

GUIDANCE NOTE ON DILIGENCE REPORT FOR BANKS

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. A list of circulars issued by the RBI in respect of Diligence Reporting is as under :

<i>Sl. No.</i>	<i>Date of Issue</i>	<i>Circular No.</i>	<i>Copy placed as</i>
1.	19/09/08	DBOD NO. BP. BC. 46/08.12.001/2008-09	Annexure A
2.	08/12/08	DBOD No. B.P. BC 94/08.12.001/2008-2009	Annexure B
3.	21/01/09	UBD.PCBNo. 36/13.05.000/2008-09	Annexure C
4.	10/02/09	DBOD.No. BP.BC. 110/08.12.001/2008-09	Annexure D
5.	12/02/09	UBD.PCB.No. 49 /13.05.000/2008-09	Annexure E

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1996, various regulatory prescriptions regarding conduct of consortium / multiple banking / syndicate arrangements were withdrawn by Reserve Bank of India with a view to introducing flexibility in the credit delivery system and to facilitate smooth flow of credit.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 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 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 Rs. 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.

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 at..... as required to be maintained under the Companies Act, 1956 (the Act) and the rules made thereunder, the provisions contained in the Memorandum and Articles of Association of the Company, the provisions of various statutes, wherever applicable, as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s for the half year ended on..... . In my/our opinion and to the best of my/our information and according to the examination carried out by me/us and explanations furnished to me/us by the Company, its officers and agents. I/We report that in respect of the aforesaid period:

1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure, and the Board was duly constituted. During the period under review the following changes that took place in the Board of Directors of the Company are listed in the Annexure, and such changes were carried out in due compliance with the provisions of the Companies Act, 1956.
2. The shareholding pattern of the company as on was as detailed in Annexure During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure..... .
3. The company has altered the following provisions of
 - (i) The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.
 - (ii) The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 for this purpose.
4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure..... .
5. The company has advanced loans, given guarantees and provided securities amounting to Rs. to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section – 295 of the Companies Act, 1956.

* (As contained in RBI Circular No. DBOD.No. BPBC.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)

6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexure.... and has complied with the provisions of the Companies Act, 1956.
7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company's domestic borrowings were as detailed in Annexure
8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies.
9. The Company has created, modified or satisfied charges on the assets of the company as detailed in Annexure.... Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure
10. Principal value of the forex exposure and Overseas Borrowings of the company as on are as detailed in the Annexure under.
11. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within the stipulated time in compliance with the provisions of the Companies Act, 1956 and other relevant statutes.
12. The Company has insured all its secured assets.
13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institutions at the time of availing any facility and also during the currency of the facility.
14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956.
15. The Company has insured fully all its assets.
16. The name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India.
17. The name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation.
18. The Company has paid all its Statutory dues and satisfactory arrangements had been made for arrears of any such dues.
19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.
20. The Company has complied with the provisions stipulated in Section 372A of the Companies Act in respect of its Inter Corporate loans and investments.
21. It has been observed from the Reports of the Directors and the Auditors

that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India.

22. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends and other amounts required to be so credited.
23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and /or its directors in such cases are detailed in Annexure.....
24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement.
25. The Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

Note : The qualification, reservation or adverse remarks, if any, are explicitly stated may be stated at the relevant paragraphs above place(s).

Place :	Signature :
Date :	Name of Company Secretary/Firm :
	C.P. No. :

GUIDANCE ON DILIGENCE REPORTING

The following paragraphs outline the Compliance Inputs that may be relied upon by the PCS for the purpose of issue of Diligence Report. Compliance Inputs and checklist are indicative and PCS shall not exclusively rely upon that, but use that as a guide and apply his own judgement to determine what is to be checked and to what extent.

Period of Reporting

Annex. III to the RBI Notification provides that the Diligence Report shall be made on a half yearly basis.

Secretary in Whole-Time Practice

Section 2(45A) of the Company Secretaries Act, 1980 defines "secretary in whole-time practice" as a secretary who shall be deemed to be in practice within the meaning of sub-section (2) of section 2 of the Company Secretaries Act, 1980 and who is not in full-time employment. Thus, a member of the Institute of Company Secretaries of India, who is not in full-time employment can become a Secretary in whole-time practice (hereinafter referred to as PCS) after obtaining from the Council of the Institute a Certificate of Practice under section 6 of the Company Secretaries Act, 1980 and the regulations thereunder.

Right to Access Records and Methodology for Diligence Reporting

To enable the PCS to issue the Diligence Report, the Company (borrower) should provide the PCS access at all times to the books, papers, minutes books,

forms and returns filed under various statutes, documents and records of the company, whether kept in pursuance of the applicable laws or otherwise and whether kept at the registered office of the company or elsewhere which he considers essential for the purposes of Diligence Reporting. The PCS shall be entitled to require from the officers or agents of the company, such information and explanations as the PCS may think necessary for the purpose of such Reporting. However, depending on the facts and circumstances he/she may obtain a letter of representation from the company in respect of matters where verification by PCS may not be practicable, for example matters like —

- (i) dis-qualification of directors;
- (ii) show cause notices received;
- (iii) persons and concerns in which directors are interested, etc.

Reporting with Qualification

The qualification, reservation or adverse remarks, if any, may be stated by the PCS at the relevant places. It is recommended that the qualifications, reservations or adverse remarks of PCS, if any, should be stated in **thick type** or in *italics* in the Diligence Report.

If the PCS is unable to form any opinion with regard to any specific matter, the PCS shall state clearly the fact that he is unable to form an opinion with regard to that matter and the reasons thereof.

If the scope of work required to be performed, is restricted on account of limitations imposed by the company or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the Report shall indicate such limitation.

If such limitations are so material as to render the PCS incapable of expressing any opinion, the PCS should state that:

“in the absence of necessary information and records, he is unable to report compliance(s) or otherwise by the Company”.

PCS shall have due regard to the circulars and/or clarifications issued by the Reserve Bank of India from time to time. It is recommended that a specific reference of such circulars at the relevant places in the Report shall be made, wherever possible.

Professional Responsibility and Penalty for False Diligence Report

While the RBI Notification has opened up a significant area of practice for Company Secretaries, it equally casts immense responsibility on them and poses a greater challenge whereby they have to justify fully the faith and confidence reposed by the banking industry and measure up to their expectations. Company Secretaries must take adequate care while issuing Diligence Report.

Any failure or lapse on the part of a Practising Company Secretary (PCS) in issuing a Diligence Report may not only attract penalty for false Reporting and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his / her negligence in issuing the Diligence Report. Therefore, it becomes imperative for the PCS that he/she exercises great care and caution while issuing the Diligence Report and also adheres to the highest standards of professional ethics and excellence in providing his/her services.

Disqualifications of Secretary in Whole-Time Practice

With a view to ensure that PCS shows utmost integrity and independence of judgement in the performance of his/her duties, it is desirable that he/she, should not accept any assignment for giving Diligence Report to a Bank, if he/it is-

- (a) a body corporate;
- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d) a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;
- (e) a person holding any security of that company which carries voting rights.

However, any securities held by such person as nominee or trustee for any third person and in which the holder has no beneficial interest shall be excluded from such disqualification.

Further, if a person is not qualified for appointment as PCS of a company for reasons stated above, then he is also disqualified for appointment as PCS of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company. If a PCS becomes subject, after his appointment, to any of the disqualifications specified above, he should vacate his office as such.

Communication to earlier incumbent

In view of the provisions of clauses (8) and (11) of Part I of the First Schedule to the Company Secretaries Act, 1980, whenever a new incumbent is assigned the Diligence Report work, he should first communicate his appointment to the earlier incumbent in writing by registered post.

Where, however, in the same year a Secretary in whole-time practice is appointed in place of another Secretary in whole-time Practice, who was appointed initially, the new incumbent should not only first communicate the same to the previous incumbent in writing by Registered Post but also first seek his consent (preferably in writing).