident of………….. (hereinafter called the manager) of the other part.

WHEREAS the company intends to appoint a Manager and Mr………….., has been considered as a suitable and competent person for the said post;

AND WHEREAS the said Mr………….. has agreed to accept his appointment as the Manager of the Company.
NOW IT IS HEREBY AGREED AS FOLLOWS:

1. The said Mr.………….. is hereby appointed on the terms and conditions hereinafter provided, as the Manager of the Company for a term of five years commencing………….. on a monthly remuneration of Rs. ... subject to the approval of his appointment by the Central Government under Section 203 of the Companies Act, 2013 and also subject to the approval of his remuneration by the Central Government pursuant to the provisions of Sections 196, 197, 198, 199 and 200 and other applicable provisions of the Act.

2. The Manager shall be entitled to other pecuniary benefits which are enjoyable by other employees of the company.

3. The Manager shall be paid travelling allowance for the tours he makes in connection with the, business of the company to perform his duties or to carry out the directions of the Board of Directors of the company.

4. The Manager shall be entitled to bonus in accordance with the provisions of the law.

5. The Manager shall be entitled to annual increment of his remuneration at the rate of Rs………… per annum.

6. The Manager shall be on probation for a period of six months. If his work is found satisfactory, his appointment shall continue for a full term of five years including the period of probation.

7. Either the company or the Manager shall be entitled to terminate this agreement by, giving the other, notice in writing of sixty days but the company may terminate this agreement by paying two months’ remuneration to the Manager in lieu of the notice.

8. If the Manager dies during his continuance of service, his salary, remuneration, bonuses, allowances etc. for the current financial year shall be paid to his heirs, legal representatives, executors, administrators in a rateable proportion of what he would have received if he had lived and had continued in the service of the company for the whole of that year.

9. The Manager shall not be entitled to make any claim for damages against the company other than liquidated damages, if his services are determined on account of a reconstruction or amalgamation whether by the winding up of the company or otherwise before the expiration of this agreement.

10. The Manager shall devote the whole of his time and attention to the business of the company during the term of his service with the company and shall work with due diligence and using his abilities to his best. He shall comply with the directions issued by the Board of Directors of the company from time to time. He shall obey the orders issued by the Board of Directors. He shall do his best to promote the interest of the company and shall faithfully serve the company.

11. The Manager shall perform the duties towards the company and exercise the powers assigned to or vested in him by the Articles of Association of the company or by the Board of Directors of the company.

12. The Manager shall not disclose during the term of his service any information obtained by him in relation to the business of the company while attending to his duties and discharging his functions or exercising his powers as the Manager even to such employees of the company as have no concern with the information or to any person not connected with the company.

13. The Manager shall not divulge any secret relating to any working process, improvement in the working process used by the company, invention leading to improvement in the working process or introduction of a new working process usable in the business of the company, invention relating to any of the articles connected with the business of the company, business matters, administrative affairs of the company, to any person not connected with such process, invention, matter and affairs either during the period of his employment in the company or any time after he has left the company.

14. The Manager shall be entitled neither to make use of any of the inventions in relation to the business of the company made by him during the employment in the company, nor to derive any benefit of all the patents
whether obtainable in respect thereof in India or abroad, as such inventions and patents shall belong to the
comppany. The Manager shall do at the expense of the company all that is necessary to give full benefit of such
invention and patents whenever he is required to do so.

15. The Manager shall be bound not to do himself or participate or associate in any capacity with others in doing
the business in which the company is engaged during the period of his employment with the company and for a
period of six years after he has left the services of the company.

16. The Manager shall never make use of the working process used by the company even after he has left the
services of the company and he shall not employ any invention relating to the business of the company either
made by him during the period of his employment in the company or invention relating to the business of the
company made by other employees of the company at any time.

IN WITNESS WHEREOF the parties hereto have set their hands on the day, month and year above written.
Witnesses:

For………….. Ltd.

1.

2.

Manager

**Contract of Appointment with Secretary**

The position of Secretary in a company is a very important one. He is the person who acts as liaison between the
Board of Directors and the shareholders on the one hand, with the Departmental Division heads and with the
world at large on the other hand. Every information from various departments, divisions, branches, executives,
departmental heads, shareholders, creditors, debtors, bankers, financial institutions, Government departments
and others concerned with the company converges in his office. He gathers all the information, arranges it in a
useful manner, furnishes it with explanations etc. on the company’s long-term policies and short-term plans as
formulated by the Board of directors to the concerned persons. He collects, arranges and presents the desired/
required information to the Board on the progress in the implement­ation of the various decisions of the Board
so that whenever and wherever some corrective or preventive actions are to be taken, the same be taken in time
by the Board.

The Company Secretary is expected to be expert in all the aspects of corporate management viz., Company
Law and Practice Income-tax Law and Practice, Excise, Sales tax, Import and Export and Industrial Licensing
Law and Practice, various types of insurance-covers, Patents, Trade Marks, Design and Copyright Law and
procedure, Industrial Law, Shops and Commercial Establishments Law and Essential Commodities Act and the
Orders issued thereunder, drafting of various corporate documents, reports etc. and, accounts, audit, banking
and finance.

The appointment of a Company Secretary is done by the Board of Directors and he functions at the pleasure of
the Board. He acts under the Board’s instructions but at the same time he is adviser to the Board in all corporate
matters. Therefore, the relation­ship between the Board and the Company Secretary has to be very cordial and
there must be perfect understanding between the two, particularly with the Chairman/Managing director, executive
director and other Chief Executive Officers.

Usually the appointment of a Company Secretary is made by an appointment letter signed and issued by the
Chief Executive Officer, who may be the managing director, executive director, whole-time director etc. under
specific authority of the Board.

This letter is an offer by the company to the prospective Company Secretary and when he accepts the same it
become a binding contract between him and the company and their relationship is governed by the terms and
conditions thereof. “company secretary”, according to Section 2(24) of the Companies Act, 2013 means a company
secretary as defined in clause (1) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is
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appointed to perform the functions of company secretary under this Act.

The Government of India has formulated the Companies (Appointment and Qualifications of Secretary) Rules, 1988.

As per Section 205(1) of the Companies Act, 2013, the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;

(c) to discharge such other duties as may be prescribed.

Therefore, even if the letter of appointment of a Company Secretary or an agreement between the company and the Company Secretary is silent on those statutory duties and functions, a Company Secretary is bound by law to perform them strictly. Therefore, the letter of appointment or the agreement need not detail all those duties. Usually it contains the fact of offer by the company, the date on or before which he is required to join the service of the company, his salary and ‘perks’, his answerability to the Board of Directors and/or other senior executives of the company, his relationship with other departmental heads, his leave eligibility and other benefits, commitment on his part not to divulge the secrets of the company, so on and so forth.

A Specimen of the Letter of Offer to the Prospective Company Secretary

Name and Address of the company.

Ref. No. Date:

Mr……………………

Dear Sir,

I have been directed to advise you that the Board of Directors of the company have decided to appoint you as Secretary of the company and the said assignment is hereby offered to you. You are requested to join the service of the company on or before………….. and contact the undersigned so that you may be introduced to the concerned persons before you start functioning.

You will be considered to have been appointed with effect from the day you actually join duty.

2. The company shall pay to you a monthly basic salary of Rs……. in the time scale of pay of Rs……………………… with other allowances as are applicable to other employees of the company in the same time scale of pay,

3. You will enjoy other benefits like the medical expenses reimbursement, leave travel allowance, bonus etc. as may be permissible under the company’s service rules.

4. You shall be allowed casual leave/sick leave/festival holidays, weekly off days and earned leave as per rules of the company.

5. You will be on probation for a period of six months and on your services during the said probation period being found satisfactory the Board of Directors may consider you for confirmation in the said post.

6. During the period of your probation, your services may be terminated by the company without any notice and you may also leave the service of the company at twenty-four hours’ notice. On confirmation, however, the contract of employment may be terminated by either party by giving the other, thirty days’ written notice or paying thirty days’ salary in lieu thereof.

7. The company may terminate your services even after confirmation without giving you any notice if you are
found by the Board of Directors of the company not performing your assigned duties and your statutory duties properly and to the satisfaction of the Board.

8. As Company Secretary you shall be exclusively responsible: (a) for complying with all the provisions of the Companies Act and the various Rules framed thereunder and other laws applicable to the company; (b) maintaining all the statutory and non-statutory essential registers, books, files, records, papers etc.; (c) preparing and filing with the Registrar of Companies and other concerned authorities the required reports, returns, documents, papers etc. complete in all respects and within the prescribed periods of time; and

(d) for carrying out the instructions, directions and advice of the Board of Directors of the company given to you from time to time.

(d) ensuring the adherences of applicable secretarial standards.

9. You shall devote your whole time and attention to the work of the company during your tenure as Company Secretary and shall work with due diligence and using your abilities to your best. You shall obey the orders of the Board of Directors of the company. You shall do your best to promote the interest of the company and shall faithfully serve the company.

10. You shall not disclose to any unauthorised person during your employment as Secretary of the company an information obtained by you in relation to the business and corporate policies of the company with special reference to the company’s policy regarding the issue of rights shares, bonus shares, time and quantum of payment and/or declaration and payment of dividends from time to time.

Please convey your acceptance of the offer and the terms and conditions attached thereto by signing the carbon copy of this letter and returning the same to the company within a period of seven days from the receipt hereof.

Thanking you.

Yours truly

For…………..Ltd.

(…………………………)

Managing Director

I accept the above offer of the post of Company Secretary with all the terms and conditions attached thereto and shall join on………….. 

(…………………………)

Company Secretary

DEEDS OF AMALGAMATION OF COMPANIES: TRANSFER OF UNDERTAKINGS

An amalgamation may be defined as an arrangement whereby the assets of two companies become vested in, or under the control of one company, which may or may not be one of the original two companies. Such a company has as its shareholders all, or substantially all, the shareholders of the two companies. An amalgamation is effected by the shareholders of one or both of the amalgamation companies exchanging their shares either voluntarily or as a result of operation of law, for shares in the other or a third company. The arrangement is frequently effected by means of a take-over offer by one of the companies for the shares of the other, or of a take-over offer by a third company for the shares of both.

Specimen Agreement between two Companies to Amalgamate by Sale of one to the other

AN AGREEMENT made this………….. day of………….. between………….. Ltd., a company incorporated under the Companies Act, 2013 and having its Registered Office at………….. (hereinafter referred to as the
“Vendor”, which expression shall, unless repugnant to the context or contrary to the meaning thereof, include its successors and assigns) to the one part and………….. Ltd., a company incorporated under the Companies Act, 2013 and having its Registered Office at………….. (hereinafter referred to as “the company”, which term shall, unless repugnant to the context or contrary to the meaning thereof, include its successors or assigns) of the other part.

WHEREAS the vendor was incorporated in the year………….. with an authorised share capital of Rs. ten lakhs divided into one lakh Equity Shares of Rs. ten each and its Memorandum of Association contains a provision that the company shall have the power to sell, transfer or otherwise dispose of the whole or any part of the business and undertaking of the vendor company and to accept in consideration, cash or shares or debentures or debenture stock or other securities of any other company and to distribute among the members in specie or otherwise any surplus assets remaining in the winding-up of the vendor company.

AND WHEREAS the company was incorporated under the Companies Act, 2013 in the year………….. with an authorised share capital of Rs. fifty lakhs divided into five lakh Equity Shares of Rs. ten each and its Memorandum of Association contains a provision that the company may acquire by purchase or otherwise the business and undertaking, in part or whole of any other company or companies having any of the purposes or objects same or similar to those of the company.

AND WHEREAS the Articles of Association of the company also provide that the company is empowered to increase its share capital.

IT IS HEREBY AGREED AS FOLLOWS:

1. The vendor shall sell and the company shall purchase the whole of the business undertaking, assets and property of the vendor, benefits of all securities which shall include cheques and bills given to the vendor from time to time in consideration or payment thereof, benefits of subsisting contracts, and debts due to the vendor relating to the business of the vendor as a running concern from the day of………….. The said purchase shall not include the uncalled capital of the vendor. Up to the aforesaid date for the aforesaid purchase the vendor shall continue to carry on the business for the benefit of the company.

2. From the aforesaid date of the aforesaid purchase the company shall be liable for all the debts and liabilities of the vendor and shall be liable to perform all its engagements. The vendor shall be indemnified by the company against all claims and demands. The company shall defend all actions and proceedings against the vendor who shall also be indemnified in respect of such actions and proceedings.

3. The company shall pay to the vendor Rs. seven lakhs as consideration for the aforesaid purchase and out of the aforesaid consideration Rs. five lakhs shall be paid in cash and the balance of Rs. two lakhs shall be paid to the vendor by allotment of twenty thousand Equity Shares of Rs. ten each in the capital of the company credited as fully paid-up shares. For the allotment of the aforesaid shares, the vendor has conveyed its acceptance, vide its letter No………….. dated…………..

4. The company shall create and issue five lakh Equity Share of Rs. ten each to increase its shares capital as aforesaid and for the same purpose the company shall pass a resolution in accordance with the Articles of Association of the company and in accordance with the provisions of the Companies Act, 2013.

5. For the purpose of Stamp Duty, the value of the immoveable properties of the vendor shall be fixed for Rs………….. and the goodwill benefits of contracts and securities, debts, stock, fittings and fixture and all other properties of the vendor shall be valued at Rs…………..

6. The title deeds to all the immoveable and other properties of the vendor and an abstract of all the properties of the vendor, the sale of which is hereby agreed shall be handed over to the company within thirty days from this day………….. of………….. The company shall accept the same titles sufficient in all respects.

7. On the………….. day of………….., the vendor shall be paid Rs. five lakhs in cash and shall be delivered the
certificates showing that the company shall have allotted twenty thousand Equity Shares of Rs. 10 each fully paid-up of the share capital of the company.

8. Thereupon, the purchase shall be deemed to have been completed and the vendor shall execute necessary documents and do all things and give assurance as may be necessary and reasonable for the vesting of all the properties, the subject matter of the aforesaid purchase by the company.

IN WITNESS WHEREOF the parties hereto have set their hands and seals.

Signatures and seals of the parties.

COMPROMISE, ARRANGEMENTS AND SETTLEMENTS

During its life time a company may find it necessary to reorganise itself. Such a re-organisation may be for many reasons. When a company is financially weak, it wishes to reach a compromise with its members and/or creditors. It may wish to take over the business of another running but endangered company. It may wish to restructure its share capital.

Sections 390 to 396 (Sections 230 to 237 of the Companies Act, 2013*) provide various methods of company re-organisation or reconstruction. The various terms used for reorganisation are arrangement, reconstruction, amalgamation, merger, take-over, etc. They are distinct terms but they have many common features and to a great extent they overlap. The expression “arrangement” is of wider import and include reconstruction and amalgamation. “Arrangement” has been defined in explanation to section 230(1) of Companies Act, 2013 as including a reorganisation of share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both these methods.

“Arrangement” has a wider interpretation and includes reconstructions and amalgamations.

“Reconstruction” has not been defined in the Act. A reconstruction normally entails the transfer of an undertaking to another company, consisting substantially of the same shareholders with a view to its being continued by the transferee company, and usually resorted to for achieving one or more of the following objects:

(a) For the purpose of raising fresh capital by issuing partly paid shares in the new company in exchange for fully shares in the old company, and calling up the balance on new shares as and when required;

(b) For extending the company’s objects;

(c) For reorganising or rearranging the capital structure and the rights of members as between themselves; and

(d) For effecting a compromise with creditors, or the allotment to them of shares or debentures in settlement of their claims.

A reconstruction may, however take place, without the promotion and incorporation of new company, by compromise with members involving alterations of various rights between each class, usually also involving the writing down of the amount of share capital (as in a reduction of capital, which is a special form of reconstruction) and by a compromise with creditors (including debenture holders).

Amalgamation usually covers a situation where two or more companies join forces either under the name of one of them or in a new company formed for the purpose. This is a blending of two or more existing undertakings into one, the shareholders of each company becoming substantially the shareholders in the company which is to carry on the blended undertakings.

Amalgamation will usually require the consent of the directors of both the companies and may also be described as “Merger”. On the other hand, the word “take-over” is usually used to describe the acquisition by one company of sufficient number of shares in another company so as to give the purchaser company control over that company.

* Yet to be notified
Amalgamations and take-overs are resorted to for any one or more of the following purposes:

(a) For saving overheads and working expenses and for improving efficiency in the management, production and marketing by reason of unified control;

(b) For reduction or elimination of competition, and some times for securing the advantages of vertical combination by an amalgamation of companies to secure a linking of different stages or processes of production back to raw materials and forward to the finished product; and

(c) For obtaining greater facilities possessed by one large company, as compared with a number of smaller companies, for raising additional capital, for buying raw materials, etc. and for securing better credit facilities on the most favourable terms, and, what is, of increasing importance now a days, for carrying out research work on a large and co-ordinated scale and basis.

The memorandum of association of almost every company permits it to amalgamate with another company. In case there is no such provision, it will be necessary to alter the memorandum before any scheme of amalgamation is drawn up.

“Arrangement”

Section 391 of the Companies Act, 1956 provides that when a compromise or arrangement (the word compromise implies the existence of some dispute, but the word arrangement is of wider application) is proposed between a company and

(a) its creditors or any class of them; or

(b) its members or any class of them,

then the court may, on the application of the company, or any creditor or member, or, if the company is being wound up, the liquidator, order a meeting to be called of the creditors or class of creditors, or of the members or class, of members, as the case may be.

The compromise or scheme of arrangement will then be binding upon:

(a) all the creditors or class of creditors;

(b) the members or class of members;

(c) the company; and

(d) in the case of a company being wound up, upon the liquidator and contributories.

Provided that:

(1) it is approved by a majority in number representing three-fourths in value of the creditors or class of creditors, or members or class of members as the case may be, present and voting in person or by proxy; and

(2) it is sanctioned by the court.

Procedure

The following procedure shall be followed for carrying through a compromise or arrangement under Section 391 of the Act:

1. To prepare a scheme of compromise or arrangement with the concerned parties.

2. To apply to court by summons in Form No. 33 appended to the Companies (Court) Rules, 1959 for an order to convene a meeting of the creditors and or members or any class of them, supported by an affidavit in Form No. 34 of the Rules. The court may give such directions as it may think fit in respect of
holding and conducting the meeting or meetings.

3. To hold the meeting or meetings and let the result be reported to the court. The court appoints a chairman for the meeting and where there are separate meetings, for each such separate meeting. The chairman of the meeting, or of each meeting, must report the result thereof to the court within the time fixed by the court, or where no time has been fixed within seven days after the conclusion of the meeting.

4. When the proposed compromise or arrangement is agreed to, with or without modification, as provided by Section 391(2) to apply to the court for confirmation of the compromise or arrangement. The petition must be made by the company (if the company is in liquidation; by its liquidator) within seven days of the filing of the report by the chairman. The petition shall be made in Form No. 40 of the said Rules.

Where a compromise or arrangement is proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies, or for the amalgamation of any two or more companies, the petition must pray for appropriate orders and directions under Section 394 for facilitating the reconstruction or amalgamation of the company or companies.

The application under Section 391 is normally made by the company but any creditor or member also may make the application. It would, therefore, seem that a scheme could be started even if the company did not wish it, but the court will, it seems, refuse to convene the meetings if the company, either through its Board or simple majority of its members in a general meeting, has not approved the proposed scheme. This would be an exercise of the court’s discretion and not a limit on its powers.

Before an application is made by a company under Section 391, it is usual for the Chairman of the Board of the company which is to be reconstructed or where an amalgamation between two or more companies is proposed, for the Chairman of the Board of each of these companies, to send a circular letter to the members of the company or companies and when the creditors are affected, to them also, explaining the scheme of reconstruction or amalgamation, as the case may be, and the reasons which prompted the preparation of the scheme. The circular letter should specify how the scheme will affect the shareholdings of the members, and when applicable, the claims of the creditors, including debenture holders.

**Specimen Scheme of Amalgamation**

1. THIS SCHEME OF AMALGAMATION is presented for the amalgamation of A Ltd., with B Ltd., pursuant to the relevant provision of the Companies Act, 1956.

2. Notice under Section 6 of the Competition Act, 2002* will be given to the Competition Commission of India within 30 days of the approval of the proposal relating to amalgamation.*

3. The authorised share capital of A Ltd. is one crore Rupees divided into ten lakh Equity Shares of Rs. 10/- each. The issued, subscribed and paid-up share capital of A Ltd. is eighty lakh rupees divided into eighty thousand Equity Shares of Rs. 10/- each.

The authorised share capital of B Ltd. is ten crore rupees divided into one crore Equity Shares of Rs. 10/- each. The issued, subscribed and paid-up share capital of B Ltd. is eight crore rupees divided into eighty lakh Equity Shares of Rs. 10/- each.

4. With effect from the 1st of July, 2007 (hereinafter called “the Appointed Date”), the properties, investments, rights and assets of every kind of A Ltd. (hereinafter called “the said assets”), without further acts or deeds, be transferred to and vested in and/or deemed to be transferred to and vested in B Ltd. pursuant to Court Order under Section 394 of the Companies Act, 1956.

5. With effect from the Appointed Date, all deeds, liabilities and obligations (hereinafter referred to as “the said liabilities”) of A. Ltd., shall, without further acts or deeds, also be transferred to or deemed to have been transferred to B Ltd. so as to become the debts, liabilities and obligations of B Ltd.
6. With effect from the Appointed Date, A Ltd. shall be deemed to have been holding, and shall hold the said assets for and on account of B Ltd. until the Effective Date. A Ltd., hereby undertakes to hold the said assets with utmost prudence until the Effective Date.

7. Between the Appointed Date and the Effective Date, A Ltd. shall not without the concurrence of B Ltd., alienate charge or otherwise deal with any of the said assets, except in the ordinary course of business.

8. Subject to the provisions of Clause 13 hereof as regards payment of dividend, income accruing to A Ltd. or losses or expenditure arising or incurred by it after the Appointment Date up to the Effective Date shall, for all purposes, be treated as income or losses or expenditure, as the case may be, of B Ltd.

9. Subject to the other provisions of this Scheme, all contracts, deeds, agreements and other instruments to which A Ltd. is a party, subsisting and operative immediately on or before the Effective Date shall be in full force and effect against or in favour of B Ltd., as the case may be, and may be enforced as fully and effectively by it instead of A Ltd. as if B Ltd. had been party thereto.

10. All actions and proceedings by or against A Ltd. pending on the Effective Date shall be continued and enforced and be enforced by or against B Ltd.

11. The transfer of the said assets and the said liabilities of A Ltd. under clauses 4 and 5 hereof to B Ltd. and the continuance of all contracts and proceedings by or against B Ltd. under clause 9 and 10 shall not affect any contracts or proceedings relating to the said assets already concluded by A Ltd. on or after the Appointed Date to the intent that B Ltd. accepts and adopts a acts, deeds, matters and things done and/or executed by A Ltd. in regard thereto as having been done or executed on behalf of B Ltd.

12. Upon the scheme of amalgamation becoming effective in consideration of the transfer in favour of B Ltd. under the foregoing clauses of the said assets of A Ltd., B Ltd., shall, without further application, issue and allot to every shareholder of A Ltd., 80 fully paid Equity Shares of Rs. 10/- each of B Ltd., for 100 fully paid Equity Shares of Rs. 10/- each of A Ltd.

13. The Equity Shares of B Ltd. to be issued and allotted to the shareholders of A Ltd. shall rank pari passu in all respects with the existing Equity Shares of B Ltd. including entitlement to dividend in respect of all dividend declared after the Effective Date. B Ltd. and A Ltd. shall be entitled to declare and pay dividends prior to the Effective Date in respect of their current earnings up to the Effective Date.

14. Until the Effective Date, neither A Ltd. nor B. Ltd. shall issue or allot any Rights Shares or Bonus Shares out of their respective Share Capital for the time being.

15. So much of the Share Capital of B Ltd., as may be necessary, shall be appropriated to the shareholders of A Ltd. in the proportion and in the manner provided by clause 12 above and shall, with all reasonable despatch after this scheme shall finally take effect, be issued, allotted and credited as fully paid-up to such shareholders accordingly.

16. A Ltd. shall, with all reasonable despatch, apply to the High Court of Judicature at…………., and B Ltd., shall also with reasonable despatch, apply to the High Court of Judicature at…………. for orders sanctioning the scheme of amalgamation under Section 391 of the Companies Act, 1956 for carrying this scheme into effect and for dissolution without winding up of A Ltd.

17. A Ltd. and B Ltd., by their respective Boards of directors, may consent to any modification or amendment of this scheme which may be in the best interest of the companies concerned, or to any condition that either of the High Courts may deem fit to impose, and after dissolution of A Ltd., B Ltd. (by its Board of Directors) shall be authorised to give such directions or take such steps as may be necessary, desirable or proper to resolve any doubts, difficulties or questions, whether by reason of any order of the High Courts or of any directive or order of other authority or otherwise howsoever, arising out of or under or by virtue of this scheme and/or matter concerned or connected therewith.
18. All subsisting agreements of A Ltd. relating to use of trade marks, patents, designs of copy rights and/or technology shall accrue for the benefit of B Ltd., and proper documentation will be entered into for this purpose.

19. On this scheme finally taking effect as aforesaid –

- all employees of A Ltd. will become employees of B Ltd. with effect from the Effective Date without any break or interruption in service, and on their existing terms and conditions of services;
- the undertaking of A Ltd. will continue to function as a “Department A” of B Ltd. and all agreements entered into by A Ltd. with its bankers, distributors, stockists, agents shall continue to be in full force and effect and may be enforced as fully and effectively by B Ltd. instead of A Ltd. as if B Ltd. had been a party thereto. Likewise, the trusts created by A Ltd. for payment of provident fund, superannuation, gratuity etc. will continue to operate in favour of the employees of the “Department A”.

All business activities engaged in by A Ltd. shall be continued in the form of a “Department A” of B Ltd. to be called “Department A” and all agreements entered into by B Ltd. with its bankers, distributors, stockists, agents etc. shall continue to be in full force and effect, and may be enforced by or against such “Department A” of B Ltd. Likewise, the trusts created by A Ltd., for payment of provident fund, superannuation, gratuity etc. will continue to operate in favour of the employees of “Department A” of B Ltd.

20. This scheme is conditional on and subject to –

(a) the requisite sanction or approval, if any, of the Controller of Capital Issues and of other appropriate authorities being obtained and granted in the matters in respect of which such sanctions or approvals are required;
(b) the approval of any agreement with respect to the scheme by the requisite majority of the members of A Ltd. and of the members of B Ltd.;
(c) the necessary special resolution by members of B Ltd.;
(d) the sanction of the High Court of Judicature at………….. and of the High Court of Judicature at………….. under Section 391 of the Companies Act, 1956 and to the necessary order under Section 394 of the said Act being obtained; and
(e) its becoming fully effective and operative in accordance with Sections 391 and 394 of the Companies Act, 1956.

The scheme, although operative from the Appointed Date, shall take effect finally upon and from the date on which any of the aforesaid sanctions and approvals shall be last obtained which shall be “the Effective Date” for the purpose of this scheme.

21. In the event of any of the approvals or sanctions enumerated in clause 20 not being obtained or complied with on or before………….. or within such further period or periods as may be agreed upon by and between A Ltd. and B Ltd., through their respective Boards of Directors, the scheme shall become null and void, and in such an event, no rights and liabilities whatsoever shall accrue to or be incurred inter se between A Ltd. and B Ltd.

22. All costs, charges and expenses of A Ltd. and B Ltd. respectively in relation to or in connection with the negotiations leading to the drawing up of this scheme and to the agreement between the parties in respect thereof and of carrying out and complying with the terms and provisions of this scheme and the agreement between the parties relating thereto and of incidental nature to the completion of the amalgamation of A Ltd. in pursuance of this scheme shall be borne and paid by A Ltd. and B Ltd. in equal shares.

Note: While formulating a scheme on the basis of compromise, arrangement or settlement, the secretary has to make sure that the arrangement agreed to by and between the managements of the two companies is precisely and unambiguously incorporated in the scheme leaving no room for any doubt whatsoever.
SLUMP SALE AGREEMENT

Slump sale is one of the widely used ways of business acquisitions. In simple words, ‘slump sale’ is nothing but transfer of a whole or part of business concern as a going concern; lock, stock and barrel. The concept of ‘slump sale’ was incorporated in the Income Tax Act, 1961 (“IT Act”) by the Finance Act, 1999 with the inclusion of section 2(42C). The term ‘slump sale’ is defined as transfer of one or more undertakings as a result of the sale for a lump-sum consideration without values being assigned to the individual assets and liabilities in such sales.

For looking at the meaning of word ‘undertaking’ resort has to be made to Explanation 1 to section 2(19AA). Section 2(19AA) defines “demerger” in relation to companies. Explanation 1 to Section 2(19AA) defines “undertaking” to be any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities. As per definition of ‘undertaking’ even any part/division of an undertaking or business activity as a whole can be considered.

Explanation 2 to S. 2(42C) clarifies that the determination of value of an asset or liability for the payment of stamp duty, registration fees, similar taxes, etc. shall not be regarded as assignment of values to individual assets and liabilities. Thus, if value is assigned to land for stamp duty purposes, the transaction will not cease to be a slump sale.

The basic condition to be satisfied to qualify as a slump sale is that the transaction relating to transfer of business should be a transfer of undertaking and not transfer of individual assets and liabilities consisting of the business activity. This has been expressly provided in the Explanation 1 to Section 2(19AA) stated above. In case of transfer of individual assets and liabilities consisting of the business activity, the same would not imply transfer of undertaking

[Duchem Laboratories Ltd. v. ACIT, ITA No. 3332/Mum/2004 June 12, 2009].

Given the high figures involved in such transactions, taxation is one of the key elements of consideration for both the buyer as well as the seller. With increase in slump sale deals, several rulings and judicial precedents have emerged over the years. The following is an illustrative list of cases where sale of an undertaking was held to be a slump sale:

(a) Land development business — CIT v. Mugneeram Bangur & Co., [57 ITR 299 (SC)]
(b) Sale of cement unit, which was transferred as a functional productive unit — Coromandel Fertilisers v. DCIT, [90 ITD 344 (Hyd.)]
(c) Sale of branch — CIT v. Narkeshari Prakashan Ltd., [196 ITR 438 (Bom.)]

Slump sale is carried out through following steps:

1. **Find Buyer**: The seller has to find the potential buyers.

Before opting for slump sale there are various issues that needs to be analyzed especially the impact of capital gain tax to the seller and stamp duty to the buyer in the light of business strategies.

**Short listing of buyer**: The buyer or transferee companies needs to be shortlisted by refining the business and tax objectives.

**Primary Valuation**: This valuation enables the seller to get a better idea about value of the business to be sold.

**Analyse and Finalise buyer**: Analysis of shortlisted buyer should consider objective of the deal, cost and time required for execution and structure of the deal. This helps to get a better idea about the deal before finalisation.

2. **Sign MoU/Term sheet**: Once the buyer company is selected, there is need to sign MoU [Memorandum of Understanding] which helps the buyer company to get access to seller entities information for making due diligence, valuation etc.

3. **Make Valuation**: Valuation is a process of determining the value of assets and liabilities of business. It is one of the most important aspects of slump sale process, as seller wants maximum valuation for its business whereas
buyer wants it at lowest end. Valuation of business is mandatory for listed company.

4. Deal Structuring: A deal should be structured considering agreement between buyer and seller. It should be time, cost and compliance effective. While structuring a deal following factors must be taken into consideration:

Objective of the deal: This includes the core objective set for deal of slump sale. While structuring the deal it must be taken into consideration that objective is getting achieved fully. As post deal factors such as ownership and control, financial impact depends on structuring of the deal.

Transaction cost: Transaction cost under slump sale majorly involve capital gain tax to the seller, stamp duty tax to the buyer and withdrawal of exemption deduction, and allowances, and apart from these professional fees to the consultants. Transaction costs involved in slump sale can go upto 5-10% of deal size.

Discharge of consideration: Lump sum consideration may be discharged by payment in cash or by way of issue of debentures and or both. Consideration being imperative aspect of slump sale should be discharged by taking in to consideration future financial, legal and strategic impact on transacting companies.

5. Slump sale agreement: Deal needs to be executed through agreement, capturing all slump sale clauses, effecting objectives predetermined and executed by both parties. The executed agreement needs to be registered as per applicable Stamp Act.

**LESSON ROUND-UP**

- The promoter of a company is a person who does the necessary preliminary work in connection with and incidental to the formation and the establishing of the company.

- The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated, such contracts are called preliminary or pre-incorporation contracts. The promoters generally enter into such contracts as agents for the company about to be formed.

- When the company comes into existence, it is not bound by the pre-incorporation contracts even when it takes the benefit of the work done on its behalf. However, specific performance of a contract between a third party and the promoters may be successfully claimed by the third party against the company, when the company enters into possession of the property on the faith of the promoters’ contract.

- The pre-incorporation agreements entered into by the promoters acting on behalf of the intended company with third party cannot always be avoided for various reasons. These agreements affect the operations of the incorporated company.

- Memorandum of Association of the company is the fundamental formation document. It is the constitution and charter of the company. Draftsmen should know that Memorandum is the main edifice upon which the whole structure of the company is erected. Based on the provisions of Section 4, the main drafting requirements of contents of a Memorandum should be kept in mind.

- Articles are rules and regulations for management of internal affairs of the company. It constitutes a contract between the company and its members and members inter se. It is framed with the object of carrying out aims and objects of the company as contained in Memorandum and if necessary it may clarify anything contained in Memorandum.

- Shareholders’ agreement is a contractual arrangement between the shareholders of a company describing how the company should be operated and the defining inter-se shareholders’ rights and obligations. shareholders’ agreement. Such agreements are specifically drafted to provide specific rights, impose definite restrictions over and above those provided by the Companies Act.
While drafting a contract of appointment for the appointment of a managing director of a company, certain important points have to be taken care of, i.e., the person who is being appointed as managing director must be a director of the company and must be entrusted with substantial powers of management.

The Board of Directors while appointing a director as managing director, critically examines the draft agreement prepared by the Secretary for the appointment of the managing director and after having approved the same with or without any modification, authorises one of its directors to sign and execute for and on behalf of the company, the agreement for the appointment of the managing director.

Being an agreement, such a contract must have all the other essential ingredients of a contract under the Indian Contract Act, 1872.

Likewise, the Secretary has to bear in mind important points while drafting an agreement for the appointment of a manager.

The appointment of a Company Secretary is done by the Board of Directors and he functions at the pleasure of the Board. Usually the appointment of a Company Secretary is made by an appointment letter signed and issued by the Chief Executive Officer, who may be the managing director, executive director, whole-time director etc. under specific authority of the Board.

This letter is an offer by the company to the prospective Company Secretary and when he accepts the same it become a binding contract between him and the company and their relationship is governed by the terms and conditions thereof.

During its life time a company may find it necessary to reorganise itself. Such a re-organisation may be for many reasons. When a company is financially weak, it wishes to reach a compromise with its members and/or creditors. It may wish to take over the business of another running but endangered company. It may wish to restructure its share capital.

The Companies Act, 2013 provide various methods of company re-organisation or reconstruction. The various terms used for reorganization are arrangement, reconstruction, amalgamation, merger, takeover, etc.

Slump sale is one of the widely used ways of business acquisitions. The term ‘slump sale’ under the Income Tax Act is defined as transfer of one or more undertakings as a result of the sale for a lump-sum consideration without values being assigned to the individual assets and liabilities in such sales.

**SELF-TEST QUESTIONS**

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

1. State in brief the law regarding ‘promoters’ contract’. Draft a specimen promoters’ contract for the purchase of an industrial plot for setting up an industrial unit of the proposed company XYZ Ltd.

2. Write in brief about the underwriting and brokerage agreements. Draft a specimen underwriting agreement.

3. ABC Co. Ltd., wants to engage Mr. M as its managing director. The Chairman of the company wants you to prepare and submit to him a draft specimen agreement of service with Mr. M. as a managing director of the company, draft the same. Also mention what care you will take while drafting the above agreement.

4. Define amalgamation. Draft specimen agreement between two companies to amalgamate by sale of one to the other.

5. Distinguish briefly ‘compromise’, ‘arrangements’ and ‘settlements’. Draft a specimen scheme of amalgamation of XYZ Co. Ltd. with ABC Co. Ltd.
6. What important points you will keep in view while drafting Articles of Association of a public limited company or object clause in Memorandum of Association.

7. What special points are taken into account while drafting notices in case of a company.
PROFESSIONAL PROGRAMME

CAPITAL, COMMODITY AND MONEY MARKET

MODULE 3 - ELECTIVE PAPER 9.2
Lesson 6: Secondary Market

### Highlights of Clause 49

**COMPOSITION OF BOARD OF DIRECTORS**

As per clause 49 (II) (A) of the Listing Agreement, the Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one women director. Further—

– not less than 50 per cent of the board of directors shall comprise of non-executive directors;
– the number of independent directors would depend on whether the chairman is executive or non-executive;
– if the Board has a Non-Executive Chairman, at least one third of the Board should comprise of independent directors;
– if the Board has an Executive Chairman, 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, at least one-half of the board of the company should consist of independent directors. The expression “related to any promoter” means:

(a) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;
(b) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

**Definition of Independent Director**

(i) **Under Listing Agreement**

‘Independent director’ shall mean a non-executive director, other than a nominee director of the company:

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
(c) apart from receiving director’s remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
(e) who, neither himself nor any of his relatives –

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of –

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;

(v) is a material supplier, service provider or customer or a lessor or lessee of the company;

(f) who is not less than 21 years of age.

(ii) Under Companies Act, 2013

According to Section 149(6) of the Companies Act, 2013 – An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director, – (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience; (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company; (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company; (c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year; (d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year; (e) who, neither himself nor any of his relatives (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed; (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm; (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or (iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds
two per cent. or more of the total voting power of the company; or (f) who possesses such other qualifications as may be prescribed.

**Limit on number of directorships**

(a) A person shall not serve as an independent director in more than seven listed companies.

(b) Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

**Maximum tenure of Independent Directors**

(a) An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

**Formal letter of appointment to Independent Directors**

(a) The company shall issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013.

(b) The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.

**Performance evaluation of Independent Directors**

(a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.

(b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.

(c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).

(d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

**Separate meetings of the Independent Directors**

(a) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.

(b) The independent directors in the meeting shall, inter-alia:

(i) review the performance of non-independent directors and the Board as a whole;

(ii) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
(iii) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

**Training of Independent Directors**

(a) The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.

(b) The details of such training imparted shall be disclosed in the Annual Report.

**Non Executive Directors’ Compensation and Disclosures**

This clause provides that 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. The shareholders’ resolution shall specify the limits for the number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The requirement of obtaining prior approval of shareholder 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 2013 for payment of sitting fees, without approval of the Central Government. Further, the independent directors shall not be entitled to any stock option.

**BOARD MEETINGS**

The Board shall meet at least four times a year with a maximum time gap one hundred and twenty days between any two meetings.

**Limits on Membership of Committees**

A director shall not be a member in more than 10 committees or act as chairman of more than five committee across all companies in which he is a director. Furthermore, every director shall inform the company about the committees positions he occupies in other companies and notify changes as and when takes place.

For the purpose of considering the limit of committees on which a director can serve, all public limited companies, whether listed or not listed, shall be included and all other companies including private limited companies, foreign companies and companies under section 8 of the Companies Act, 2013 shall be excluded.

For the purpose of considering the limit of the committees on which a director can serve, Chairmanship/ membership of the Audit Committee and the Share-holders' Grievance Committee alone are to be considered.

**Other provisions as to Board and Committees**

The Board shall 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.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or
three months from the date of such vacancy, whichever is later. Provided that where 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 shall not apply.

The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.

**Code of Conduct**

1. The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.

2. 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.

3. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.

4. An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.

Explanation: The term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

**Whistle Blower Policy**

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

2. This mechanism should also provide for adequate safeguards against victimization of director(s) / employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases.

3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board’s report.

**AUDIT COMMITTEE**

Clause 49(III) deals with Audit Committee, its composition, power etc.

(i) The requirement of giving terms of reference of the Audit Committee is a must.

(ii) There should be minimum three directors as members.

(iii) 2/3rd of the members of audit committee shall be independent directors.

(iv) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
Explanation: (a) The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

(b) A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

(v) The Chairman of the audit committee shall be an independent director and shall be present at the Annual General Meeting to answer shareholder queries.

(vi) 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.

(vii) The company secretary should act as the secretary to the committee.

**Powers of the Audit Committee**

The powers of the Audit Committee shall include the following:

(i) To investigate any activity within its terms of reference.

(ii) To seek information from any employee.

(iii) To obtain outside legal or other professional advice.

(iv) To secure attendance of outsiders with relevant expertise, if it considers necessary.

**Meetings and Role of Audit Committee**

There is requirement of holding at least four meetings in a year and not more than four months shall elapse between the two meetings of audit committee. Quorum of the meeting shall be two member or 1/3rd of members of the Audit Committee whichever is greater, but there should be a minimum of two independent members present.

The role of the audit committee shall include the following:

1. 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.

2. Recommending for appointment, remuneration and terms of appointment of auditors of the company.

3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.

4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:

   (a) Matters required to be included in the Director’s Responsibility Statement to be included in the Board’s report in terms of clause (c) of section 134 of the Companies Act, 2013.

   (b) Changes, if any, in accounting policies and practices and reasons for the same.

   (c) Major accounting entries involving estimates based on the exercise of judgment by management.

   (d) Significant adjustments made in the financial statements arising out of audit findings.
(e) Compliance with listing and other legal requirements relating to financial statements.

(f) Disclosure of any related party transactions.

(g) Qualifications in the draft audit report.

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.

6. Reviewing, with the management, the statement of uses/application of fund raised through an issue (public issue, right 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 utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take steps in this matter.

7. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.

8. Review and monitor the auditor’s independence and performance and effectiveness of audit process.

9. Approval of any subsequent modification of transaction of the company with related parties;

10. Scrutiny of inter-corporate loans and investment.

11. Valuation of undertaking or assets of the company, wherever it is necessary.

12. Evaluation of internal financial control and risk management systems.

13. 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.

14. Discussion with internal auditors any significant findings and follow up there on.

15. 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.

16. 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.

17. 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.

18. To review the functioning of the Whistle Blower mechanism, in case the same is existing.

19. Approval of appointment of CFO (i.e. the whole-time finance Director or any other person heading the finance function or discharging that function) after assessing the qualification, experience and back of mind, etc. of the candidate.

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

**Review of Information by Audit Committee**

The Audit Committee is required to mandatorily review the following information:

(a) Management discussion and analysis of financial condition and results of operations;
(b) Statement of significant related party transactions (as defined by the audit committee), submitted by the management;
(c) Management letters/letters of internal control weaknesses issued by statutory auditors;
(d) Internal audit reports relating to internal control weaknesses; and
(e) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Nomination and Remuneration Committee

A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

B. The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;
2. Formulation of criteria for evaluation of Independent Directors and the Board;
3. Devising a policy on Board diversity;
4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders’ queries. However, it would be up to the Chairman to decide who should answer the queries.

SUBSIDIARY COMPANY

(i) Atleast one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of 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 is required to be placed at the Board meeting of the listed holding company.

(iv) 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.

(v) The company shall formulate a policy for determining ‘material’ subsidiaries and such policy shall be disclosed to Stock Exchanges and in the Annual Report.

(vi) For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.
(vii) No company shall dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting.

(viii) Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary shall require prior approval of shareholders by way of special resolution.

| 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 also apply to the listed subsidiary insofar as its subsidiaries are concerned. |

Risk Management

A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

Related Party Transactions

A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

B. A ‘related party’ is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:

1. A person or a close member of that person’s family is related to a company if that person:
   a. is a related party under Section 2(76) of the Companies Act, 2013; or
   b. has control or joint control or significant influence over the company; or
   c. is a key management personnel of the company or of a parent of the company; or
2. An entity is related to a company if any of the following conditions applies:
   a. The entity is a related party under Section 2(76) of the Companies Act, 2013; or
b. The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or

c. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or

d. Both entities are joint ventures of the same third party; or

e. One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or

f. The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or

g. The entity is controlled or jointly controlled by a person identified in (1).

h. A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity);

**DISCLOSURES**

The following disclosures are required to be made under the revised clause:

– Related Party Transactions
– Disclosure of Accounting Treatment
– Remuneration of Directors
– Management
– Shareholders
– Resignation of Directors
– Formal letters of appointment
– Annual Report
– Proceeds from public issues, Rights issues, preferential issues etc.

**CEO/CFO CERTIFICATION**

Clause 49(IX) deals with the CEO/CFO certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and Companies Act 2013 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 the 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

Clause 49(X) narrates the details with respect to Corporate Governance.

The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format prescribed in this clause. The report is required to be signed either by the Compliance Officer or the Chief Executive Officer of the company. In annual report there should be a separate section on corporate governance and should contain the details as given in listing agreement.

COMPLIANCE CERTIFICATE

Clause 49(XI) deals with compliance certificate on Corporate Governance.

The practising Company Secretaries have also been recognised to issue Certificate of Compliance of Conditions of Corporate Governance. The clause provides that 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.

NON-MANDATORY REQUIREMENTS

The following non-mandatory requirements have additionally been provided:

(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.

(2) 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 share-holders.

(3) Audit qualifications: Company may move towards a regime of unqualified financial statements.

(4) Separate posts of Chairman and CEO: The Company may appoint separate persons to the post of chairman and Managing Director/CEO.

(5) Reporting of Internal Auditor: The internal auditor may report directly to the Audit Committee.
<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>Clause 49</th>
<th>Companies Act, 2013 &amp; Rules, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Partition of Nominee Director and IDs</td>
<td><strong>Clause 49</strong>(II)(B): Nominee director is excluded from the definition of IDs.</td>
<td><strong>Section 149(6)</strong> An independent director in relation to a company, means a director other than a MD or a WTD or a nominee director.</td>
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<td>2.</td>
<td>Modified definition of IDs</td>
<td><strong>Clause 49</strong>(II)(B): SEBI has amended the definition of Independent Director in alignment with the provisions of Companies Act, 2013.</td>
<td><strong>Section 149(6)</strong> of the Companies Act 2013 defines the term Independent Director.</td>
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<td>3.</td>
<td>Qualification of IDs</td>
<td>The qualifications of IDs are not specified in the amended clause 49 of the listing agreement</td>
<td><strong>Companies (Appointment and Qualification of Directors) Rules, 2014:</strong> An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.</td>
</tr>
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<td>4.</td>
<td>Whistle-Blowing Mechanism</td>
<td><strong>Clause 49</strong>(II)(F): The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy. This mechanism should also provide for adequate safeguards against victimization of director(s)/employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. The details of establishment of such mechanism shall be disclosed by</td>
<td><strong>Section 177(9):</strong> Every listed company and other classes of companies to establish a Vigil mechanism for directors and employees to report genuine concern. It provide adequate safeguards against victimization of employees and directors who avail of the Vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. The details of establishment of Vigil mechanism</td>
</tr>
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</table>
|   | Prohibited Stock options for IDs | Clause 49(II)(C):  
IDs shall not be entitled to any stock options. | Section 197(7):  
IDs shall not be entitled to any stock option. |
|---|-------------------------------|-------------------------------------------------|--------------------------------------------------|
| 5. | Separate meeting of IDs       | Clause 49(II)(B)(6):  
The IDs of the company shall hold at least one meeting in a year, without the attendance of non independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting. | Section 149 read with Schedule IV:  
IDs of the company shall hold at least one meeting in a year, without the attendance of non independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting. |
| 6. | Training of IDs               | Clause 49(II)(B):  
The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc. The details of such training imparted shall be disclosed in the Annual Report. | The Companies Act 2013 did not specify any training of IDs and Board of Directors. |
| 7. | Liability of IDs              | Clause 49(II)(E):  
An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement. | Section 149(12):  
An independent director, a NED not being promoter or KMP, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently. |
| 8. | Stakeholders Relationship Committee | Clause 49(VIII)(E):  
A committee under the Chairmanship of a non-executive director and such other members as | Section- 178(5):  
The Board of Directors of a company which consists of more than one thousand shareholders, |
may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee (SRC) consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. The SRC shall consider and resolve the grievances of security holders of the company.

1. All pecuniary relationship or transactions of the non-executive directors vis-a-vis the company shall be disclosed in the Annual Report.
2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be 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.
3. The company shall publish its |

|  | Section 197 (2) and Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:
(1) Every listed company shall disclose in the Board’s report:
   (i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;
   (ii) the percentage increase in remuneration of each director, CFO, CEO, CS or Manager, if any, in the financial year;
   (iii) the percentage increase in the median remuneration of employees in the financial year;
   (iv) the number of permanent employees on the rolls of the company;
   (v) the explanation on the relationship between average increase in remuneration and company performance;
   (vi) comparison of the remuneration of the KMP against the performance of the company; |
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 therefrom in the annual report.

4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.

5. Non-executive directors shall be required to disclose their shareholding (both own or held by/for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment.

These details should be disclosed in the notice to the general meeting called for appointment of such director.

(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;

(viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(ix) the key parameters for any variable component of remuneration availed by the directors;

(x) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and

(xi) affirmation that the remuneration is as per the remuneration policy of the company.
| 11. | Performance evaluation of IDs | Clause 49(II)(B)(5): |
|     |                             | (a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors. |
|     |                             | (b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report. |
|     |                             | (c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated). |
|     |                             | (d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director. |
| 12. | Related Party Transaction (RPT) | Clause 49 (VII): |
|     |                             | A RPT is a transfer of services or obligations between a company and a related party, regardless of whether a price is charged. |
|     |                             | A ‘related party’ is a person or entity that is related to the company. |
|     |                             | Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following: |
|     |                             | 1. A person or a close member of that person’s family is related to a company if that person: |
|     |                             | (a) is a related party under Section 2(76) of the Companies Act, 2013; or |
|     |                             | (b) has control or joint control or significant influence over the company; or |
|     |                             | Section 178(2) read with Schedule IV: |
|     |                             | The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director’s performance. |
|     |                             | The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. |
|     |                             | On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director. |
|     |                             | Section 2 (76) & 188 |
|     |                             | "Related party", with reference to a company, means – |
|     |                             | (i) a director or his relative |
|     |                             | (ii) a KMP or his relative; |
|     |                             | (iii) a firm, in which a director, manager or his relative is a partner; |
|     |                             | (iv) a private company in which a director or manager is a member or director; |
|     |                             | (v) a public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital; |
|     |                             | (vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, or instructions of a director or manager; |
(c) is a KMP of the company or of a parent of the company; or

2. An entity is related to a company if any of the following conditions applies:

(a) The entity is a related party under Section 2(76) of the Companies Act, 2013; or

(b) The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or

(c) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or

(d) Both entities are joint ventures of the same third party; or

(e) One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or

(f) The entity is a post employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or

(g) The entity is controlled or jointly controlled by a person identified in (1).
(h) A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or

The company shall formulate a policy on materiality of RPTs and also on dealing with RPTs. A transaction with a related party shall be considered material if the transaction/transactions to be entered into individually or taken together with previous transactions during a financial year:

- exceeds 5% of the annual turnover or
- 20% of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

All RPTs shall require prior approval of the Audit Committee. All material RPTs shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.

- Net Worth.
  - leasing of property of any kind exceeding 10% of the net worth or exceeding 10% of turnover.
  - availing or rendering of any services directly or through appointment of agents exceeding 10% of Net Worth.
  - appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs.2,50,000/ remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth.

Turnover or Net Worth shall be on the basis of the Audited Financial statements of the preceding Financial Year.

In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.

No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

Every contract or arrangement entered into, shall be referred to in the Board’s report to the shareholders along with the justification for entering into such contract or arrangement.
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<tr>
<td>13</td>
<td>Disclosure of RPTs</td>
<td>Clause 49(VIII)(A): Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance. The company shall disclose the policy on dealing with RPTs on its website and also in the Annual Report.</td>
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<td></td>
<td></td>
<td>No such Provision.</td>
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<tr>
<td>14</td>
<td>Disclosure of Different Accounting Standard</td>
<td>Clause 49(VIII)(B): Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.</td>
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<td>Section-129(5): Where the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.</td>
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<td>15</td>
<td>Constitution of Nomination &amp; Remuneration Committee</td>
<td>Clause 49(IV)- The company shall set up a nomination and remuneration committee which shall comprise</td>
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<td></td>
<td>Section 178 and Companies (Meetings of Board and its Powers) Rules, 2014: The Nomination and Remuneration</td>
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atleast 3 directors, all of whom shall be NEDs and at least ½ shall be independent.

A. Chairman of the committee shall be an independent director.

B. The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, KMP and other employees;

2. Formulation of criteria for evaluation of IDs and the Board;

3. Devising a policy on Board diversity;

4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

C. The Chairman of the nomination and remuneration committee could be present at the AGM, to answer the shareholders’ queries. However, it would be upto the Chairman to decide who should answer the queries.

Committee is applicable to the following classes of Companies:

(i) Every listed Company

(ii) Every other Public Company

(a) Having Paid up capital of Rs.10 crores or more; or

(b) Having turnover of Rs.100 Crores:

- Which have, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores.

- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

The above mentioned companies shall constitute the Nomination and Remuneration Committee consisting of –

- 3 or more NEDs out of which not less than one half shall be IDs.

- The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

The Nomination and Remuneration Committee shall –

- Identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal, carry out evaluation of every director’s performance.
| 16. Appointment of one Woman Director | Clause 49 (II)(A): The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive Directors. | Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014: (i) every listed company; (ii) every other public company having - (a) paid-up share capital of Rs.100 Crores or more; or (b) turnover of Rs.300 Crore or more shall appoint at least one woman director. A company shall comply with provisions within a period of six months from the date of its incorporation. |

Formulate the criteria for determining qualifications, positive attributes and independence of a director and Recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees. The Nomination and Remuneration Committee shall ensure that –

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(c) remuneration to directors, KMPs and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

The policy shall be disclosed in the Board’s report.
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<tr>
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<th>Maximum No. of directorship of IDs</th>
<th>Clause 49 (II)(B)(3): A person shall not serve as an independent director in more than seven listed companies. Any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.</th>
<th>Section 165: A person shall hold not office as a director, including any alternate directorship in more than 20 companies. The max no. of public companies in which a person can be appointed as a director shall not exceed 10.</th>
</tr>
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<tr>
<td>17.</td>
<td>Maximum tenure of IDs</td>
<td>Clause 49(II)(B): An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the A person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only. An independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.</td>
<td>Section 149: An independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.</td>
</tr>
<tr>
<td>18.</td>
<td>Risk management</td>
<td>Clause 49 (VI): The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company. The company shall also constitute a Risk Management Committee. The Board shall define the roles and</td>
<td>Section 134(3): A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.</td>
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| 20. | **Succession planning** | **Clause 49 (II)(D) (6):**  
The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management. |
|   |   | There is no such provision. |
| 21. | **Filing of Casual Vacancy of IDs** | **Clause 49 (II)(D):**  
An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.  
Where 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 shall not apply. |
|   |   | **Schedule IV:**  
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 one hundred and eighty days from the date of such resignation or removal, as the case may be. Where 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 shall not apply. |
| 22. | **Code of Conduct of Board of Directors & Senior Management** | **Section 149 & Part III of Schedule IV:**  
The independent directors shall—  
1. undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;  
2. seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense 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.  
The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013. |
(3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;

(4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;

(5) strive to attend the general meetings of the company;

(6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

(7) keep themselves well informed about the company and the external environment in which it operates;

(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

(11) report concerns about unethical behaviour, actual or suspected fraud or violation
| 23. | **Disclosure of Appointment of Director** | **Clause 49(VIII)(G):** The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment. | A return containing the particulars of appointment of director or key managerial personnel and changes therein, shall be filed with the Registrar in Form DIR-12 along with such fee as may be provided in the Companies (Registration Offices and Fees) Rules, 2014 within thirty days of such appointment or change, as the case may be. |
| 24. | **Disclosure of Resignation of Director** | **Clause 49(VIII)(F):** The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website. | **Section 169:** A director may resign from his office by giving a notice in writing to the company and the Board shall on receipt of such notice take note of the same and the company shall intimate the Registrar in such manner, within 30 days in form DIR-12 and shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company. Where a director resigns from his office, he shall within a period of thirty days from the date of resignation, forward to the Registrar a copy of his resignation along with reasons for the resignation in Form DIR-11 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014. |
FOREIGN PORTFOLIO INVESTOR

Foreign Portfolio Investor (FPI) means a person who satisfies the eligibility criteria prescribed under SEBI (Foreign Portfolio Investors) Regulations, 2014 and has been registered under Chapter II of these regulations, which shall be deemed to be an intermediary in terms of the provisions of the SEBI Act, 1992. All existing Foreign Institutional Investors (FIIs) and QFIIs are to be merged into one category called FPI.

Categories of FPI

- **Category I FPIs include:** Government and Government-related investors such as central banks, Governmental agencies, sovereign wealth funds and international or multilateral organisations or agencies.
- **Category II FPIs include:** appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies;
  - appropriately regulated persons such as banks, asset management companies, investment managers/advisors, portfolio managers;
  - broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated. However, the investment manager of such broad based fund should be registered as a Category II FPI and should undertake that it shall be responsible and liable for all acts of commission and omission of all its underlying broad based funds and other deeds and things done by such broad based funds under these regulations.
  - university funds and pension funds; and
  - university-related endowments already registered with SEBI as FIIs or sub-accounts.
- **Category III FPIs include:** all others not eligible under Category I and II FPIs such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

Investment Conditions and Restrictions

- The instruments available for investments to FPIs are broadly in line with the instruments offered under the FII regime.
- Total investment by each FPI is restricted to 10% of the issued equity capital of the company.
- In case the same set of ultimate/end beneficial owner(s) invest through multiple entities, such entities shall be treated as part of the same group and the investment limits of all such entities shall be clubbed as applicable to a single FPI.

Note: A threshold of 50% of direct or indirect common shareholding/beneficial ownership/beneficial interest will be considered for the purpose of clubbing investment limits across a common investor group.
Lesson 9: Resource Mobilisation through International Markets

Provisions of Companies Act, 2013 relating to issue of GDR


According to Section 2(44) of Companies Act, 2013, “Global Depository Receipt” means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts;

Section 41 provides that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.

Companies (Issue of Global Depository Receipts) Rules, 2014

Eligibility to issue depository receipts

Rule 3 lays down that a company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

Conditions for issue of depository receipts

Rule 4 lays down the following conditions to be fulfilled by a company for issue of depository receipts:

(1) The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.

(2) The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting. Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.

(3) The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

(4) The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

(5) The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of
Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

**Manner and form of depository receipts**

Rule 5 deals with the manner and form of issue of depository receipts.

(1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

**Voting rights**

Rule 6 provides the provisions for voting rights of depository receipts holder.

(1) A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

(2) Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

**Proceeds of issue**

Rule 7 provides that the proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.
Non applicability of certain provisions of the Act

(1) The provisions of the Act and any rules issued thereunder in so far as they relate to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

(2) The offer document, by whatever name called and if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88 of the Companies Act, 2013, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company.
Lesson 13: Insider Trading

PROVISIONS RELATING TO INSIDER TRADING IN COMPANIES ACT, 2013

Section 195 of the Companies Act, 2013 deals with the provisions on prohibition on insider trading of securities, which is as under:

Sub-section (1) lays down that no person including any director or key managerial personnel shall enter into insider trading:

Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law.

(a) “insider trading” means –

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company, or

(ii) an act of counselling about, procuring or communicating directly or indirectly any non-public price sensitive information to any person;

(b) “price-sensitive information” means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Sub-section (2) provides that If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.