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**STUDY MATERIAL**

**PROFESSIONAL PROGRAMME**

**SECRETARIAL AUDIT  
COMPLIANCE MANAGEMENT  
AND DUE DILIGENCE**

**MODULE 1**

**PAPER 2**



**THE INSTITUTE OF  
Company Secretaries of India**  
**IN PURSUIT OF PROFESSIONAL EXCELLENCE**  
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## PROFESSIONAL PROGRAMME

### SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

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

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

Compliance management is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution. Secretarial Audit and Compliance management are the routine tools for effective governance. Compliance management is to be built into the corporate system to avoid non compliances and the Secretarial audit is carried out on periodical basis by an independent professional. Due diligence is a pre-emptive tool to assess a business transaction.

The study material 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 December, 2016). In respect of sections of The Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with in the study.

Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of the study material may not be enough. Besides Company Secretaries Regulations, 1982 requires the students to be conversant with the amendments to the laws made upto six months preceding the date of examination. This study material may therefore be regarded as basic material and must be read along with the notified provisions of Companies Act, 2013 and rules made thereunder and the provisions of Companies Act 1956 which is still in force.

The amendments made upto June 2017 have been incorporated in this study material. However, it may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the e-bulletin 'Student Company Secretary' and ICSI Journal Chartered Secretary and other publications for updation of study material. In the event of any doubt, students may contact the Directorate of Academics at [academics@icsi.edu](mailto:academics@icsi.edu).

Although due care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the e-bulletin 'Student Company Secretary'.

**PROFESSIONAL PROGRAMME**

**SYLLABUS  
FOR**

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

**Level of Knowledge:** Expert Knowledge

**Objective:**

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

**Detailed Contents:**

**PART A: Secretarial Audit (25 Marks)**

**1. Secretarial Standards**

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

**2. Secretarial Audit**

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

**3. Checklist for Secretarial Audit**

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

**4. Due Diligence - An Overview**

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

**5. Issue of Securities**

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

(v)

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

## **6. Depository Receipts Due Diligence**

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

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

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

## **8. Competition Law Due Diligence**

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

## **9. Legal Due Diligence**

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

## **10. Due Diligence for Banks**

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

## **11. Environmental Due Diligence**

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

## **12. Search and Status Reports**

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

## **13. Compliance Management**

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

## LIST OF RECOMMENDED BOOKS

### MODULE I

## PAPER 2 : SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

### Recommended Readings and References:

1. Taxmann : SEBI Manual
2. Mamta Bhargava : Compliances and Procedures under SEBI Law, Shreeji Publishers, 8/294, Sunder Vihar, New Delhi – 110087
3. ICSI : Handbook on Mergers Amalgamations and takeovers.
4. Snow white : Mergers/Amalgamations, takeovers, Joint Ventures, LLPs and Corporate Restructure by K R Sampath
5. Butterworths : Mergers et al by S Ramanujam
6. The Art of M&A Due Diligence : Alexandra Reed Lajoux & Charles M. Elson
7. Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc from time to time.
8. Bare Acts
9. SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015.
10. Guidance Note on Diligence Report for Banks (ICSI Publication)
11. Referencer on Secretarial Audit (ICSI Publication)
12. Important Websites
  - (a) [www.sebi.gov.in](http://www.sebi.gov.in)
  - (b) [www.rbi.org.in](http://www.rbi.org.in)
  - (c) [www.finmin.nic.in](http://www.finmin.nic.in)
  - (d) [www.dipp.nic.in](http://www.dipp.nic.in)
  - (e) [www.mca.gov.in](http://www.mca.gov.in)

### Journals:

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

### Note:

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

**ARRANGEMENT OF STUDY LESSONS**

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

*Lesson No.*

*Subject*

**PART A**

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

**PART B**

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



## PROFESSIONAL PROGRAMME

## SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

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# Lesson 1

## Secretarial Audit and Secretarial Standard– An Overview

### LESSON OUTLINE

- Secretarial Audit – Concept
- Objective, Scope of Secretarial Audit
- Benefits and Beneficiaries
- Secretarial Audit process
- Professional Responsibilities and Penalties
- Secretarial Standards – Concept
- Secretarial Standards under the Companies Act, 2013
- Secretarial Audit Report – Format

### LEARNING OBJECTIVES

Timely examination of compliance reduces risks as well as potential cost of non-compliance and also builds better corporate image. Secretarial Audit establishes better compliance platform by checking the compliances with the provisions of various statutes, laws, rules & regulations, procedures by a Practicing Company Secretary to make necessary recommendations/ remedies. The primary objective of the Compliance Management backed Secretarial Audit is to safeguard the interest of the Directors & officers of the companies, shareholders, creditors, employees, customers etc. With the introduction of concept of 'Secretarial Audit' in Corporate Governance Voluntary Guidelines (CGVG) issued by Ministry of Corporate Affairs in 2009 and mandated by 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.



## INTRODUCTION

MCA Corporate Governance Voluntary Guidelines, 2009 provided for conducting Voluntary Secretarial Audit by the Companies as under:-

“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.”

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.

Secretarial Audit is also applicable to a private company which is a subsidiary of a public company, and which falls under the prescribed class of companies as indicated above. The companies which are not covered under section 204 may obtain Secretarial Audit Report voluntarily as it provides an independent assurance of the compliances of applicable laws of the company.

Company secretary in practice has been exclusively recognised for conducting secretarial audit. The section 204 further provides that Secretarial Audit Report is to be submitted in a format prescribed under rules. As per sub-rule (2) of Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the format of the Secretarial Audit Report shall be in Form 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 summarized as under.

- To check & report on compliances of applicable laws and Secretarial Standards
- To point out non-compliances and inadequate compliances
- To protect the interest of various stakeholders i.e. the customers, employees, society etc.
- To avoid any unwarranted legal actions/penalties 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
12. Borrowings
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, 2015;
- (iii) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- (iv) The Securities and Exchange Board of India (Share Based Employee Benefit) Regulations, 2014;
- (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;
- (ix) SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015 (where applicable).

*(iii) Other Applicable Laws include:*

Reporting on compliance of 'Other laws as may be applicable specifically to the company' shall mean all the laws which are applicable to specific industry for example for Banks- all laws applicable to Banking Industry; for insurance company-all laws applicable to insurance industry; likewise for a company in petroleum sector-all laws applicable to petroleum industry; similarly for companies in pharmaceutical sector, cement industry etc.

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. SS-1 requires every company to specify list of laws applicable specifically to the company at its Board Meeting.

Examining and reporting whether the adequate systems and processes are in place to monitor and ensure compliance with general laws like labour laws, competition law, and environmental laws.

The provisions relating to audit of accounts and financial statement of a company is dealt in the Statutory Audit, and that relating to taxation is dealt in Tax Audit, the Secretarial Auditor may rely on the reports given by statutory auditors or other designated professionals. However, Secretarial Auditor is expected to report on the Secretarial Compliance of these laws.

*(iv) to examine and report on the compliance with Secretarial Standards issued by ICSI.*

*(v) 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 thereof;

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.

### NEED FOR SECRETARIAL AUDIT

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

- Effective mechanism to ensure that the legal and procedural requirements are duly complied with.
- Provides a level of confidence to the directors & 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 governance and compliance risk management tool.
- It helps the investor in analyzing the compliance level of companies, thereby increases the reputation.

### Secretarial Audit & Company Secretary in Practice (PCS)

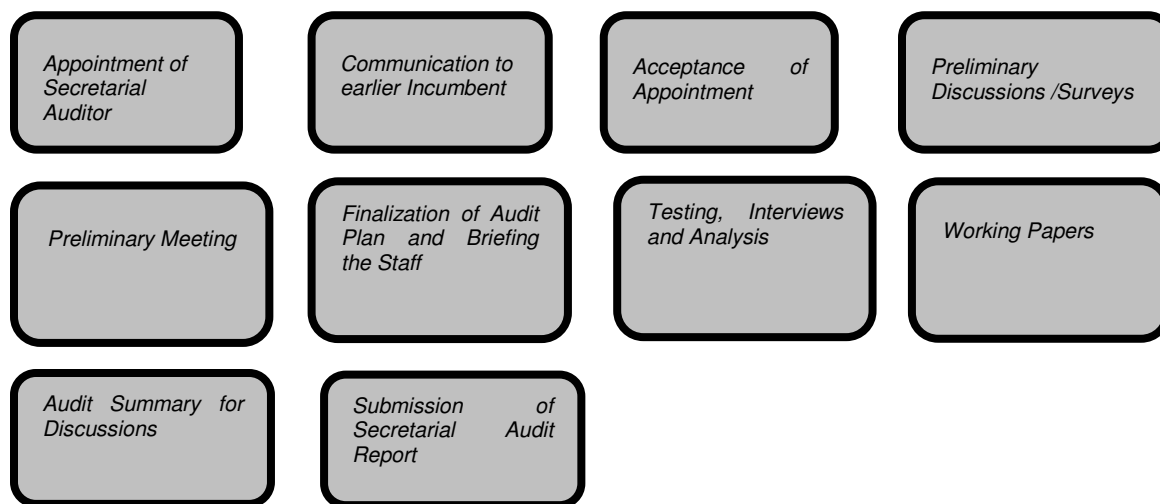
A Company Secretary in practice is considered to be a professional well-versed in matters of statutory,

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 terms of section 204(1), only a member of the Institute of Company Secretaries of India holding certificate of practice (company secretary in practice) can conduct Secretarial Audit and furnish the Secretarial Audit Report to the company.

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 a guidance note on Secretarial Audit.

### Secretarial Audit – The process



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.

Besides, the Company Secretary in Practice shall be liable for professional or other misconduct mentioned in First or Second Schedule or in both the Schedules to the Company Secretaries Act, 1980 and where held guilty, be liable for the following actions:

- (i) where found guilty of professional or other misconduct mentioned in the First Schedule:
  - (a) reprimand;
  - (b) removal of name from the Register of members upto a period of three months;
  - (c) fine which may extend to one lakh rupees.
- (ii) where found guilty of professional or other misconduct mentioned in the Second Schedule:
  - (a) reprimand;
  - (b) removal of name from the Register of members permanently or such period as may be thought fit by the Disciplinary Committee;
  - (c) fine which may extend to five lakh rupees.

### **Duty to Report Fraud**

A very significant duty has been cast on the company secretary in practice under section 143 (12) of the Companies Act, 2013. It provides that if the company secretary in practice, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving the prescribed amount is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government.

Section 143(12) read with the Companies (Audit and Auditors) Amendment Rules, 2015 provides that if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud which involves or is expected to involve individually an amount of rupees one crore or

above, is being or has been committed against the company by its officers, the auditor shall report the matter to the Central Government.

- The auditor shall report the matter to the Central Government as under:-
  - (a) the auditor to report the matter to the Board/ Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
  - (b) on receipt of such reply, the auditor to forward his report and the reply of the Board/Audit Committee along with his comments to the Central Government within 15 days from the date of receipt of such reply or observations;
  - (c) in case the auditor fails to get any reply or observations from the Board/ Audit Committee within 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
  - (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same.
  - (e) the report shall be in the form of a statement as specified in Form ADT-4.

In case of a fraud involving lesser than rupees one crore, the auditor shall report the matter to Audit Committee or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:-

- (a) Nature of Fraud with description;
- (b) Approximate amount involved; and
- (c) Parties involved.

The following details of each of the fraud reported to the Audit Committee or the Board during the year to be disclosed in the Board's Report:-

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken.

In case, company secretary in practice does not comply with the provisions of section 143(12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

### **Limits for the issue of Secretarial Audit Reports**

The Council of the Institute at its 235th meeting held on February 11, 2016 reviewed the existing limits for the issue of Secretarial Audit Reports and decided as below:

- 10 Secretarial Audits per partner/ PCS, and
- an additional limit of 5 secretarial audits per partner/PCS in case the unit is peer reviewed.

These limits will be applicable for the Secretarial Audit Reports to be issued for the financial year 2016-17 onwards.

## SECRETARIAL STANDARDS

### Secretarial Standards - Meaning

The term 'Secretarial Standards' is defined as an explanation to Section 205(1) 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.

Secretarial Standards lay down a set of principles which companies are expected to adopt and adhere to, in discharging their responsibilities. The Secretarial Standards seek to integrate, harmonize and standardize the diverse secretarial practices being followed by various corporates through assimilation of best practices. Secretarial Standards provide a clear direction to complement the laws, which at times have varied interpretations, thereby ensuring that the law is followed both in letter and spirit.

### 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 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 major Industry Associations viz, FICCI, CII and ASSOCHAM, representatives of regulatory authorities, such as the Ministry of Corporate Affairs, Securities & Exchange Board of India, Reserve Bank of India, Bombay Stock Exchange, National Stock Exchange of India Ltd. 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 are 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.

Secretarial Standard on Meetings of the Board of Directors (SS-1) and Secretarial Standard on General Meetings (SS-2) issued by the Institute of Company Secretaries of India (ICSI) are applicable to all companies w.e.f 1<sup>st</sup> July, 2015 (except One Person Company in which there is only one director and class or classes of companies which are exempted by the Central Government through notification). The Company Secretary in employment as well as in practice are entrusted to ensure the compliance of applicable Secretarial Standards.

Section 118 (10) shall not apply in case of Specified IFSC Public Company and Specified IFSC Private Company – MCA Notification dated 4th January, 2017.

## 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 Secretarial Standard generally includes 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 Secretarial Standard will be finalised by SSB and submitted to the Council of ICSI.
  8. The Council will consider the final draft of the 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, Companies 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.

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 endeavor to strive for good governance.

### **Secretarial Standards and the Companies Act, 2013**

The Companies Act, 2013 recognizes the Secretarial Standards specified by the Institute of Company Secretaries of India (ICSI). It is the beginning of a new era in corporate governance, where not only financial standards but also non-financial standards have been prioritized and given statutory recognition.

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. The ICSI has issued Secretarial Standard on Meetings of the Board of Directors (SS-1) and Secretarial Standard on General Meetings (SS-2) after the approval of Central Government. The Companies are now mandatorily required to observe the SS-1 & SS-2 w.e.f. 1<sup>st</sup> July, 2015.

However, the Secretarial Standards Board (SSB) of ICSI has commenced consultative process with the stakeholders for formulation/revision of the following Secretarial Standards:

- Secretarial Standard on Dividend
- Secretarial Standard on Board's Report
- Secretarial Standard on Registers and Records

Earlier,

ICSI had issued ten Secretarial Standards, in consonance with the Companies Act, 1956, 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 (Merged with SS-1 & SS-2)

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

SS-10: Secretarial Standard on Board's Report.

#### **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 on a day other than the National Holiday, 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 serial number, day, date, time and full address of the venue of the Meeting.  |

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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 the directors within the stipulated period through one of the specified modes.
- 
7. In case of a Meeting at shorter notice/sending agenda in respect of Unpublished price Sensitive information 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**

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9. In case of the first Meeting of the Board, it was held within the specified period.
- 
10. The specified number of meetings were held in a year (calendar year) and the gaps between two consecutive meetings did not exceed the period specified in the Standard.
- 
11. Meetings of the Committees were held as stipulated by the Board or as prescribed by any law or authority.
- 

#### **Quorum**

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12. The requisite quorum 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 the restricted item of business at the Board and audit committee meetings were not approved through Electronic Mode.
- 

#### **Attendance at the Meetings**

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19. The Separate Attendance Registers for the Board and Committee Meetings were duly maintained, either at the registered office of the Company or such other place, as approved by the Board and are in the custody of the Company Secretary or any other person authorized by the Board
- 
20. In case of Directors participating through Electronic Mode, the attendance of such Directors had been confirmed by the Chairperson.
- 
21. The attendance register are preserved for a period of at least eight financial years and destruction of such records/registers, if any, was made with the approval of the Board. The proceedings of Meeting through Electronic Mode were duly recorded and preserved.
- 
22. The entries in the attendance registers were duly authenticated by the Company Secretary or Chairman by appending signature to each page.
- 
23. Leave of absence was granted to a Director as per the Standard, if requested for.
- 

#### **Chairman**

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24. The Chairman of the Company or any other director duly elected as Chairman conducted the Meetings of the Board.
- 
25. Check whether the Chairman of the Committee or any other member of the Committee duly elected conducted the Meetings of the Committee.
- 

#### **Passing of Resolutions by Circulation**

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26. 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**

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27. 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.
- 
28. 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**

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29. Check that the draft of the resolution proposed to be passed by circulation alongwith necessary papers including explanatory note had



been circulated to all the directors of the company through the specified modes of delivery.

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

### **Approval**

---

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

### **Recording**

---

32. 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 including the fact that the Interested Director, if any did not vote on the resolution.
- 

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

34. 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.
- 

### **Minutes**

---

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

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

### **Maintenance**

---

37. Check whether:

- Minutes are being recorded in books maintained for that purpose.
  - Distinct Minutes book are being maintained in respect of Board and Committee Meeting.
  - Minutes maintained in electronic form, if any, with Timestamp.
  - The pages of the Minutes book are being consecutively numbered.
- 

38. Check that the Minutes are not being pasted or attached to Minutes Book, altered or tempered with in any manner.
- 

39. 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.

- 
40. Check that the Minutes Books are being kept at the Registered Office of the company or at such other place as may be approved by the Board.
- 

### Contents

---

41. Check whether

- Minutes begin with the number and type of the Meeting, name of the company, day, date, venue and time of commencement and conclusion of the meeting.
  - Minutes record the names of the Directors present physically or through electronic mode, the company secretary in attendance at the Meeting and invitees, if any.
  - Minutes contain a record of all appointments made at the Meeting
  - Minutes contain other contents as per the Standard.
- 

42. 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.
- 

43. Check whether the minutes recorded the fact that a resolution was passed pursuant to the casting vote of Chairman of the Meeting.
- 

### Recording

---

44. Each item of business taken up at the Meeting was numbered. The minutes contain a reference to the identification of papers including report or notes laid before the meeting.
- 

45. Minutes of the preceding Board/Committee Meeting were noted at the next Meeting held immediately following the date of entry of such minutes in the Minutes Book.
- 

46. Where an earlier resolution or decision is superseded or modified, the Minutes contain a reference to the earlier resolution or decision.
- 

### Finalisation

---

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

### Entry

---

48. 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

---

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

### Inspection & Extracts

---

50. 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

---

51. Minutes of all Meetings are being preserved permanently and kept in the custody of authorised person as prescribed under the Standard.
- 
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
- 

## 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. Proof of despatch of the notice was retained by the company.
- 
3. The Notice was hosted on the website, if any, of the company.
- 
4. The notice clearly specified the day, date, time and full address of the venue of the Meeting including the route map and prominent land mark wherever required besides clearly specifying the nature of the Meeting and the business to be transacted thereat.
- 
5. The notice prominently contained a statement on entitlement to appoint proxy.

- 
6. 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.
- 
7. In respect of items of Special Business 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. In respect of ordinary business the ordinary resolution was included in the notice if the auditors or directors were appointed other than those the retiring one.
- 
8. 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.
- 
9. Check that the notice of meeting and accompanying documents were given at least 21 clear days in advance of the meeting. In case of Meetings at shorter notice, due procedure as per the Standard had been followed.
- 
10. 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.
- 
11. 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

---

12. The AGM had been duly held in accordance with the requirement of the Act and Standards
- 
13. In case of an Extra-Ordinary General Meeting or a postal ballot, only items of business other than ordinary business and those of an urgent nature had been transacted.
- 

### Quorum

---

14. The requisite quorum was present in the meeting.
- 
15. The Quorum was present throughout the Meeting.
- 
16. Proxies had been excluded for determining the Quorum.

---

**Presence of Directors and Auditors**

---

17. Directors of the company had attended the General Meetings of the company, particularly the Annual General Meeting.
- 
18. If any Director was unable to attend the Meeting, the Chairperson had explained such absence at the Meeting.
- 
19. The Auditors of the company unless exempted by the company, 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.
- 
20. Secretarial Auditor, unless exempted by the company, attended the Annual General Meeting, either by himself or through his authorised representative and were given the right to be heard at such Meeting on that part of the business which concerns him as SecretarialAuditors.
- 

**Chairman**

---

21. Check that the Meetings was conducted either by Chairman 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.
- 
22. Check whether the Chairman had explained the objective and implications of the Resolutions before they were put to vote at the meeting.
- 
23. In case of public companies, check that the Chairman 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.
- 

**Proxies**

---

24. 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.
- 

**Voting**

---

25. The Resolution had been duly proposed by a member and seconded by another member.
- 
26. In case of a company having its equity shares listed (other than the exempted companies) the e-voting facility was provided to its members to exercise their voting rights.

The Resolution has been put to vote through a ballot process at the meeting. Every Resolution, in the first instance, was put to vote on a show of hands, unless a poll was validly demanded.

---

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

---

28. Voting was conducted by the company in the manner prescribed under the Act/Secretarial Standard.

---

#### **Conduct of Voting by Electronic Mode**

---

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

---

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

---

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

---

32. 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**

---

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

---

34. 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.

---

35. Each Resolution put to vote by poll, had been put to vote separately.

---

36. 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.

---

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

---

#### **Withdrawal of Resolutions**

---

38. 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**

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39. Check that no Resolution passed at a Meeting has been rescinded subsequently without a Resolution passed at a subsequent meeting.

---

**Modifications to Resolutions**

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

---

**Reading of Reports-**

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41. 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.
42. Check whether the attention of the Members present was drawn to the explanations/comments given by the Board of Directors in their report to the qualifications/observation and comments of the auditors.
43. Check that the no gifts, coupons or cash in lieu of gifts was distributed to any member at or in connection with the meeting.

---

**Adjournment of Meetings**

---

44. Check that a duly convened Meeting was not adjourned arbitrarily by the Chairman.
45. Check whether
- 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.
46. 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.

---

**Passing of Resolutions by Postal Ballot**

---

47. Check that any Resolution required to be passed through postal ballot was passed through such mode only by following the due process in accordance with Law & Standard.

Check that if the board opt for any other matter to be transacted through postal ballot, then the due process has been followed as per the law and standard..

---

### Minutes

---

48. Check whether the Minutes of the General Meetings were entered in the minutes book and signed within 30 days of conclusion of the Meeting.

---

49. Check whether:

- Minutes are being recorded in books maintained for that purpose.
  - Distinct Minutes book are being maintained in respect of Meeting of members, creditors etc.
  - Minutes maintained in electronic form, if any, with Timestamp.
  - The pages of the Minutes book are being consecutively numbered.
- 

50. Check that the Minutes are not being pasted or attached to Minutes Book, altered or tempered with in any manner.

---

51. In case the Minutes are maintained in loose-leaf form, check whether it is being bound periodically depending on size and volume.

---

52. Check that the Minutes Books are being kept at the Registered Office of the company or at such other place as may be approved by the Board.

---

### Contents

---

53. Check whether

- Minutes begin with the Meeting details, name of the company, day, date, venue and time of commencement and conclusion of the meeting.
  - Minutes record the names of the Directors and the company secretary present at the Meeting.
  - Minutes contain other specific contents as per the Standard.
- 

54. Check whether the summary/brief report on e-voting or postal ballot including the summary of scrutinizers report in respect of resolutions passed through e-voting/postal ballot, has been recorded in the minute's book.

---

55. Each item of business taken up at the Meeting was numbered in a manner to enable ease of reference or cross reference.

### Signing and dating

---

56. Check whether the Minutes are initialled, dated and signed by the Chairman either physically or digitally as required by the Standard.



---

**Inspection & Extracts of Minutes**

---

57. 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**

---

58. Minutes of all meetings are preserved permanently in physical or in electronic form with Timestamp in the custody of company secretary or any director duly authorised by the Board.
- 
59. Office copies of Notices, scrutiniser's report and other related papers are duly preserved in good order in physical or electronic form for the stipulated period.
- 
60. Office copies of Notices, scrutiniser's report and related papers of the transferor company, as handed over to the transferee company, are being duly preserved for the stipulated period.
- 
61. Necessary approval had been taken, where any records had been destroyed.
- 

---

**Report of the Annual General Meeting**

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62. 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 within 30 days of the conclusion of the AGM.
- 

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**Disclosure**

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63. Check whether the Annual Return of a company discloses the date of Annual General Meeting held during the financial year.

***\*Note: These checklist are prepared on the basis of the Secretarial Standard on Meetings of the Board of Directors (SS-1) and General Meetings (SS-2). Since, SS-1 & SS-2 are now mandatory for compliance w.e.f 1<sup>st</sup> July, 2015, Students are advised to study the Secretarial Standards in detail.***

**Annexure A****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<sup>1</sup>;
  - (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<sup>2</sup>;

<sup>1</sup> The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 have been repealed by the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 w.e.f 15<sup>th</sup> January, 2015.

<sup>2</sup> The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 have been repealed by the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 w.e.f 28<sup>th</sup> October, 2014.

- (e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
- (f) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;
- (g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
- (h) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;
- (vi) ..... (Mention the other laws as may be applicable specifically to the 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.
- The ICSI has issued Secretarial Standard on Meetings of the Board of Directors (SS-1) and Secretarial Standard on General Meetings (SS-2) after the approval of Central Government. The Companies are now mandatorily required to observe the SS-1 & SS-2 w.e.f. 1st July, 2015.

## 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?

- \_\_\_\_\_

[illegible]

# 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

A corporation has to function within the periphery of host of legislations. It is essential for a corporation to abide by plethora of applicable laws, rules, procedures, regulations and the internal regulatory framework.

Under most of the laws, the persons who are responsible for compliance and liable for punishment for non-compliances are directors, the Company Secretary and officers who have been designated to ensure compliances of specific laws and regulations applicable to a company.

Under the Companies Act, 2013, a managing and/or whole-time director, along with other Key Managerial Personnel and other Directors may be treated as 'officers who are in default' and will be liable for penal consequences for non-compliance, while under most of the other laws, persons in charge of and responsible for the conduct of business of the company are held responsible.

Secretarial Audit is a mechanism which gives necessary comfort to the management, regulators and the stakeholders, as to the compliance by the company of applicable laws and the existence of proper and adequate systems and processes.

Secretarial Audit also covers non financial aspects of the business having impact on its business and performance and verifies compliances of applicable laws, regulations and guidelines. Nonetheless, this exercise also mitigates business risk to a great extent. It evaluates the manner in which the affairs of a company are conducted. While pursuing its business activities, the company has to comply with the rules and regulations relating to the Companies Act, Securities laws, FEMA, industry specific laws and general laws like Labour Laws, Competition Law and Environmental and Pollution Related laws.

Secretarial Audit postulates verification on a test basis of records, books, papers and documents to check compliance with the provisions of various statutes, laws and rules & regulations by a Company Secretary in Practice to ensure compliance of legal and procedural requirements and processes.

Secretarial Audit is, therefore, an independent and objective assurance intended to add value and improve operations of a company. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

## 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.

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, conversion of shares
- 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 Form MGT-14 as per the Companies (Management and Administration) Rules, 2014.
2. The company has altered its name with the approval of Central Government by filling application in Form INC-24.
3. The company has obtained fresh certificate of incorporation from the registrar in Form INC-25 as per Companies (Incorporation) Rules, 2014.
4. If the company has shifted the registered office from one state to another state, it is with the approval from the Central government. Check whether the order of the Central Government is filed with both the states in Form INC - 28.
5. In case company has raised money from public through prospectus and still has any unutilised amount out of the money so raised, a special resolution has been passed through postal ballot by the company to change its objects for which it raised the money through prospectus.



- The notice contains the details as provided in Rule 32 of the Companies (Incorporation) Rules, 2014
- 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 were given an opportunity to exit by the promoters and shareholders having control in accordance with regulations specified by the Securities and Exchange Board.

### ***Alteration of Articles***

#### **Check whether**

1. The company has passed special resolution with respect to alteration of articles and has filed Form MGT-14.
2. In case of the conversion of a private company into a public company or vice versa, the application was filed in Form INC-27
3. A copy of order of the Tribunal approving the alteration has been filed with the Registrar in Form INC-27 together with the printed copy of the altered articles within fifteen days from the receipt of the order from the Tribunal.
4. Provision for entrenchment has been made by an amendment in the Articles, with the consent of all the members in case of a private company/by passing special resolution in case of a public company
5. Every alteration made in the memorandum or articles has been noted in every copy of the memorandum or articles.
6. The company sends on payment of fee, a copy of each of the following documents to a member within seven days of the request being made by him-
  - (I) the memorandum;
  - (II) the articles;
  - (III) every agreement and every resolution referred to in section 117(1) if they have not been embodied in the memorandum and articles.

Checked by:

Reviewed by:

Date:

Date:

#### **Indicative list of documents to be checked (Alteration of memorandum):**

1. Notice convening general meeting with relevant explanatory statement
2. Minutes of General Meeting
3. Annual Return
4. Financial Statement
5. Return of deposits
6. Advertisement for change in objects
7. Memorandum of Association

8. Articles of Association
9. INC23, INC24, INC25, INC26, INC28 (along with attachments)

**Indicative list of documents to be checked (Alteration of Articles):**

1. Minutes of General Meeting
2. Memorandum of Association
3. Articles of Association
4. INC27, MGT14

**Checklist**

**II. DISCLOSURES**

Sl. No.	Particulars
1.	The Name, address of registered office of Company is displayed at its registered office and all other offices as per section 12; Where the company has changed its name(s) during the last two years, it has affixed along with its name, the former name(s) so changed during the last two years.
2.	Where the authorised share capital has been displayed in its official publications, the subscribed/paid-up share capital is also displayed as per section 60;
3.	Company has disclosed its CIN, website address etc. as provided in section 12
4.	Website of company discloses the mandatory information.
5.	Director Identification Number of each director is mentioned while furnishing any return, information or particulars as are required to be furnished under the Section 158 of the Act.

**Indicative list of documents to be checked :**

- Certificate of Incorporation
- Director Identification Number
- Website of the company

**Website disclosures under the Companies Act, 2013**

<b>Section/Rules</b>	<b>Requirement as per Companies Act</b>
Sec 13(8)(i) read with Rule 32(3) of the Companies (Incorporation) Rules, 2014.	A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company, the details in respect of such resolution, shall also be placed on the website of the company, if any.

Sec 73 read with Rule 4(3) of the Companies (Acceptance of Deposits) Rules, 2014	A company intending to invite deposits shall upload a copy of circular issued to members inviting deposits on its website, if any.
Sec 91 read with Rule 10 (1) of the Companies (Management and Administration) Rules, 2014	Seven days previous notice of closure of the register of members, debenture holders or other security holders to be uploaded on the website of the company, if any, or any other website as notified by the Central Government.
Sec 101 read with Rule 18 (3)(ix) of the Companies (Management and Administration) Rules, 2014	In case notice of general meeting is sent through electronic means, such notice shall be uploaded on the website of the company, if any, or any website as notified by the Central Government.
Sec 108 read with Rule 20(4) (ii) of Companies (Management and Administration) Rules, 2014	The company shall place the notice of the meeting on the website of the company and of the agency forthwith after it is sent to the members.
Sec 108 read with Rule 20(4) (xvi) of the Companies (Management and Administration) Rules, 2014 [Inserted by Companies (Management and Administration) Rules, 2015 dated 19.03.2015]	In case the voting at general meeting is held through electronic mode, the results declared along with the scrutinizer's report shall be placed on the website of the company, if any, immediately after the result is declared by the Chairman.
Sec 110 read with Rule 22 (4) of the Companies (Management and Administration) Rules, 2014	Where any resolution is being passed by postal ballot, notice of postal ballot to be uploaded on the website of the company, if any, and it shall remain on the website till the last date for receipt of the postal ballot from members.
Sec 110 read with Rule 22 (13) of the Companies (Management and Administration) Rules, 2014	Where any resolution is being passed by postal ballot, the result declared along with the scrutinizer's report shall be uploaded on the website of the company, if any.
Sec 115 read with Rule 23 (4) of the Companies (Management and Administration) Rules, 2014	Where for a resolution special notice has been given by a member of the company and it is not possible for the company to send the notice in the same manner as notice of general meeting, then apart from publishing it in the newspaper, notice shall be placed on the website of the company, if any, within seven days before the meeting.
Sec 124(2)	The company, making any transfer of an amount to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place

	it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose within 90 days of making any transfer.
Sec 135(4) (a) read with rule 9 of Companies (Corporate Social Responsibility Policy) Rules, 2014	The Company shall disclose contents of CSR Policy in Board's report and also place it on its website, if any.
Sec 136(1)	A listed company shall also place its financial statements and all other documents required to be attached thereto, on its website, if any.
Sec 136(1)(a)	Every company having a subsidiary or subsidiaries shall, place separate audited accounts in respect of each of its subsidiary on its website, if any.
Sec 149 read with Schedule IV	The terms and conditions of appointment of independent director shall also be posted on the company's website.
Sec 177(10)	Details of establishment of vigil mechanism shall be disclosed by the company on its website, if any.
Sec 230(3)	Where a meeting is proposed to be called in pursuance of an order of the Tribunal under sub-section (1) of sec 230, a notice of such meeting and every detail shall also be placed on the website of the company, if any.
Sec 160 read with Rule 13 of the Companies (Appointment and Qualification of Director) Rules, 2014	Place the notice of or intention for the candidature of a person for the office of a director on the website of the company, if any, Seven days before the general meeting
Sec 168 read with Rule 15 of the Companies (Appointment and Qualification of Director) Rules, 2014	Information about resignation of the Director shall be posted on the website of the company, if any, within 30 days from the date of receipt of notice.
Rule 7(3) of the Companies (Prospectus and Allotment of Securities) Rules, 2014	The notice of special resolution with regard to variation in terms of contract or objects in prospectus shall be placed on the web-site of the company, if any.
Rule 20(3) (b) the Companies (Incorporation) Rules, 2014.	The existing company shall, for the purpose of license under section 8, to publish a notice in the newspaper, and shall also be uploaded on the websites as may be notified by the Central Government, within a week from the date of making the application to the Registrar
Rule 22 (1) (b) the Companies (Incorporation) Rules, 2014.	Companies registered under section 8 for the purpose of seeking conversion into any other kind shall upload a notice on the website of the company, if any, within a week from the date of making the application to the Regional Director.

**Indicative list of documents to be checked:**

- Website of the company
- Copy of documents which are uploaded on website

## ISSUE OF SHARES AND OTHER SECURITIES

*Private Placement U/S 42 (read with the 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. It is to be noted that any offer or invitation made to qualified institutional buyers or to employees of the company under scheme of employees stock option shall not be considered while calculating the limit of two hundred persons.
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 and requirements of Section 102, 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. Sent 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 Form PAS-5.
9. Company has filed Private Placement offer letter with ROC in Form PAS-4 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. Ensure that payment has been made from the bank account of the person subscribing to such securities.
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. Company filed Return of allotment in Form PAS-3 within 30 days. A return of allotment shall be filed within 30 days of allotment in Form PAS-3 along with complete list of security holders containing -
  - (i) the full name, address ,PAN and E-mail id of such security holder;
  - (ii) the class of security held;
  - (iii) the date of allotment of security;
  - (iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.
15. Board resolution to specifically contain authority for issuance of share certificates to Two directors and CS/one authorized person. One of the two directors should be director other than MD / WTD.
16. Share application money to be kept in separate bank account and was utilized only for (a) adjustment against allotment or (b) repayment.
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

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*

1. 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 may dispose of the shares in a manner not disadvantageous to the company and shareholders.
  - d. Ensure that the allotment was made within 60 days from the date of receipt of the share application

money to else money received from shall be treated as deposit. Companies (Acceptance of Deposits) Rules, 2014

2. In case of any preferential offer made by a company to one or more existing members only, the provisions of sub-rule (1) and proviso to sub-rule (3) of Rule 14 of Companies (Prospectus and Allotment of Securities) Rules, 2014 shall not apply.

3. The issue is authorized by its articles of association

4. The company other than private company has passed Special resolution.

5. The Price of shares shall not be less than the price determined on basis of valuation report of a registered valuer.

6. The company shall make the following disclosures in the explanatory statement to be annexed to the notice of the general meeting pursuant to Section 102 of the Act:

- (i) the objects of the issue;
- (ii) the total number of shares or other securities to be issued;
- (iii) the price or price band at/within which the allotment is proposed;
- (iv) basis on which the price has been arrived at along with report of the registered valuer;
- (v) relevant date with reference to which the price has been arrived at;
- (vi) the class or classes of persons to whom the allotment is proposed to be made;
- (vii) intention of promoters, directors or key managerial personnel to subscribe to the offer;
- (viii) the proposed time within which the allotment shall be completed;
- (ix) the names of the proposed allottees and the percentage of post preferential offer capital that may be held by them;
- (x) the change in control, if any, in the company that would occur consequent to the preferential offer;
- (xi) the number of persons to whom allotment on preferential basis have already been made during the year, in terms of number of securities as well as price. The pre issue and post issue pattern for shareholding shall be in format prescribed under Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014;
- (xii) the justification for the allotment proposed to be made for consideration other than cash together with valuation report of the registered valuer.

7. The allotment of securities on a preferential basis made pursuant to the special resolution passed shall be completed within a period of twelve months from the date of passing of the special resolution. 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.

8. 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. 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 pursuant to conversion shall be determined-

- (i) either upfront at the time when the offer of convertible securities is made, on the basis of valuation report of the registered valuer given at the stage of such offer, or

- (ii) at the time, which shall not be earlier than thirty days to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer given not earlier than sixty days of the date when the holder of convertible security becomes entitled to apply for shares.

Provided that the company shall take a decision on point (i) or (ii) at the time of offer of convertible security itself and make such disclosure in the explanatory statement.

9. 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;

10. 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.

**Indicative list of documents to be checked:**

- Minutes of Board Meeting
- Copy of notice of offer of shares
- Articles of Association
- Intimation to accept /decline the shares offered
- Special Resolution to offer of shares to employees under ESOP and minutes thereof
- Scheme of employee stock option
- Special Resolution for offering the shares to any other persons and minutes thereof.
- PAS-3, MGT-14

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

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 Practising Company Secretary 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. Check the copy of the special resolution for approving the scheme of ESOP.
3. The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-
  - (a) the total number of stock options to be granted;
  - (b) identification of classes of employees entitled to participate in the Employees Stock Option Scheme;
  - (c) the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;



- (d) the requirements of vesting and period of vesting;
  - (e) the maximum period within which the options shall be vested;
  - (f) the exercise price or the formula for arriving at the same;
  - (g) the exercise period and process of exercise;
  - (h) the Lock-in period, if any ;
  - (i) the maximum number of options to be granted per employee and in aggregate;
  - (j) the method which the company shall use to value its options;
  - (k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;
  - (l) the specified time period within which the employee shall exercise the vested options in the event of proposed termination of employment or resignation of employee; and
  - (m) a statement to the effect that the company shall comply with the applicable accounting standards .
4. Check whether special resolution has been filed with ROC in Form MGT -14 as per the Companies (Management and Administration) Rules, 2014.
  5. 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.
  6. (a) The company may by special resolution, vary the terms of Employees Stock Option Scheme not yet exercised by the employees provided such variation is not prejudicial to the interests of the option holders.
  - (b) The notice for passing special resolution for variation of terms of Employees Stock Option Scheme shall disclose full of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such variation.
  7. (a) There shall be a minimum period of one year between the grant of options and vesting of option:  

Provided that in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause;
  - (b) The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.
  - (c) The Employees shall not have the right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.
  8. 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 the Companies (Share Capital and Debentures) Rules, 2014.
  9. Verify the Register of Employee Stock Options maintained in Form SH-6 of the 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.

**Indicative list of documents to be checked:**

- Minutes of Board Meeting
- Special Resolution approving ESOP alongwith explanatory statement
- Minutes of General meeting
- Board's Report
- Register of Employee Stock Option (Form SH-6)
- PAS-3, MGT-14

**Checklist: Issue of Capital and Securities:**

**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. Whether the bonus is declared only out of
  - (i) Free reserves
  - (ii) Securities Premium Account
  - (iii) Capital Redemption Reserve Account and not out of revaluation reserve created out of revaluation of assets
7. Ensure that the company which has once announced the decision of its Board recommending a bonus issue does not subsequently withdraw the same;
8. Check whether Return of allotment is filed with the registrar in Form PAS.3

**Indicative list of documents to be checked :**

- Articles of Association
- Minutes of Board Meeting
- Minutes of General meeting
- Register of fixed deposits
- Auditor's Report
- 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 whether***

1. 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. The Resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors, or employees to whom such equity shares are to be issued.
2. Explanatory statement to be annexed to the notice of the general meeting contains the specified particulars [Rule 8 of the Companies (Share Capital and Debenture) Rules, 2014].
3. Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business;
4. 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.
5. The Sweat Equity Shares to be issued are valued at a price determined by a registered valuer. A copy of the gist report shall be send to the shareholder along with notice of General Meeting
6. If the shares are issued pursuant to acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards and the amount of the accounting value of the sweat equity shares that is in excess of the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company. The Accounting value shall be the fair value of the sweat equity shares as determined by a registered value.
7. Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company- (a) 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 (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standard
8. The Sweat Equity Shares issued are locked in / non transferable for a period of three years from the date of allotment. The fact and the period of lock in is stamped in bold on such share certificates.
9. The amount of Sweat Equity shares issued is included as a part of managerial remuneration while calculating the limits, if the following conditions are fulfilled
  - (a) the sweat equity shares are issued to any director or manager; and
  - (b) they are issued for consideration other than cash, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

10. Details as per Rule 8(13) of Companies (Share Capital and Debentures) Rules, 2014 of the Sweat Equity shares are mentioned in the Director's Report .
11. The company is maintaining Register of Sweat Equity Shares in Form SH-3
12. The Register of Sweat Equity Shares is maintained at the registered office of the company or such other place as the Board may decide.
13. 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.

**Indicative list of documents to be checked:**

- Minutes of Board Meeting
- Special Resolution with Explanatory Statement
- Minutes of General meeting
- Valuation Report
- Board's Report
- SH-3
- PAS-3, MGT-14

### **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.

**Indicative list of documents to be checked:**

- Minutes of Board meeting
- Articles of Association
- Copies of Call letter
- Proof of dispatch of call letters

### **Buy-back of Shares/Securities**

***Buy back by Unlisted companies:***

1. The offer for buy back is not made within 1 year of closure of preceding offer of buy back.
2. 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.

3. Form MGT-14 as per the Companies (Management and Administration) Rules, 2014 has been filed with RoC within 30 days of passing the special resolution.
4. In case, buy back of securities are upto 10% of total paid up equity capital & free reserves, whether a board resolution was passed authorizing the buy-back.
5. 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)
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.
7. After passing of special resolution but before buy-back, the letter of offer has been filed with RoC in Form SH-8 with the requisite fee.
8. The Letter of offer shall contain:
  - (a) 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;
  - (b) the company shall not issue any new shares including by way of bonus shares from the date of passing of special resolution authorizing the buy-back till the date of the closure of the offer under these rules, except those arising out of any outstanding convertible instruments;
  - (c) 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;
  - (d) the company shall not withdraw the offer once it has announced the offer to the shareholders;
  - (e) the company shall not utilize any money borrowed from banks or financial institutions for the purpose of buying back its shares; and
  - (f) 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
9. 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 twenty days from its filing with the Registrar of Companies.
10. The offer for buy-back shall remain open for a period of not less than fifteen days and not exceeding thirty days from the date of dispatch of the letter of offer.
11. The company shall complete the verifications of the offers received within fifteen 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 twenty one days from the date of closure of the offer.
12. 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 in terms of these rules.
13. 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.

14. The shares or other securities so bought back are extinguished and physically destroyed within seven days of the completion of buy-back.
15. The declaration of solvency required pursuant to Section 68 (6) of the Companies Act, 2013 has been filed in Form SH-9 as per Companies (Share Capital and Debentures) Rules, 2014 with RoC.
16. The declaration of solvency has been signed and verified by atleast two directors, one of whom shall be the managing director of the company, if any.
17. The company maintains a register of shares or other securities which have been bought back in Form SH-10 as per the Companies (Share Capital and Debentures) Rules, 2014.
18. The company has filed a return containing within 30 days of completion of buy-back in Form SH-11 as per the Companies (Share Capital and Debentures) Rules, 2014 with RoC and in case of a Listed company with the Securities and Exchange Board of India.
19. The certificate of compliance in Form SH-15 signed by two directors of the company including the managing director, if any, and verified by the Company Secretary in Practice is annexed to the return filed with RoC in Form SH-11.

**Indicative list of documents to be checked:**

- Articles of Association
- Minutes of Board meeting
- Minutes of General meeting
- Notice authorising buy-back alongwith explanatory statement
- Letter of offer (SH-8)
- Declaration of Solvency (SH-9)
- Register of shares/other securities bought back (SH-10)
- Return of Buy-back (SH-11)
- Certification of Compliance (SH-15)
- MGT-14

## Debentures (Section 71)

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

Following class of Companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years (Rule 18 Companies (Share Capital and Debentures) Rules, 2014):

- Companies engaged in setting up of infrastructure projects;
- Infrastructure Finance Companies as defined in clause (vii a) of sub-direction (1) of direction 2 of Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;
- Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

2. In case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge shall not apply.
3. In case of any loan taken by a subsidiary company from any bank or financial institution, the charge or mortgage may be created on the properties or assets of the holding company.
4. The company has appointed a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures
5. A trust deed in Form SH-12 or as near thereto as possible has been executed by the company issuing debentures in favour of the debenture trustees within three months of closure of the issue or offer.
6. The company has created a Debenture Redemption Reserve for the purpose of redemption of debentures in accordance with the conditions specified in sub rule (7) of Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014.
7. In case, any amount received by a company against issue of commercial paper or any other similar instrument issued in accordance with the guidelines or regulations or notification issued by the Reserve Bank of India, Rule 18 shall not apply.
8. In case of any offer of foreign currency convertible bonds or foreign currency bonds issued in accordance with the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or regulations or directions issued by the Reserve Bank of India, Rule 18 shall not apply, unless otherwise provided in such Scheme or regulations or directions.
9. The provisions of the Companies (Share Capital and Debenture) Rules, 2014 shall apply to:
  - a. all unlisted public companies;
  - b. all private companies; and
  - c. listed companies so far as they do not contradict or conflict with any other regulation framed in this regard by the Securities and Exchange Board of India.

**Indicative list of documents to be checked:**

- Minutes of Board Meeting
- Notice alongwith explanatory statement
- Minutes of General meeting
- Charge documents
- Prospectus or letter of offer for subscription of debentures
- Written consent from debenture trustee
- Requisition signed by debenture holders for meeting
- Trust deed (SH-12)
- Financial Statement

**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 (Section 46)

#### ***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. Every certificate of share or shares shall be in Form SH-1 or as near thereto as possible and shall specify the name(s) of the person(s) in whose favour the certificate is issued, the shares to which it relates and the amount paid-up thereon and the company shall maintain the details of the share certificate holder in Form No. SH-2.
3. The company has issued and delivered share certificates as per section 46 of the Act;
4. The company has executed Debenture Trust Deed in case of secured debentures;
5. The company has complied with delivery of certificates within the time limits prescribed under Section 56(4).
6. Proper stamp duty has been paid.
7. The certificates are issued in accordance with the provisions of the Articles of Association.

#### **Indicative list of documents to be checked:**

- Register of members
- Register of renewed or duplicate shares certificate (SH-2)
- Letter of Allotment or fractional coupons
- Letter of acceptance or of renunciation



## Transfer and Transmission of Shares (Section 56)

### 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 time stipulated 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. A company shall not register a transfer of partly paid shares, unless the company has given a notice in Form SH-5 to the transferee and the transferee has given no objection to the transfer within two weeks from the date of receipt of notice.
5. The company has taken indemnity in respect of instrument of transfer that has been lost or not delivered within the prescribed limit.
6. Entries in the register of transfers have been made from time to time.
7. All transfers have been properly included in the Annual Return.

### 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.

#### Indicative list of documents to be checked:

- Instrument of transfer (SH-4)
- Notice to transferee (SH-5)
- Share certificates
- Letter of Allotment of Securities
- Order of Court/ Tribunal/ other authority, if any

## DEPOSITS

#### Check whether

1. The Company has not accepted any deposit which is repayable on demand or upon receiving a notice within a period of less than six months or more than thirty six months from the date of acceptance or renewal of deposit. If, so accepted the company has complied with the conditions prescribed in Rule 3 of the Companies (Acceptance of Deposits) Rules, 2014.
2. The company referred to in Section 73(2) 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 referred to in Section 76 being an eligible Company as defined under the Rules, has issued circular in the form of advertisement in Form DPT-1.
4. The form of application contains a declaration by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.
5. Whether the company filed Return of deposits with the Registrar in Form DPT-3.
6. The company (accepting deposits from members or eligible companies) has entered into a contract for providing deposit insurance as prescribed in Rule 5.
7. The company has provided for security by way of charge as prescribed in Rule 6.
8. The company has executed deposit trust deed in Form DPT-2 at least seven days before issue of circular or advertisement.

#### **Indicative list of documents to be checked**

- Circulars inviting deposits (DPT- 1)
- Newspaper Advertisement
- Minutes of board meetings
- Contract of deposit insurance
- Instrument creating charge
- Written consent from trustee for depositors
- Deposit trust deed (DPT-2)
- Written requisition calling meeting of depositors
- Application form for deposits
- Receipts of amount received by company
- Register of deposits
- Return of deposit (DPT-3)
- Statement regarding deposits (DPT-4)
- Financial statement

### **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 CHG-1 (for other than Debentures) or Form CHG-9 (for debentures including rectification of particulars)].
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 3(4) of the Companies (Registration of Charges) Rules, 2014.
3. The company has reported satisfaction of charge to the Registrar within the period of thirty days of

its payment/ satisfaction in Form CHG-4 and obtained certificate of registration of satisfaction of charge in Form 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 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.

**Indicative list of documents to be checked**

- Minutes of Board Meeting
- Instrument creating / modifying charge (CHG-1 or CHG-9)
- Application for delay (CHG-1)
- Certificate of Registration (CHG-2)
- Certificate of modification (CHG-3)
- Register of charge
- Satisfaction of charge (CHG-4)
- Certificate of registration of satisfaction (CHG -5)
- Notice of appointment/ Cessation of securities (CHG-6)
- Copy of filing of order (INC-28)
- Register of charges (CHG-7)
- Application for Condonation of delay (CHG-8)

**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. The Company has observed the Secretarial Standard on Board Meeting SS-1.
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.

## DIVIDEND

### *Check whether*

1. The amount of dividend, including interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.
2. The amount of dividend, including interim dividend, was deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.
3. The company has paid dividend within 30 days from the date of declaration.
4. The company has transferred the total amount of dividend which remains unpaid or unclaimed for 30 days from the date of declaration to unpaid dividend account within seven days from the expiry of the said 30 days.
5. The company has prepared a statement containing the names and other details to whom the unpaid dividend is to be paid alongwith the amount of unpaid dividend and place the same on the website of the company and also on any other web-site approved by the Central Government for this purpose, within 90 days after holding of AGM or the date on which it should have been held.
6. In case of inadequate profits or absence of profits, the rate of dividend declared has not exceeded the average at the rates at which dividend was declared by it in the three years immediately preceding that year.
7. The company has not declared and paid any dividend from reserves other than free reserves as defined in Section 2(43).
8. The total amount to be drawn from such accumulated profits shall not exceed one – tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
9. Ensure that carried over previous losses and depreciation not provided in previous year(s) are set off against profits of the Company of the current year.
10. The dividend is paid by the company by cheque or warrant or by any electronic mode.
11. The company has before declaration of dividend transferred such percentage of profits to reserves as decided.
12. The company has transferred the amount remaining unpaid or unclaimed for a period of seven years from the date of transfer to the Unpaid Dividend Account to the Investor Education and Protection Fund and has filed the Statement of amounts credited to IEPF in Form IEPF-1.
13. The company has followed the procedures prescribed in Rule 3 before the dividend is declared out

of reserves (as applicable).

#### **Indicative list of documents to be checked**

- Statement containing names of unpaid dividends
- Website of company
- Statement of transfer of unpaid dividend A/c to IEPF with receipt
- Financial statement
- Minutes of Board Meeting
- Bank account details of scheduled bank
- Details of payment of dividend
- Details of unpaid dividend account

### **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. Check whether the holding or subsidiary, and a foreign company having its branch office or project office in India fulfils the criteria specified in sub-section (1) of section 135 of the Act
3. Check whether the company has computed Net worth, turnover or net profit of a foreign company in accordance with balance sheet and profit and loss account of such company. (Rule 3)
4. The Board has approved the CSR Policy including a list of CSR projects or programmes within the purview of schedule VII as well as the monitoring process of such projects or programmes as recommended by CSR Committee.
5. The Composition of CSR Committee is disclosed in the Board's Report.

The CSR activities were under taken as per its stated CSR policy, as projects, programs or activities excluding activities undertaken in pursuance of its normal course of business.

6. The company has instituted a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.
7. The company has instituted a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.
8. The Board of a company has decided to undertake its CSR activities approved by the CSR Committee, through
  - a) a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or alongwith any other company, or
  - b) a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity

established under an Act of Parliament or a State legislature:

If the Board of a company decides to undertake its CSR activities approved by the CSR committee, through a registered trust or a registered society or a company established under section 8 of the Act by the company, either singly or along with its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company, or otherwise

Check whether-

- such trust, society or company have an established track record of three years in undertaking similar programs or projects;
  - The company has specified the project or programs to be undertaken through these entities and every detail related thereto.
9. The CSR projects or programs or activities undertaken in India only amount to CSR expenditure.
  10. The 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 alt item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.
  11. The company has disclosed the contents of the policy in Board's report and at its website, if any. The Board's report includes an annual report on CSR containing prescribed particulars.
  12. 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.
  13. The company has complied with the procedure specified under rules.

Indicative list of documents to be checked

- Indicative list of documents to be checked:
- Balance sheet and P&L account
- Minutes of Board Meeting
- Minutes of CSR Committee
- Company website, if any.

## **DIRECTORS AND KEY MANAGERIAL PERSONNEL ("KMP")**

**Check whether**

1. The minimum 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 any one following category -
  - (i) 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. The Company being the listed company has at least one-third of the total number of directors as independent directors or such higher number as specified in the listing agreement. Listing Agreement shall be replaced by SEBI (Listing Obligation & Disclosure Requirements) Regulation, 2015 by 1.11.2015.
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 Unlisted Public Companies having paid up share capital of ten crore rupees or more; or
  - (ii) the Unlisted Public Companies having turnover of one hundred crore rupees or more; or
  - (iii) the Unlisted 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 other than Government Company and Private 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 other than Private 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) in Form DIR-2 and Form DIR-12 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 and MR 1 with registrar within thirty days and sixty days of such appointment or of any changes therein.
16. A company other than the companies covered above, which has a paid up share capital of five crore rupees or more, has appointed a whole-time company secretary.
17. Appointment of key managerial personnel is made by a board resolution.
18. 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.

19. 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.

#### **Indicative list of documents to be checked**

- Articles of Association
- Minutes papers of Board Meetings
- Notice and minutes of Annual General Meeting, Report of AGM
- Register of directors and KMP
- DIR-2, DIR-6, DIR-8, DIR-9 (if any), DIR-10 (if any), DIR-11, DIR-12
- Declaration of independence given by Independent Directors
- Filings with Stock Exchanges
- Balance sheet and P&L account and Board's Report

#### **Resignation of director**

##### ***Check whether***

1. The letter of resignation of the director is received by the company or from the effective date which is earlier.
2. The Board takes note of the resignation and intimates 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.

#### **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. [Note: in calculating the total number of directors, independent directors should not be included]
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 according to Section 160.
6. The provisions of the Act, Articles of Association and other applicable rules have been complied with.

#### **Indicative list of documents to be checked:**

- Articles of Association
- Register of directors and KMP



- Notice and minutes of Annual General Meeting, Report of AGM
- Board's Report
- DIR-2, DIR-6, DIR-8, DIR-9, DIR-10 (if any), DIR-12

### **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 special notice was signed by member(s) holding not less than one percent of total voting power or holding shares on which an aggregate sum of more than five lakh rupees has been paid up.
3. 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;
4. 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.
5. If the 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.
6. The director who was removed from office was not reappointed as a director by the Board of directors;

#### **Indicative list of documents to be checked:**

- Special notice received
- Notice and minutes of Annual General Meeting/EGM, , Report of General Meeting
- Board's Report
- DIR-2, DIR-6, DIR-8, DIR-9, DIR-10 (if any), DIR-12

#### **Checklist**

### **XII. LOANS TO DIRECTORS (Section 185)**

#### **Check whether:**

1. The company has not directly or indirectly advanced any loans to its directors or any other person in whom the director is interested or given any guarantee or provided any security in connection with any loan taken by him or such other person. (other than to its wholly owned subsidiary company).

Any other person in whom director is interested means-

- (a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
- (b) any firm in which any such director or relative is a partner;
- (c) any private company of which any such director is a director or member;

In case of Specified IFSC Public Company and Specified IFSC Private Company, clause (c) shall

be read as under:-

“(c) any private company of which any such director is a director or member in which director of the lending company do not have direct or indirect shareholding through themselves or through their relatives and a special resolution is passed to this effect;”

- (d) any body corporate at a general meeting of which not less than twenty five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or
- (e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

2. If the loan is advanced to a Managing or Whole Time Director check whether it is as a part of the conditions of service extended by the company to all its employees or pursuant to any scheme approved by the members by a special resolution.

### **Related Party Transactions (Section 188)**

1. The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-
  - (a) the name of the related party and nature of relationship;
  - (b) the nature, duration of the contract and particulars of the contract or arrangement;
  - (c) the material terms of the contract or arrangement including the value, if any;
  - (d) any advance paid or received for the contract or arrangement, if any;
  - (e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
  - (f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
  - (g) any other information relevant or important for the Board to take a decision on the proposed transaction.
2. Check whether the company has prepared a list of related parties as per Section 2(76) of the Act and there exists a system to check whether any contracts / arrangements are being entered into with any of those Parties. Also any department wise mechanism is derived to intimate the same to the secretarial department.
2. If the company is claiming exemption from the applicability of the section on the grounds that the transactions are in the ordinary course of business and are on arms length basis, check whether the Board has taken an informed decision about the nature of transaction based on criteria given in Rule 15.
3. The company has entered into a contract/ arrangement with any related party through a board resolution at a meeting of the board.
4. The company has obtained prior approval of the shareholders by a resolution in case the transaction exceeds the limit prescribed under Rule 15. Other conditions specified in Rule 15 subsist.
5. Check that no member of the company who is the related party with whom the transaction is being

entered into, has voted on such resolution.

6. The company has annexed explanatory statement to the notice of the board or general meeting as may be applicable disclosing the details required under Rule 15.
7. Check whether any director or related party is appointed as an office or place of profit in the company, its subsidiary or associate company and complied with the provisions.
8. The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company.

**Indicative list of documents to be checked:**

- Minutes of Board Meetings
- MBP-1, MBP-2, MBP-3 and MBP-4
- Notice and minutes of AGM/EGM
- Balance sheet and Profit & Loss account; Board's Report
- Auditor's Report

### **XIII. LOANS, INVESTMENTS, GUARANTEES AND SECURITIES (SECTION 186)**

**Check whether**

1. The board resolution has been passed with respect to loans and investments by the company.
2. Company has directly or indirectly —
  - a. given any loan to any person or other body corporate;
  - b. given any guarantee or provide security in connection with a loan to any other body corporate or person; and
  - c. acquired by way of subscription, purchase or otherwise, the securities of any other body corporate,  
 exceeding sixty per cent. of its paid-up share capital, free reserves and securities premium account or one hundred per cent. of its free reserves and securities premium account, whichever is more.
3. Special Resolution has been passed if the limit exceeds as prescribed above and the resolution specifies the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition. The company has disclosed financial statements the full particulars of the loans given investment made or guarantee given as prescribed under the Act.
4. The company cannot make investment through more than two layers of investment companies. Two layers are condition are-
  - (a) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
  - (b) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation frame under any law for the time being in force.
5. The company has not defaulted repayment of deposit while granting loans/ giving guarantee/ providing security.

6. The company maintains register containing such particulars in Form MBP-2 at the registered office of the company
7. The company has obtained prior approval of the public financial institution if term loan is subsisting.
8. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose and the entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

**Indicative list of documents to be checked:**

- Minutes of Board Meetings
- Notice and minutes of AGM/EGM
- MBP-2, MBP-3, DPT-3, DPT-4

**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. Where certificates were 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 utilized, the renewed certificate state on the face of it, that it is "Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation".
3. Prior/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 of 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 forty five days, from the date of submission of complete documents to the company.
7. The register for renewed or duplicate share certificate is maintained in Form SH-2 in accordance with the 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. Entries are incorporated simultaneous 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.

**Indicative list of documents to be checked**

- Minutes of Board Meetings/Meeting of Committee of Directors
- Register of renewed and duplicate share certificates in Form SH-2
- Register of members

**Register of Members (Section 88)**

***Check whether***

1. The company having share capital has maintained register of members as per Form MGT-1 prescribed under the Companies (Management and Administration) Rules, 2014.
2. The Register contains particulars as mentioned in the aforesaid Rule 3(2)
3. The company maintains register of debenture holders or any other security holders as per Form 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 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 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.

### **Register of Investments (Section 187)**

#### ***Check whether***

1. A register of investment not held in the name of the company is maintained as per Form MBP -3, in accordance with the 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 contract or arrangement relates to the following:
  - (a) for the sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the cost of such services does not exceed five lakh rupees in the aggregate in any year; or
  - (b) by a banking company for the collection of bills in the ordinary course of its business.

If yes, register is not required to be maintained for the abovementioned contracts or arrangements.
3. 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.
4. The register(s) is kept at the registered office of the company and is preserved permanently and is in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.
5. 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 kept for that purpose.

2. Every director present at any meeting of the Board or of a Committee thereof has signed against his name.
3. The requirements as specified in the Secretarial Standards have been complied with.

**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 containing details of transfer of securities and the procedure of transfer meets the statutory requirements pursuant to Section 56 read with Rule 11 of the Companies (Share Capital and Debentures) Rules, 2014.
6. All transfer of securities held in physical form are in Form SH-4

*Register of Documents, where common seal was affixed*

7. If the company has common seal company has to maintain 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. Where no AGM is held in any year, 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 MGT-7 referred to in Rule 11 of the Companies (Management and Administration) Rules, 2014.
4. The annual return has been signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice.
5. In case company does not have a company secretary the annual return signed by Company secretary in practice.
6. 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 MGT-8 of aforesaid rules.
7. 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. If the financial statements are not adopted at annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents shall be filed with the Registrar within thirty days of the date of annual general meeting and the Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose.
5. After the holding of adjourned AGM, adopted financial statements are filed within 30 days of the date of adjourned AGM
6. Where AGM for any year has not been held, the financial statements duly signed along with the statement of facts and reasons for not holding the AGM, have been filed with the Registrar within thirty days of the last date before which the AGM should have been held.

### **Report on Annual General Meeting (Section 121)**

#### ***Check whether***

1. In case of a listed company, it has filed with the Registrar in Form 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 company secretary of the company.

#### **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 SH-7 of the Companies (Share Capital and Debentures) Rules, 2014.
4. The effect if alteration is noted in every copy of the Memorandum and Articles of Association of the company.

#### **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 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) (To be complied with Company other than Private Company.)**

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:

<b><i>Section</i></b>	<b><i>Section name</i></b>	<b><i>Particulars</i></b>
5(4)	Articles	Inclusion of Entrenchment provisions in the articles of association of a public company
12(5)	Registered office of company	Change of the registered office outside the local limits of any city, town or village where such office is situated.
13(1)	Alteration of memorandum	Alteration of the memorandum of the

		company to change the objects for which the money has been raised from public through prospectus and still has any unutilized amount out of the money so raised.
14	Alteration of articles	Alteration of any clause of the articles
27(1)	Variation in terms of contract or objects in prospectus	Variation in the terms of contract referred to in the prospectus or objects for which the prospectus was issued.
41	Global depository receipt	Issuance of Depository receipts in any foreign country
48(1)	Variation of shareholders rights	Variation of the rights attached to the shares of any class
54	Issuance of sweat equity shares	Issuance of sweat equity shares of a class of shares already issued
62(l) (b)/ (1)(c)/ (3), proviso	Further issue of share capital	<p>Issue of further shares to employees under a scheme of employees' stock option.</p> <p>Issue of further shares to any person whether or not those persons include the existing members or employees for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer.</p> <ul style="list-style-type: none"> <li>For approving the terms of issue of debentures or loan containing an option to convert such debentures or loans into shares.</li> </ul>
66	Reduction of share capital	Reduction of share capital subject to the confirmation of the Tribunal
67(3)(b)	Restriction on purchase by company or giving of loans by it for purchase of its shares	Approving any scheme for the purchase of, or subscription for, fully paid up shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by trustees for the benefit of the employees or such shares held by the employee of the company.
68	Power of company to purchase its own securities	Buy back of securities
71	Debentures	Issue of debentures with an option to convert whole or part of the debentures into shares at the time of redemption.

94	Place of keeping and inspection of registers, returns, etc.	To Keep registers, returns etc., at any other place than the registered office, where more than one- tenth of the total number of members reside
140	Removal of auditors	Removal of the auditor before the expiry of his term after obtaining the previous approval of the Central Government
149(1), proviso/(10)	Company to have Board of directors -	Appointment of more than fifteen directors by a company. Re-appointment of an independent director after expiry of a term of five consecutive years.
165(2)	Number of directorships	Specifying number of companies ( 10/20 ) in which director of the company may act as director.
180	Restrictions on powers of Board	Certain powers to be exercised by the Board of directors only with the consent of company.
185	Loan to directors, etc.	Approving a scheme pursuant to which any loan may be given to a managing or whole – time director.
186	Loan and investment by company	Giving of any loan or guarantee or providing any security or the acquisition exceeds the limits of sixty per cent. of its paid-up share capital, free reserves and securities premium account or one hundred per cent. of its free reserves and securities premium account, whichever is more
196	Appointment of managing director, whole time director or manager	Appointing the person as a managing director, whole-time director or manager who has attained the age of 70 years.
197(4)	Overall maximum managerial remuneration and managerial remuneration in case of inadequacy or absence of profits.	If Articles so provide determining the remuneration payable to the directors of a company, including any managing or whole-time director or manager
210	Investigation into affairs of company	For applying to Central Govt for investigation of the affairs of the company.
212	Investigation into affairs of	For applying to Serious Fraud Investigation

	company by Serious Fraud Investigation Office	Office for investigating the affairs of the company.
248	Power of Registrar to remove name of company from register of companies.	Filing an application before the Registrar to remove the name of company from the register of companies.
271	Circumstances in which company may be wound up by Tribunal	To resolve that the company be wound up by the Tribunal.
371	Effect of registration under this Part	To adopt table F in schedule I, if required

- (b) Resolutions which have been agreed by all the members but which, if not so agreed to, would not have been effective unless passed as special resolutions
- (c) Board Resolution/agreement relating to appointment, re-appointment or renewal of the appointment, or variation in the terms of appointment of managing director
- (d) Resolution passed by class of members
- (e) Members' resolutions authorising the board to exercise powers under section 180(1) (a) &(c)
- (f) 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 Appointing internal auditor
- xiv. Appointing secretarial auditor

Serial No. (xi-xx) above as per Companies (Meetings of Board and its Powers) Rules, 2014.

**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 MGT-14 as per the 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.

**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 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 CHG-1 (for other than Debentures) or Form 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 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 1st of every year. The circular is available at [www.rbi.org.in](http://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 guideline 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 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 5 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](http://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 400% 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 charge 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 step down 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 are fulfilled, if applicable.
- 14 Check whether the transfer of shares by resident to another resident or non-resident as the case may be is 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 Depositary 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](http://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 3

## Due Diligence — An Overview

### LESSON OUTLINE

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

### LEARNING OBJECTIVES

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

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

## INTRODUCTION

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

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

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

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

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

## Why Due Diligence?

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

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

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

## Objectives of Due Diligence

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

The objective of due diligence includes—

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

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

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

### **Scope of Due Diligence**

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

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



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

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

The investigation or inspection would cover:

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

## **Types of Due Diligence**

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

The most important types of Due Diligence are:

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

### **A. Business Due Diligence**

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

of investment. It involves:

***(i) Operational due diligence***

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

***(ii) Strategic due diligence***

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

***(iii) Technical Due Diligence***

Technical due diligence covers—

- (a) Intellectual Property due diligence; and
- (b) Technology due diligence.

***(a) Intellectual Property due diligence***

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

***(b) Technology due diligence***

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

***(iv) Environmental Due Diligence***

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

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

It involves risk identification and assessment with respect to:

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

**(v) Human Resource Due Diligence**

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

**(vi) Information Security Due Diligence**

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

**(vii) Ethical Due Diligence**

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

**B. Legal Due Diligence**

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

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

**C. Financial Due Diligence**

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

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

The tax due diligence comprises an analysis of:

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

**Factors to be kept in mind while conducting Due Diligence****Objectives and purpose**

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

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

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

### **Planning the schedule**

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

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

### **Negotiation for time**

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

### **Risk Minimisation**

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

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

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

### **Information from external sources**

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

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

### **Limit the report with only material facts**

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

### **Structure of information**

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

### **Stages / Process of Due Diligence**

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

#### ***(i) Pre diligence***

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

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

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

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

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

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

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

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

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

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

### ***(ii) Diligence***

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

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

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

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

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

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

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

### ***(iii) Post Diligence***

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

## Transactions Requiring Due Diligence

### **1. Mergers, amalgamations and Acquisitions**

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

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

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

### **2. Joint venture and collaborations**

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

### **3. Venture Capital Investment**

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

### **4. Public Offer**

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

- (1) Decisions on public issue.

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

### **DOCUMENTS TO BE CHECKED IN DUE DILIGENCE PROCESS**

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

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

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

### **THE CONCEPT OF DATA ROOM IN DUE DILIGENCE**

#### **What is Data Room?**

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

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

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



### **Why Data Room?**

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

### **What type of information is provided under a data room?**

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

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

Some Occasions those require creation of Data Room.

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

### **Data Room – Virtual or Physical**

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

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

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

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

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

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

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

#### **Major Advantages of Virtual Data Room**

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

#### **Some Disadvantages of Virtual Data Room**

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

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

#### Virtual and Physical Data Room – A comparison

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

### Data room administration and data security

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

### Due Diligence Vs Audit

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

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

### ANNEXURE I

#### XYZ Limited Non Disclosure Agreement

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

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

IT IS HEREBY AGREED AS FOLLOWS.

#### 1. Definitions

In this Agreement:

##### 1.1 Confidential Information’:

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

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

(b) includes without limit:

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

## 2. Undertakings

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

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

## 3. Exceptions

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

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

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

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

#### **4, No title of Use**

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

#### **5. No Obligation to Disclose, No Representations**

Nothing in this Agreement shall be construed as—

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

#### **6. Term & Termination**

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

#### **7. Miscellaneous**

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

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

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

Signed for and on behalf

“XYZ Limited”

By its duly authorised representative

---

(Signature)

---

(Name)

---

(Title/position)

---

(Date)

Signed for and on behalf

“ABC Limited”

By its duly authorised representative

---

(Signature)

---

(Name)

---

(Title/position)

---

(Date)

## LESSON ROUND UP

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

## SELF TEST QUESTIONS

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

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

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# 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

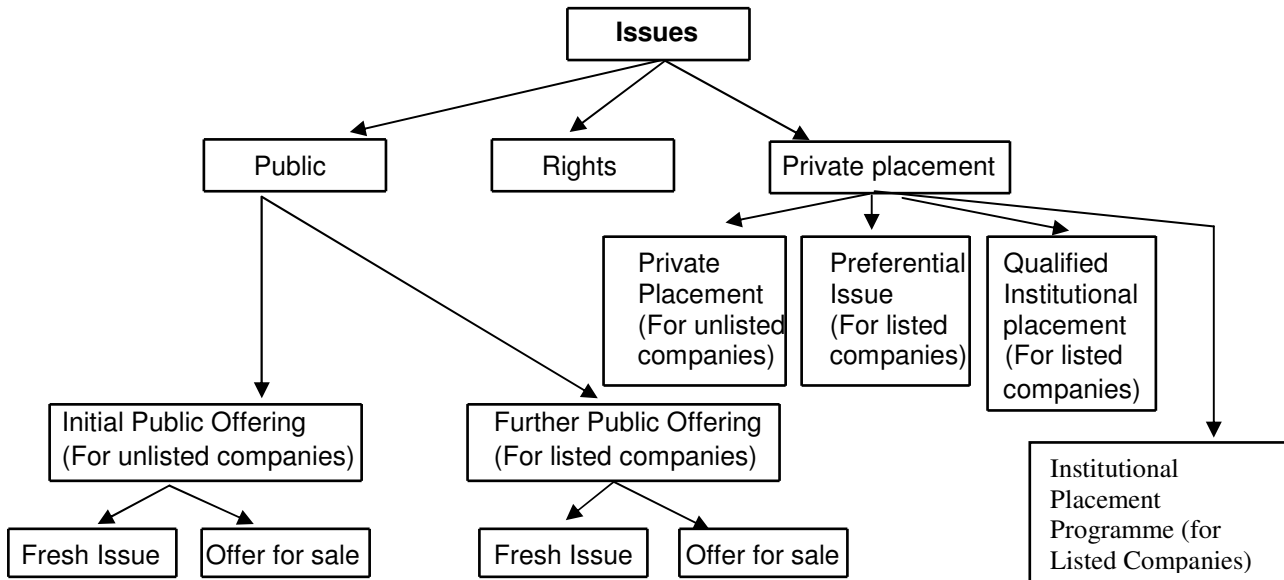
The options as to the issue of securities have been getting diversified as the market grows with more number of financial instruments and funding options. To raise the money in the capital market, the company may resort to IPO/FPO, rights issue, preferential issue, issue of different debt instruments 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, 2013. Similarly, the SEBI (Issue of Capital and Disclosure Requirements) (ICDR) Regulations, 2009, regulates the issue of convertible debt instruments whereas issue of non-convertible debt instruments is regulated by SEBI (Issue and Listing of Debt securities) Regulations, 2008.

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



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

- a) **Initial Public Offering (IPO)** 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.
- b) **A further public offering (FPO)** When an existing 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.
- c) **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.
- d) **Bonus issue** When an issuer makes an issue of shares to its existing shareholders based on the number of shares already held by them in a particular ratio to their holdings as on a record date without any consideration it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account.
- e) **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 the aggregate as per Rule 14 of The Companies (Prospectus and Allotment of Securities) Rules, 2014, 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:

- f) 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.
- g) 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.
- h) 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 VIIIA 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

The SEBI (ICDR) Regulations, 2009 is applicable to listed companies and to the types of following issues as per Regulation 3:

- (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 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. **(Regulation 14) (1):** Whether the Company has received the minimum subscription which shall not be less than ninety per cent. of the offer through offer document.
2. **(Regulation 14) (2):** 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.
3. **(Regulation 16):** Check whether the monitoring agency appointed in case where the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees has submitted its report to the issuer on quarterly basis, till at least ninety five percent of the proceeds of the issue, excluding the proceeds under offer for sale and amount raised for general corporate purposes, have been utilised.
4. **(Regulation 18):** 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.
5. **(Section 27 of Companies Act, 2013):** Whether the issuer has altered the terms (including the terms of issue) of specified securities and are they likely to 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 to be obtained.
6. **(Regulation 39):** 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.
7. Whether the application money received has been utilised in accordance with the section 40 (3) of Companies Act, 2013.
8. **(Regulation 51 A):** 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.
9. **(Regulation 17):** 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.
10. **(Regulation 8):** Check the copy of compliance certificate filed by the merchant banker before opening of the issue along with the draft offer document.

### Conditions for making initial public offer (Regulation 26)

Regulation 26(1): The issuer has to fulfil all the following five conditions to make IPO:

- (1) 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.

- (2) 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.
- (3) It has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
- (4) 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;
- (5) 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.

Regulation 26 (2): 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.

Regulation 26(3): 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.

Regulation 26(4): An issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.

Regulation 26(5): 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.

Regulation 26 (6): Subject to provisions of the Companies Act, 2013 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.

Regulation 26 (7): The issuer may obtain grading for the initial public offer from one or more 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 eighteen months from their date of allotment in the public/rights issue;
- (b) not more than one warrant shall be attached to one specified security;
- (c) the price or conversion formula of the warrants shall be determined upfront and at least 25% of the consideration amount shall also be received upfront;
- (d) 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 warrant shall be forfeited by the issuer.

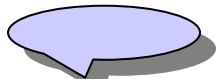
#### **Limit regarding money proposed to be spent on General Corporate Purposes (Regulation 4(4))**

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? (Regulation 4 (2))**

No issuer shall make a public issue or rights issue of specified securities:

- (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) Unless it has 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;
- (d) Unless it has entered into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued;
- (e) Unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited;
- (f) Unless the company has 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 along with relevant rules*
- *Securities Contracts (Regulation) Act, 1956*
- *Foreign Exchange Management Act, 1999*
- *Securities Contracts (Regulation) Rules, 1957*
- *SEBI (ICDR) Regulations, 2009*
- *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.*

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

When the due diligence is carried out as part of the steps leading to an IPO, the exercise takes on added meaning and encompasses a wider scope, as it identifies the areas or the issues where the company

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

The due diligence process aspires to achieve the following:

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

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

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

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

Key areas to be focused:

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



Illustrative list of documents/information to be examined:

*(i) Basic documents*

Review of basic corporate documents like:

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

*(ii) Promoters/Personnel*

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

*(iii) Financials*

1. Projections of combined operations (existing + proposed) for 5 years including the following:
  - Income details including prices
  - Cash flow and Balance Sheet
  - Capacity utilization details
  - Interest calculation – Assessment of rate/Repayment schedule
  - Depreciation
  - Tax
  - Assumptions with reference to. 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 along with 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/reschedule, if any – copy of correspondence with lenders.
  5. Accounts for last 3 years and latest unaudited accounts.
  6. Associate/Group Companies' concerns accounts for last 3 years. Also give: Profile of the concerns.
  7. Audited Balance Sheet, P&L Account for last 3 years of the promoter company (i.e. if promoter is a Co.)
  8. In case any liabilities are not disclosed in the Balance Sheet, details thereof, or any secret reserves.
  9. Age-wise analysis of stocks, debtors, creditors and loans & advances given
  10. Terms of various loans & advances given
  11. If names of any associates/related units are present in the debtors or parties to whom loans & advances have been given
  12. Details of contingents liabilities including guarantees given by Co./directors
  13. Trends in profit ratios.

#### *(iv) Project Information*

1. Project Feasibility report
2. Reports/documents prepared by independent research agencies in respect of the state of the industry and demand and supply for the company's products
3. Break-up of Cost of Project:
  - Land – Location 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 Engineer. (for existing building and suitability of site)
  - Equipments – Invoices/Quotations of main items. (Indicate Imported machinery separately)
  - Margin Money for Working Capital – Margin Money for Working Capital (calculation)
  - Preliminary & Pre-operative expenses – break-up
  - Provision for contingencies – break-up
4. Schedule of Implementation.
5. Status of Project as on a recent date – Amount spent & sources
6. Promoter's contribution till date (supported by Auditor's Certificate, if possible)
7. Current & proposed Shareholding pattern

8. Sanctions received by the issuer from bankers/institutions for debt financing in the project
9. Notes on the following: Technical process, utilities (power, water, transport, effluent treatment, location, land building, Plant & Machinery).
  - (a) Manpower
    - (i) Break-up of employees – whether any agreements are entered into with employee – If so, copy of agreement
    - (ii) Details of Pay scales/bonus (including performance bonus)/PF/ Gratuity etc.
    - (iii) Employment of contract labour – no. of workers, copy of contract.
  - (b) Quality Control facilities, Research & Development.
10. Market (Demand/supply with sources along with copies),
11. Marketing & Distribution (network etc.) & relevant documents wherever applicable.
12. Arrangements and strategy of the company for marketing its products
13. Discussions with important customers, suppliers, Joint Venture partners, collaborators of the company.

#### *(v) General Information*

1. Details on Litigation, Disputes, overdue, statutory dues, other Material development and tax status of Company & promoters.
2. Copies of IT returns of the Company along with copies of Assessment orders for last three years.
3. Copies of IT/Wealth tax returns of the promoters along with copies of Assessment orders for last three years.
4. Copy of documents for Collaborations/Marketing Tie-ups/Other Tie-ups if any.
5. NOC/Approval/Sanctions from State Government authorities as applicable.
6. Copy of SIA Registration/SSI Registration/EOU License/LOI or License, as applicable.
7. Incentives if any – such as subsidy, Sales tax loans/exemption/concession/ power subsidy.
8. List of existing plant & machinery with cost & age & type of ownership (lease etc.)
9. R&D (if any) cost for the project for the last three years. (Sources of any outside R&D funds including any joint venture agreements)
10. Summary of Bad Debts experience for the last five years.
11. Approvals from company's Board of Directors/Shareholders to issue securities to the public.
12. Copies of documents filed with Registrar of Companies.
13. Names of stock exchanges where shares of the Co. are listed.
14. Stock Market quotation of share, wherever applicable, as on recent date.
15. Special legislation applicable, if any, and compliance thereof (e.g. NBFCs etc.)

#### *(vi) Third Parties*

1. Brochure on collaborators, copy of Government approval for collaboration.
2. Copy of Agreement with Consultants, Copy of Government approval in case of foreign consultants.
3. Copies of important Agreements/Contracts of any sort with all the parties concerned with the company.

4. Copy of FIPB/RBI approvals (NRI/Foreign participant etc.), wherever applicable.
5. Details of Patents, Trademarks, Copyrights, Licenses etc., if any.
6. List of major customers/clients (attach copies of main pending orders).
7. Competitors & Market shares for Company's products (with sources, wherever possible).
8. Sales arrangements, terms & conditions.
9. Main suppliers – terms & conditions.

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

#### **1. Appointments**

- Check whether the issuer has appointed one/more merchant bankers at least one of whom shall be the lead merchant banker, to carry out the obligations relating to the issue.
- If the merchant banker is an associate of an issuer it shall declare itself as marketing lead manager 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 has appointed registrars who have connectivity with both depositories (i.e., 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 at least 21 days from the date of such filing with SEBI. .
- Check whether a statement on the comments received from public on draft offer document is filed with SEBI.
- Ensure whether the observations/suggestions of SEBI on draft offer documents have been carried out while registering of prospectus with ROC.
- Check whether a copy of letter of offer is filed with SEBI and with stock exchanges where the specified 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.

### 3. Pre issue-Due Diligence Certificates

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

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

### 4. Time limitation in opening of issue (Regulation 11)

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

- (i) Twelve months from the date of issuance of observations from the SEBI on draft offer document or
- (ii) Within three months from the later of the following dates if there are no observations.
  - a) Date 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;
- (iii) In case of Fast Track issues the issue shall be opened within 90 days from the registration of prospectus with ROC;
- (iv) 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 (Regulation 12)

Ensure that the offer document and other issue related instruments is dispatched to Bankers, Syndicate

Members, registrar to issue and share transfer agents, depository participants, stock brokers, underwriters etc. registrar to issue and share transfer agents, depository participants, stock brokers, in advance.

#### **6. Underwriting for issue through book building (Regulation 13)**

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 (Regulation 14)**

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

#### **8. Minimum allottees (Regulation 26 (4))**

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

#### **9. Monitoring agency (Regulation 16)**

Ensure that the issue size of more than 100 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 (Regulation 17)**

Ensure that the entire 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. However, 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 (Regulation 18)**

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. In case the allotment is not made or refund is not made as mentioned above within the prescribed period, the issuer shall pay interest at such rate and within such time as disclosed in the offer document.

#### **12. Pricing (Regulations 28 to 30)**

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

#### **13. Promoters Contribution (Regulation 32)**

- 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.

As per **Regulation 33**, ensure that the securities ineligible for promoters' contribution is not included while calculating the above limits. 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. However specified securities allotted to promoters against capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible.
- (d) Specified securities pledged with any creditor.
- Ensure that the minimum promoters contribution including contribution made by alternate investment funds and excess promoters contribution is locked in for 3 years and one year respectively. **(Regulation 36)**

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) rights issue. **(Regulation 34)**

#### 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:

##### **(Regulation 36)**

- (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.

**(Regulation 37):** 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.

**(Regulation 38):** 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.

**(Regulation 39):** 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.

**(Regulation 40):** Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, the specified securities held by promoters and locked-in 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. 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 (Regulation 41):**

The Minimum net offer to the Public shall be subject to the provisions of sub-clause (b) of Sub-rule (2) of Rule 19 of Securities Contracts (Regulations) Rules, 1957. According to the said rules, the minimum offer and allotment to public in terms of an offer document shall be-

- (i) atleast twenty five percent of each class or kind of equity shares or debentures convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is less than or equal to one thousand six hundred crore rupees;
- (ii) atleast such percentage of each class or kind of equity shares or debentures convertible into equity shares issued by the company equivalent to the value of four hundred crore rupees, if the post issue capital of the company calculated at offer price is more than one thousand six hundred crore rupees but less then or equal to four thousand crore rupees;
- (iii) atleast ten percent of each class or kind of equity shares or debentures convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is above four thousand crore rupees.

**16. Reservation on Competitive Basis (Regulation 42)**

- *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) in case of existing issuer - 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) in case of existing issuer - 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 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;
  - (b) In case issue is made otherwise through book building process and when the promoting companies being financial institutions or state and central financial institutions, the shareholders of such promoting companies
- 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 audited operative results are not available.

#### **17. Allocation in net offer to public (Regulation 43)**

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 and
  - (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 and
  - (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 up to sixty 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 (Regulation 46)

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

#### ***What is the Minimum and Maximum period of Subscription?***

Minimum Period – 3 working days

Maximum Period – 10 working days



#### 19. Advertisements

- ***Pre issue (Regulation 47)***

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 (Regulation 48)***

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

- ***Advertisement (Regulation 66)***

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;

## **20. Minimum Application Value (Regulation 49)**

Ensure that Minimum Application Value is kept between ten thousand rupees to fifteen thousand rupees. "Minimum application value" shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Minimum sum payable on application shall be twenty five per cent of the issue price. Provided that in case of an offer for sale, the sale price payable for each specified security shall be brought in at the time of application.

## **21. Allotment procedure and basis of allotment (Regulation 50)**

The allotment of specified securities to applicants other than retail individual investors and anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer.

Provided that value of specified securities allotted to any person in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 42, shall not exceed two lakhs rupees.

The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

The executive director or managing director of the designated stock exchange along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in Schedule XV.

## **22. Appointment of Compliance officer (Regulation 63)**

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.

Here, the term "securities laws" means the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made thereunder and the regulations, general or special orders, guidelines or circulars made or issued by the Board.

## **23. Redressal of investor grievances (Regulation 62)**

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 there from.

**24. Post issue diligence (Regulation 64)**

- (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 fulfill 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 (Regulation 65)**

In public issue, the lead merchant banker shall submit final post-issue report as specified in Part C of Schedule XVI, within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

In rights issue, 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 (Regulation 51 A)**

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 SEBI (LODR) Regulations, 2015
    - (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 and in case the company proposes to list its securities abroad, he is also required to comply with conditions for listing abroad.

### **III. DUE DILIGENCE – ISSUES OTHER THAN IPO/FPO**

Companies might issue shares through routes other than IPO/FPO. This includes preferential allotments, issue of shares through rights issue, bonus issue or ESOP scheme etc. various important aspects to be taken care before and after the issue are discussed below.

#### **III-A. DUE DILIGENCE – PREFERENTIAL ISSUE**

Due diligence of preferential issue may be

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

#### **Due diligence of preferential issues by listed companies**

#### **(a) Due Diligence Preferential issue of listed Companies- a Check list under Chapter VII of SEBI(ICDR) Regulations 2009**

##### **Non Applicability (Regulation 70)**

(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 or sub-section (3) and (4) of section 62 of the Companies Act, 2013, whichever applicable;
- (b) pursuant to a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956 or a Tribunal under sections 230 to 234 of the Companies Act, 2013, whichever applicable:

Provided that the pricing provisions of this Chapter shall apply to the issuance of shares under schemes mentioned in clause (b) in case of allotment of shares only to a select group of shareholders or shareholders of unlisted companies pursuant to such schemes;

- (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 or the Tribunal under the Insolvency and Bankruptcy Code, 2016, whichever applicable:

Provided that the lock-in provisions of this Chapter shall apply to preferential issue of equity shares mentioned in clause (c).

(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 Regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 or Regulation 11 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, whichever applicable, 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 of India or a Scheduled Bank listed under the Second Schedule of the Reserve Bank of India Act, 1934 or a Public Financial Institution as defined in clause 72 of section 2 of the Companies Act, 2013.
- (5) Conversion of debt into equity under strategic debt restructuring scheme -The provisions of this Chapter shall not apply where the preferential issue of equity shares is made to the consortium of banks and financial institutions pursuant to conversion of their debt, as part of the strategic debt restructuring scheme in accordance with the guidelines specified by the Reserve Bank of India, subject to the following conditions:
- (a) conversion price shall be determined in accordance with the guidelines specified by the Reserve Bank of India for strategic debt restructuring scheme, which shall not be less than the face value of the equity shares;
  - (b) conversion price shall be certified by two independent qualified valuers, and for this purpose 'valuer' shall have the same meaning as assigned to it under clause (r) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002;
  - (c) equity shares so allotted shall be locked-in for a period of one year from the date of trading approval: Provided that for the purposes of transferring the control, the consortium of banks and financial institutions may transfer their shareholding to an entity before completion of the lock-in period subject to continuation of the lock-in on such shares for the remaining period with the transferee;
  - (d) applicable provisions of Companies Act, 2013 are complied with, including the requirement of special resolution.

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\* Section 4A of the Companies Act, 1956 corresponding to section 2 (72) of the Companies Act, 2013, is notified.

(6) The provisions of this Chapter shall not apply when any other secured lenders opt to join the strategic debt restructuring scheme in accordance with the guidelines specified by the Reserve Bank of India and convert their debt into equity share in accordance with sub-regulation (5).

#### **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 of 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 Regulation 31 of the SEBI (LODR) Regulations, 2015 with reference to holding of specified securities and shareholding pattern.
- 6 Check the copy of the confirmation submitted by the Managing Director/Company Secretary of the issuer company with reference to compliance with the regulations.
- 7 Check whether the allotment has been made in dematerialised form.

#### **Frequently Traded Shares (Regulation 71A)**

Frequently Traded Shares means shares of an issuer, in which the traded turnover on any stock exchange during the twelve calendar months preceding the relevant date, is at least ten per cent of the total number of shares of such class of shares of the issuer:

Provided that where the share capital of a particular class of shares of the issuer is not identical throughout such period, the weighted average number of total shares of such class of the issuer shall represent the total number of shares.

#### **CONDITIONS FOR PREFERENTIAL ISSUE (REGULATION 72)**

##### **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" according to Regulation 71 means:

- (a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date.

- (b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Where the relevant date falls on a Weekend/Holiday, the day preceding the Weekend/Holiday will be reckoned to be the relevant date.

### **(Regulation 73)**

- The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956\* or any other applicable law, disclose according to Regulation 73, 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 natural persons who are the ultimate beneficial owners of the shares proposed to be allotted and /or who ultimately control 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;

Provided that if there is any listed company, mutual fund, bank or insurance company in the chain of ownership of the proposed allottee, no further disclosure will be necessary.

- (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.
- (h) disclosures, similar to disclosures specified in Part G of Schedule VIII, if the issuer or any of its promoters or directors is a wilful defaulter indicating the following:
  1. (a) Name of the bank declaring the entity as a wilful defaulter;
  - (b) The year in which the entity is declared as a wilful defaulter;

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\* Section 173 of the Companies Act, 1956 corresponding to section 102 of the Companies Act, 2013, is notified.

- (c) Outstanding amount when the entity is declared as a wilful defaulter;
  - (d) Name of the party declared as a wilful defaulter;
  - (e) Steps taken, if any, for the removal from the list of wilful defaulters;
  - (f) Other disclosures, as deemed fit by the issuer in order to enable investors to take informed decisions;
  - (g) Any other disclosure as specified by the Board.
2. The fact that the issuer or any of its promoters or directors is a wilful defaulter shall be disclosed prominently on the cover page with suitable cross-referencing to the pages.
  3. Disclosures specified herein shall be made in a separate chapter or section distinctly identifiable in the Index / Table of Contents.

## **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 SEBI (LODR) Regulations, 2015..

## **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 have sold any equity shares of the issuer in preceding six months (Regulation 72)**

Ensure that the issuer has not made 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.

However, if any person belongs to promoter(s) or the promoter group has sold his equity shares in the issuer during the six months preceding the relevant date, that person shall be ineligible for allotment of specified securities on preferential basis.

In case, any person belongs to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but failed to exercise the warrants, that person shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from:

- (a) the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or
- (b) the date of cancellation of the warrants, as the case may be.

## **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 (Regulation 74)**

- Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

### **Exceptions**

Where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of order on such application or the date of approval or permission, as the case may be.

Where 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.
- Notwithstanding anything contained in this regulation, where a preferential allotment is made that attracts an obligation to make an open offer for shares of the issuer under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, and there is no offer made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, the period of fifteen days shall be counted from the expiry of the period specified in sub-regulation (1) of regulation 20 or date of receipt of all statutory approvals required for the completion of an open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011:

Provided that if an offer is made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, the period of fifteen days shall be counted from the expiry of the offer period as defined in the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011:

Provided further that the provisions of this sub-regulation shall not apply to an offer made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of

Shares and Takeovers) Regulation, 2011, pursuant to a preferential allotment.”

### **9. Tenure of convertible securities (Regulation 75)**

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

### **10. Pricing of equity shares (Regulation 76)**

#### **I. Frequently Traded Shares**

##### **(a) If already listed for twenty six weeks or more:**

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of twenty six weeks 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 volume weighted average price 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 volume weighted average price 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 volume weighted average price 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 volume weighted average price 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 volume weighted average 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 twenty six weeks prior to the relevant date.

## **II Pricing of equity shares – Infrequently traded shares**

76A. Where the shares are not frequently traded, the price determined by the issuer shall take into account valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies:

The issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent merchant banker or an independent chartered accountant in practice having a minimum experience of ten years, to the stock exchange where the equity shares of the issuer are listed.

### **Adjustments in pricing - Frequently or Infrequently traded shares 76B**

The price determined for preferential issue in accordance with regulation 76 or regulation 76A, 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.

## **11. Payment of consideration (Regulation 77)**

- Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities:

### **Exceptions/Conditions**

In case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

- An amount equivalent to at least twenty five per cent. of the consideration shall be paid against each warrant on the date of allotment of warrants. The balance seventy five per cent. of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.
- In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such shall be forfeited by the issuer.
- The issuer shall ensure that the consideration of specified securities, if paid in cash, shall be received

from respective allottee's bank account.

- The issuer shall submit a certificate of the statutory auditor to the stock exchange where the equity shares of the issuer are listed stating that the issuer is in compliance of the above mentioned sub-regulation and the relevant documents thereof are maintained by the issuer as on the date of certification.

## 12. Lock-in of specified securities (Regulation 78)

- 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 trading approval granted for 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 trading approval

Equity shares allotted in excess of the twenty per cent. shall be locked-in for one year from the date of trading approval 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 trading approval.
- 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 trading approval. However partly paid up equity shares, if any, shall be locked-in from the date of trading approval 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 up to a period of six months from the date of trading approval.

## 13. Transferability of locked-in specified securities and warrants issued on preferential basis (Regulation 79)

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, specified securities held by promoters and locked-in may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer:

However, that lock-in on such specified securities shall continue for the remaining period with the transferee.



The specified securities allotted on preferential basis shall not be transferred by the allottee till trading approval is granted for such securities by all the recognised stock exchanges where the equity shares of the issuer are listed.

### **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 (1) 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.

Provided that in case of any preferential offer made by a company to one or more existing members only, the provisions of sub-rule (1) and proviso to sub-rule (3) of Rule 14 of Companies (Prospectus and Allotment of Securities) Rules, 2014 shall not apply.

(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.

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 company shall make the disclosures prescribed in this rule like the objects of issue, total number of shares proposed to be issued, the price of issue, the relevant date, to whom it is proposed to be issued etc. in the explanatory statement to be annexed to the notice of the general meeting pursuant to Section 102 of the Act.
- (d) 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.
- (e) 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.
- (f) 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.

- (g) 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.
- (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 pursuant to conversion shall be determined-
  - (i) either upfront at the time when the offer of convertible securities is made, on the basis of valuation report of the registered valuer given at the stage of such offer, or
  - (ii) at the time, which shall not be earlier than thirty days to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer given not earlier than sixty days of the date when the holder of convertible security becomes entitled to apply for shares:

Provided that the company shall take a decision on sub-clauses (i) or (ii) at the time of offer of convertible security itself and make such disclosure under the explanatory statement to be annexed to the notice of the general meeting.

- (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**

#### **Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 (these regulations)**

The Securities Exchange Board of India (SEBI) on 28 October 2014 has notified the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 which have replaced the erstwhile ESOP guidelines. The Regulations are effective from the date of notification of these regulations.

#### **Applicability of these regulations**

The provisions of these regulations shall apply to any company whose shares are listed on a recognised stock exchange in India, and has a scheme:

- (i) for direct or indirect benefit of employees; and
- (ii) involving dealing in or subscribing to or purchasing securities of the company, directly or indirectly;

and

- (iii) satisfying, directly or indirectly, any one of the following conditions:
- the scheme is set up by the company or any other company in its group;
  - the scheme is funded or guaranteed by the company or any other company in its group;
  - the scheme is controlled or managed by the company or any other company in its group.

### **Types of schemes covered under these regulations**

The provisions of these regulations shall apply to following:

- employee stock option schemes;
- employee stock purchase schemes;
- stock appreciation rights schemes;
- general employee benefits schemes; and
- retirement benefit schemes.

### **Treatment of Preferential allotment to employees**

- Nothing in these regulations shall apply to shares issued to employees in compliance with the provisions pertaining to preferential allotment as specified in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- The provisions pertaining to preferential allotment as specified in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 shall not be applicable in case of a company issuing new shares in pursuance and compliance of these regulations.

Section 62(1) (b) of the Companies Act, 2013, Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 and the SEBI (LODR) Regulations, 2015 are applicable for listed companies while private and unlisted public companies are required to follow the Articles of Association, the Companies Act, 2013 and the rules made thereunder.

### **Checklist for compliances under Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 and Companies Act 2013**

#### **For listed companies**

<i>Sl. No.</i>	<i>Particulars</i>	<i>Compliance</i>	<i>Remarks</i>
1.	Whether the company has used the direct route or through irrevocable trust route for issue of ESOP?		
2.	Whether the implementation through trust was decided upfront at the time of taking approval of the shareholders for setting up of the schemes?		
3.	In case the scheme involves secondary acquisition or gift or		

	both, whether the scheme is mandatorily implemented through trust?		
4.	Whether a director, KMP, promoter, holding/subsidiary/associate companies, any relative of director/KMP/promoter, any person beneficially holder ten percent or more of the paid up capital of the company is not appointed as trustee?		
5.	Whether approval of shareholders is obtained authorising the trust to implement the scheme?		
6.	Whether the trust deals only in delivery based transactions and not in derivatives?		
7.	Whether secondary acquisition in a financial year by a trust does not exceed two percent of the paid up capital as at the end of the previous financial year?		
8.	Whether the total number of shares under secondary acquisition held by the trust is within the prescribed limits?		
9.	Whether the trust holds shares acquired through secondary acquisition for a minimum period of six months?		
10.	Whether the off market transfers by the trust has been made only under circumstances specified in these regulations?		
11.	Whether the trust sells shares in the secondary market only under the circumstances specified under these regulations?		
12.	Whether the company has constituted compensation committee for administration of the scheme?		
13.	Whether the employee is eligible to participate in the scheme?		
14.	Whether the scheme is approved by the shareholders through special resolution?		
15.	Check whether the explanatory statement to the special resolution complies with Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014.		
16.	Check whether other procedural aspects as prescribed under Rule 12 of Companies (Share Capital and Debentures) Rules, 2014.		

17.	Whether the specified disclosures as prescribed under Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 have been made in the Board's Report?		
18.	Whether the company has complied with prescribed norms for varying the terms of the schemes?		
19.	Whether unlisted companies going for IPO, complies with the provisions prescribed with regard to Pre-IPO scheme?		
20.	Whether the board of directors place auditor's certificate, certifying compliance under these regulations, before the shareholders in annual general meeting?		

### Compliance with respect to specific schemes

#### Employee Stock Option Scheme

1. Whether the minimum vesting period is one year?
2. Whether the disclosures specified have been made to prospective option grantees?
3. Whether employee does not receive dividend or vote till the exercise of option?

#### Employee Stock Purchase Scheme

1. Whether shares issued under ESPS is locked in for a minimum period of one year from the date of allotment?
2. Whether ESPS forming part of public issue are issued at the same price as in the public issue?
3. Whether ESPS scheme contains the details of the manner in which the scheme will be implemented and operated?
4. Whether ESPS forming part of public issue and issued at the same price as in the public issue? If yes, then the shares issued to employees pursuant to ESPS shall not be subject to lock-in.

#### Stock Appreciation Rights Scheme (SARS)

1. Whether SARS contains the details of the manner of implementation and operation?
2. Whether specified disclosures has been made to the prospective SAR grantees?
3. Whether the minimum vesting period is one year?
4. Whether employee does not receive dividend or vote or enjoy the benefits of a shareholder in respect of SAR granted to him?

#### General Employee Benefits Scheme (GEBS)

1. Whether GEBS contains the details of the manner of implementation and operation?
2. Whether, the shares of the company or shares of its listed holding company does not exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of GEBS, at any point of time?

**RETIREMENT BENEFIT SCHEME (RBS)**

Whether the retirement benefit scheme contains the details of the benefits under the scheme and the manner in which the scheme shall be implemented and operated.

<i>Sl. No.</i>	<i>Particulars</i>	<i>Compliance</i>	<i>Remarks</i>
1.	Whether the shares of the company or shares of its listed holding company does not exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of RBS at any point of time.		
2.	The company has obtained in Principle approval from the stock exchange.		
3.	Form PAS-3 as per the Companies (Prospectus and Allotment of Securities) Rules, 2014, Form SH-7 as per the Companies (Share Capital and Debentures) Rules, 2014 and Form MGT-14 as per the Companies (Management and Administration) Rules, 2014, as applicable, has been filed with ROC.		
4.	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.		
5.	Check the copy of the in principle approval granted by the stock exchange under Regulation 28 (d) of SEBI (LODR) Regulations, 2015.		
6.	Check compliance with relevant regulations of the SEBI (LODR) Regulations, 2015.		

**III-C. DUE DILIGENCE- BONUS ISSUE (CHAPTER IX)****Checklist for issue of Bonus shares**

- 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 .
- 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.
- The 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.
- A confirmation that all the existing securities of the company are fully paid-up and are listed on the Exchange to be made.
- The names of the Stock Exchanges where the securities of the company are listed.

6. A certified true copy of latest Annual Report.
7. Check whether an issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval, has implemented the bonus issue 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, MGT-14 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.
7. 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 lakhs.
8. 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 (Regulation 52)**

- 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 (Regulation 53)**

No issuer shall make a rights issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.

The equity shares so reserved for the holders of fully or partially compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments at the same terms at which the equity shares offered in the rights issue were issued.

## **3. Letter of offer, abridged letter of offer (Regulation 54)**

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 (Regulation 54 (5))**

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 (Regulation 54 (6))**

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 (Regulation 54 (7))**

The issuer shall give only one payment option out of the following:

- (a) part payment on application and balance money paid in calls; or
- (b) full payment on application

In case of part payment option, necessary regulatory approvals are required and part payment shall not be less than 25% of the issue price.

## **7. Pre-Issue Advertisement for rights issue (Regulation 55)**

The issuer shall issue an advertisement for rights issue disclosing the following like:

- (a) the date of completion of dispatch 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 etc.
- (c) a statement that if the shareholders entitled to receive the rights entitlements have neither received the original application forms nor they are in a position to obtain the duplicate forms, they may make application in writing on a plain paper to subscribe to the rights issue;
- (d) a format to enable the shareholders entitled to apply against their rights entitlements, to make the application on a plain paper specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of equity shares held, ledger folio numbers, depository participant ID, client ID, number of equity shares entitled and applied for, additional shares if any, amount to be paid along with application, and particulars of cheque, etc. to be drawn in favour of the issuer's account;
- (e) a statement that the applications can be directly sent by the shareholders entitled to apply against rights entitlements through registered post together with the application moneys to the issuer's designated official at the address given in the advertisement;
- (f) a statement to the effect that if the shareholder makes an application on plain paper and also on application form both his applications shall be liable to be rejected at the option of the issuer.

The advertisement shall be made 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, at least three days before the date of opening of the 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 DILLIGENCE: QUALIFIED INSTITUIONS PLACEMENT (CHAPTER VIII)**

#### **1. Conditions for qualified institutions placement**

1. Check the copy of the special resolution approving the qualified institutions placement passed by its shareholders and Form MGT-14 filed with ROC.
2. Check whether the issuer company has complied with Regulation 31 of the SEBI (LODR) Regulation, 2015 with reference to shareholding pattern.
3. Check whether it is in compliance with the requirement of minimum public shareholding specified in the Securities Contracts (Regulation) Rules, 1957.

#### **2. Appointment of merchant banker (Regulation 83 (1))**

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. (Regulation 83 (2))**

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 (Regulation 84)**

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 (Regulation 85)**

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.

However, the issuer may offer a discount of not more than five percent on the price so calculated for the qualified institutions placement, subject to approval of shareholders.

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 (Regulation 86)**

- 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 (Regulation 87)**

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.

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 (Regulation 88)**

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 (Regulation 89)**

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 (Regulation 90)**

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 (Regulation 91)**

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 SEBI (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, promoter / promoters group of listed issuer.

#### **Conditions for Institutional Placement Programme (Regulation 91C)**

- 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 (Regulation 91D)**

An institutional placement programme shall be managed by merchant banker(s) registered with SEBI who shall exercise due diligence.

#### **Offer Document (Regulation 91E)**

- 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 (Regulation 91F)**

- 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

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\* Section 81 (1A) of the Companies Act, 1956 corresponding to section 62 of the Companies Act, 2013 is notified.

- 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 (Regulation 91G)**

- The promoter or promoter group shall not make institutional placement programme if the promoter or any person who is part of the promoter group has purchased or sold the eligible securities during the twelve weeks period prior to the date of the programme and they shall not purchase or sell the eligible securities during the twelve weeks period after the date of the programme. 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/r 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.

**Minimum number of allottees (Regulation 91H)**

- The minimum number of allottees for each offer of eligible securities shall not be less than ten. However, no single allottee shall be allotted more than 25 per cent of offer size.
- For this purpose, the qualified institutional buyers belonging to the same group or who are under soame control shall be deemed to be a single allottee.

**Restrictions on size of the offer (Regulation 91-I)**

- 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 (Regulation 91J)**

- 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 (Regulation 91K)**

The eligible seller shall have the right to withdraw the offer in case it is not fully subscribed.

**Transferability of eligible securities (Regulation 91L)**

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, allotment of not more than ten per cent. 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 lowers the on-going information and monitoring costs for the banks.

In view of the aforesaid concerns raised by the market participants / industry representatives, there was a felt need for developing a dedicated stock exchange for the SME sector so that SMEs can access capital markets easily, quickly and at lower costs. Such dedicated SME exchange is expected to provide better, focused and cost effective service to the SME sector. The need for having a separate exchange / platform for SMEs was also discussed during the 32nd Annual Conference of IOSCO held in April 2007 in Mumbai and it was felt that the same would be necessary for the focused development of the SME sector.

Internationally also, countries have provided for a separate exchange / trading platform to facilitate listing of securities of growth companies / new economy companies / small and medium companies. Some of the cases in point are the Alternative Investment Market (AIM), London, the Growth Enterprises Market (GEM), Hong Kong and MOTHERS (Market of High Growth Emerging Stocks), JAPAN.

**SME EXCHANGES IN INDIA**

In India BSE and NSE have created SME exchanges BSESME and EMERGE respectively. BCB Finance Ltd. was the first Indian SME to get listed on BSE SME. The vision of BSESME is 'Wealth creation by the SMEs through inclusive economic growth' and the mission is 'Provide the world class Platform for SMEs and Investors to come together and raise equity capital'. The term 'EMERGE' stands for investment opportunities in emerging companies.

**REGULATORY FRAMEWORK FOR LISTED SMEs**

In recognition of the need for making finance available to small and medium enterprises, SEBI has decided

to encourage promotion of dedicated exchanges and/or dedicated platforms of the exchanges for listing and trading of securities issued by Small and Medium Enterprises ("SME"). Consequently, SEBI amended SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("SEBI (ICDR) Regulations") by inserting Chapter XB on "Issue of specified securities by small and medium enterprises", with effect from 23.9.2011.

Accordingly

1. SMEs having a post issue face value capital which does not exceed Rupees ₹10 crores can get its shares listed on SME exchanges.
2. SMEs having a post issue face value capital of more than ₹10 crores up to 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 get 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 at least 15% of the issue size in their own account.
7. Minimum number of allottees shall be fifty in any IPO made under Chapter XB of SEBI (ICDR) Regulations, 2015.

"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 nationwide 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 (Regulation 106V)**

Market making is compulsory for a minimum period of 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 clauses, 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.

### Migration to SME exchange (Regulation 106T)

A listed issuer whose post issue face value capital is less than twenty five crore rupees may migrate its specified securities to SME exchange if its shareholders approve such migration by passing a special resolution through postal ballot and if such issuer fulfils the eligibility criteria for listing laid down by the SME exchange.

### Migration to Main Board (Regulation 106U)

A listed issuer whose specified securities are listed on a SME exchange and whose post issue face value capital is more than ten crore rupees and up to twenty five crore rupees may migrate its specified securities to Main Board if its shareholders approve such migration by passing a special resolution through postal ballot and if such issuer fulfils the eligibility criteria for listing laid down by the Main Board.

## DEBT SECURITIES

### REGULATORY FRAMEWORK FOR DEBT SECURITIES

- (a) SEBI (ICDR) Regulations, 2009
- (b) SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015
- (c) SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- (d) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008
- (e) The Companies Act, 2013 and rules made thereunder.

### A. Checklist for compliances under SEBI (ICDR) Regulations, 2009

#### GENERAL COMPLIANCES

- 1 Check the refund orders/other bonafide records of dispatch 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 / bonafide records of dispatch 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 and if so, whether it is likely to adversely affect the interests of the holders of that specified securities. If so, whether 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 as per the terms of the loan, 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 are equally applicable to public issue of convertible debt instruments also.]

Additionally, the issuer of debt instruments has to comply with the following: (Regulation 20)

- (a) obtain credit rating from one or more credit rating agencies;
- (b) appoint one or more debenture trustees in accordance with the provisions of section 117B of the

Companies Act, 1956\* and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;

- (c) create debenture redemption reserve in accordance with the provisions of section 117C of the Companies Act, 1956\*;
- (d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:
  - such assets are sufficient to discharge the principal amount at all times;
  - such assets are free from any encumbrance;
  - where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or *pari passu* charge has been obtained and submitted to the debenture trustee before the opening of the issue;
  - the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge. The issuer shall redeem the convertible debt instruments in terms of the offer document.

#### **Roll over of non convertible portion of partly convertible debt instruments (Regulation 21)**

(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

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\* Section 117B of the Companies Act, 1956 corresponding to section 71 of the Companies Act, 2013, is notified.

\* Section 117C of the Companies Act, 1956 corresponding to section 71 of the Companies Act, 2013, is notified.

shall be decided by the debenture trustee.

### **Conversion of optionally convertible debt instruments into equity share capital (Regulation 22)**

(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. Non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares. However, where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provision stated in sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

### **Issue of convertible debt instruments for financing purposes (Regulation 23)**

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, 2009 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. Check whether the issuer or its promoter has been restrained or prohibited or debarred by SEBI.

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 at least one credit rating agency for the proposed issue.
6. Check whether the offer document shall contain all material disclosures which are necessary for the subscribers of the debt securities to take informed investment decisions.
7. The confirmation letter of the debenture trustee to act as debenture trustee of the debt securities.
8. The Debenture Trust Deed has been executed in Form SH-12 as per the Companies (Share Capital and Debentures) Rules, 2014, by the company in favour of the debenture trustees within sixty days of allotment of debentures.
9. Creation of debenture redemption reserve as provided in sub-rule 7 of Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014.
10. The agreement entered into by the company with the depository registered with SEBI for dematerialization of debt securities.
11. 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 SEBI (Issue and Listing of Debt Securities) Regulations, 2008.
12. The offer document has been filed with the ROC.

Note: Certain companies as specified under Regulation 6A may file Shelf Prospectus.

13. Check whether the draft and final offer document shall be displayed on the websites of stock exchanges.
14. Ensure that every application form issued is accompanied by a copy of Abridged Prospectus.
15. If minimum subscription has not been received, the application moneys have been repaid forthwith.
16. Check the compliance with regard to the SEBI (LODR) Regulations, 2015 for debt securities.
17. Resolution passed by the Board of Directors for allotment of securities specifically should make a mention of total number of securities allotted/allocated by the issuer.
18. If offer document refers to creation of security, whether charge has been created?
19. Form PAS-3 as per the Companies (Prospectus and Allotment of Securities) Rules, 2014 should be filed.
20. 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 should be checked
21. 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 to be checked

22. The basis of allotment has been approved by the designated Stock Exchange.

23. 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 or conversion of illiquid assets into liquid assets

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 at least 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 at least two registered credit rating agencies and the same is disclosed in the offer document.
- Ensure that the contents of offer document has the required details and does not contain any misleading statements.
- Ensure to file necessary information/reports, post issue as directed by SEBI from time to time.
- Ensure that the special purpose distinct entity complies with its obligation relating to Minimum public offering for listing, continuous listing conditions etc.

### LESSON ROUND UP

- The Company shall have a debenture trustee for each debenture issued and listed by it on a exchange on a continuous basis
- The Company shall create and maintain security ensuring adequate security cover at all times for secured debentures
- Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.
- Public issue is governed mainly by SEBI (ICDR) Regulations, 2009.
- Public issue, whether through normal route or book building route involves various process such as appointment of merchant bankers and other intermediaries, filing of offer documents with SEBI/ROC, listing approvals from stock exchanges, co-ordination with intermediaries etc.
- As regards book building it involves mandatory electronic bidding facility, agreement with stock exchanges for online offer of securities, appointment of book runners, arrangement of collection centers, bidding process for arrival of price etc.
- Issue of stock options to employees by listed companies is governed by SEBI (Share Based Employee Benefits) Regulations, 2014.
- Issue of preferential shares by listed companies is 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, 2009 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?

[illegible]

# 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
- Companies (Issue of Global Depository Receipts) Rules, 2014.

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, 2014
  - (b) Chapter VIII of SEBI (ICDR) Regulations 2009
  - (c) SEBI (LODR) Regulations, 2015

### LEARNING OBJECTIVES

Depository receipts (global and American) are one of the mode through which an Indian company raises money from international market or a foreign company raises money from Indian market. Similarly, foreign companies access Indian market through issue of Indian depository Receipts. Issue of Global/American Depository Receipts exposes Indian investors to international market, where as issue of Indian Depository Receipts exposes foreign investors to get exposed to Indian market. Issue of global depository receipts are mainly governed by Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme in addition to SEC regulations, EU directive as applicable.

Similarly issue of Indian Depository Receipts are regulated by SEBI (ICDR) Regulations, 2009, Chapter VII of SEBI (LODR) Regulations, 2015, Companies (Registration of Foreign Companies) Rules, 2014 etc.

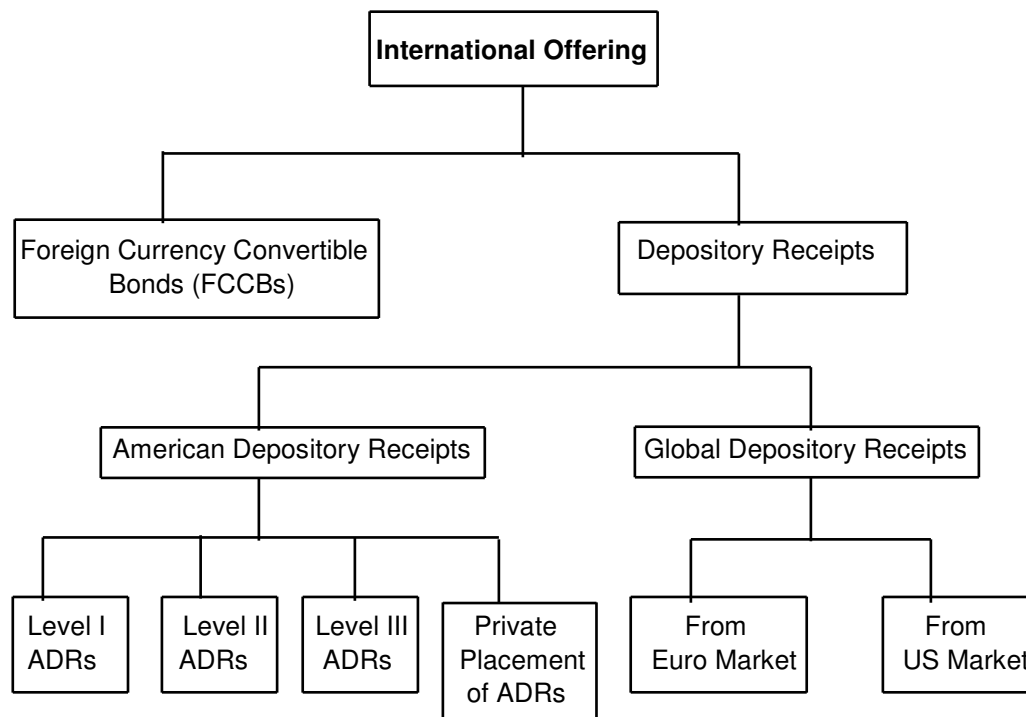
After reading this lesson you should be able to understand the concepts, regulatory framework and procedural aspects as to the issue of Global and Indian Depository Receipts.



## 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. Euro issue means raising funds in the international market and not just in Europe. 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 any of 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 (transferable) 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, amounts raised through 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 itself. At present there are several active depository receipts such as issued by Infosys, ITC, Dr. Reddys, L&T etc. that are listed either

on American exchanges like the New York 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 1 ADR (unlisted, OTC traded/Pink Sheets)*

This is the least expensive and lowest 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. The company is not required to issue quarterly or annual reports in compliance with U.S. GAAP. These ADRs 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. This is the most convenient way for a foreign company to have its equity traded in the United States. Companies with shares trading under a Level 1 program may decide to upgrade their program to a Level 2 or Level 3 program for better exposure in the United States markets.

#### *(b) Level 2 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.

When a foreign company wants to issue Level II ADRs, it must file a registration statement with the SEC and also file a Form 20-F annually. In their filings, the company is required to follow U.S. GAAP standards or the International Financial Reporting Standards (IFRS)

The advantage that the company has by issuing Level II ADR is that the shares can be listed on a

U.S. stock exchange like New York Stock Exchange (NYSE), NASDAQ etc.

While listed on these exchanges, the company must meet the exchange's listing requirements. If it fails to do so, it may be delisted and forced to downgrade its ADR program.

- (c) *Level 3 ADRs* (US listed Capital Raising Transaction i.e., through fresh issue of shares) – This type of ADR issue should comply with SECA Registration, Reporting requirement and after document filing.

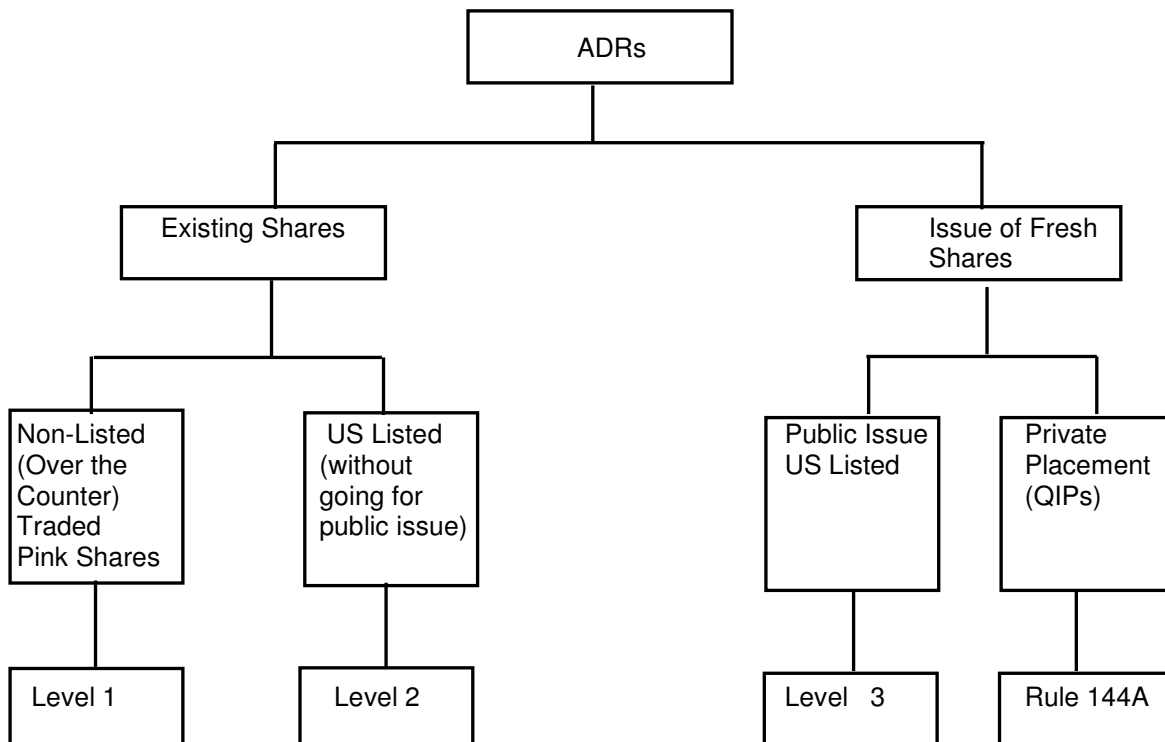
A Level 3 American Depositary Receipt program is the highest level a foreign company can sponsor. Because of this distinction, the company is required to adhere to stricter rules that are similar to those followed by U.S. companies.

Setting up a Level 3 program means that the foreign company is not only taking steps to permit shares from its home market to be traded in the United States; it is actually issuing shares to public to raise capital. In accordance with this offering, the company is required to file a Form F-1, which is the format for a prospectus for the issue of shares. They also must file a Form 20-F annually and must adhere to U.S. GAAP standards or IFRS. In addition, any material information given to shareholders in the home market, must be filed with the SEC through Form 6K.

Foreign companies with Level 3 programs will often issue materials that are more informative and are more accommodating to their U.S. shareholders because they rely on them for capital.

- (d) Rule 144A Depository Receipts (Privately placed for QIBs and cannot be bought on the public exchanges or over the counter.)

Some foreign companies will set up an ADR program under SEC Rule 144A. This provision makes the issuance of shares a private placement. Shares of companies registered under Rule 144-A are restricted stock and may only be issued to or traded by qualified institutional buyers (QIBs).



## 2. Global Depository Receipts

As per Section 2(44) of the 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;

According to Section 41 of Companies Act, 2013, 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 should comply with SEC requirements and the European portion is to comply 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 by Indian shareholders 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 pre specified number, in our example it is 1 million shares they 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. The Scheme thus, provides for purchase and re-conversion of only as many shares into ADRs/GDRs which are equal to or less than the number of shares emerging on surrender of ADRs/GDRs which have been actually sold in the 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 AND FCCB**

*(a) Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 1993 (in case of FCCBs) and Depository Receipts Scheme 2014 (in case of GDRs)*

Global Depository Receipts in India are made under Depository Receipts Scheme 2014 and FCCBs 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 Depository Receipts Scheme 2014 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 it exceeds, 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) SEBI (LODR) Regulations, 2015*

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 Relevant Regulation of LODR 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 (Takeover 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
- exchange such depository Receipts with underlying shares carrying voting rights.

*(e) Companies Act, 2013 read with Company (Issue of Global Depository Receipts) Rules, 2014.*

## **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.

A non-US company (say an Indian Company) to be able to sell its DRs representing its shares in 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 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 this document.

#### *Form 6K*

Form 6k is to be filed with Securities Exchange Commission by a foreign private issuer, pursuant to Rule 13a-16 or 15d-16 under the Securities Exchange Act of 1934 to provide information that is required to be made public in the country of its domicile.

#### *Form 20-F – Report on material business activities*

A Form 20-F is a comprehensive Annual report of all material business activities and financial results and must comply with US GAAP. It has four distinct parts.

Part I requires a full description of the issuer's business, details of its property, any outstanding legal proceedings, taxation and any exchange controls that might affect security holders.

Part II requires a description of any securities to be registered, the name of the Depository bank for the GDRs and all fees to be charged to the holders of GDRs.

Part III requires information on any defaults upon securities, and

Part IV requires various financial statements to be submitted.

This reporting requirement is essential when the company desires to list its securities in the US exchange through sponsored program or fresh issue.

#### *Form F-1 – Filing of information to be included in the prospectus*

Indian Companies planning a public offering in the US and wants to get its securities on US exchange has to register its securities in Form F-1. This form requires certain information to be included in the prospectus such as use of proceeds, summary information, risk factors and ratio of earnings to fixed charges, determination of offering price, dilution, plan of distribution, description of securities to be registered, name of legal counsel and disclosure of commissions etc.

<i>Particulars</i>	<i>Level I ADR</i>	<i>Level II ADR</i>	<i>Level III ADR</i>	<i>Private Placement</i>
Listing	Unlisted programme/OTC traded (called Pink Sheets)	Listed on US exchange	Shares offered and listed on US exchange	Issued to QIBs (i.e. Rule 144A)
SEC compliance	Registration under Form F-6 and exempted from reporting requirements	Registration in form 6 and to comply with reporting requirements in Form 20-F	Registration under Form F-6, Reporting under Form 20-F and registration of securities offered in Form F-1	None

#### *(b) Compliance under EU directive in respect of issue of Global Depository Receipts*

Issue of GDRs being listed in European exchanges has to comply with Prospectus directive, Transparency

obligations directive and Market Abuse Directive issued by EU and also country specific laws.

### ***Prospectus directive***

The Prospectus Regulations, 2005, implementing the EU Prospectus Directive 2003/71/EC, were made on 26 May 2005.

The Prospectus Directive (PD) sets out the initial disclosure obligations for issuers of securities that are offered to the public or admitted to trading on a regulated market in the EU. It provides a passport for issuers that enable them to raise capital across the EU on the basis of a single prospectus.

### ***Transparency obligations directive***

It requires issuers to make certain periodic disclosures including annual, half yearly reports etc.

### ***Market Abuse Directive***

The Market Abuse Directive aims at tackling insider dealing and market manipulation in the EU and the proper disclosure of information to the market. It requires immediate disclosure of price-sensitive information by issuers of securities which are admitted to an EU market

## **IV. PARTIES, APPROVALS, DOCUMENTATION AND PROCESS INVOLVED IN THE ISSUE OF GDRs**

### ***1. Appointment of Parties***

The following agencies are normally involved and should be appointed in a 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 (in which case known as Global Depository Receipts) 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 Overseas Depository Bank 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 explain 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 is **NOT** required for GDR issue under the present DR Scheme, 2014.*

*(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 generally 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. Agreements executed:**

The following principal documents are involved in the issue of GDRs:

- (i) Subscription Agreement
- (ii) Depository Agreement
- (iii) Custodian Agreement
- (vi) Listing Agreement
- (vii) Information Memorandum
- (viii) SEC Registration/Reporting and Exemptions

*(a) Subscription Agreement*

Subscription agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

*(b) 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 concerned 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

**4. Process involved in the issue of GDRs**

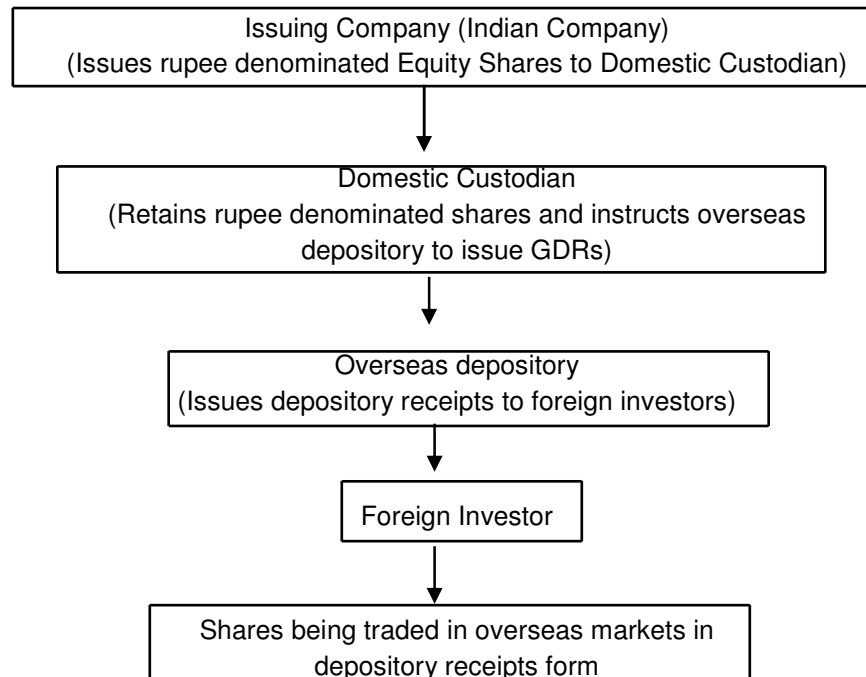
Following are the broad steps involved in GDR issue

1. Indian company would issue rupee denominated shares to a Depository outside India (ODB), where

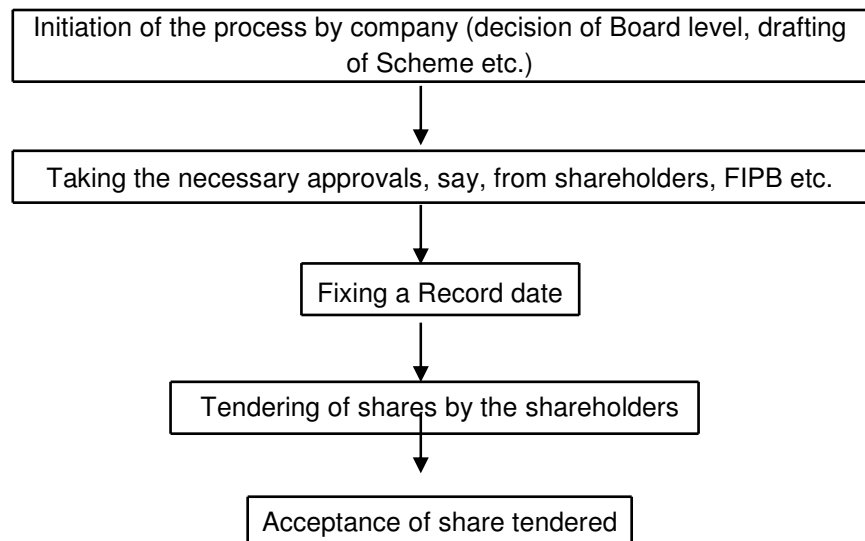
the GDRs are proposed to be issued.

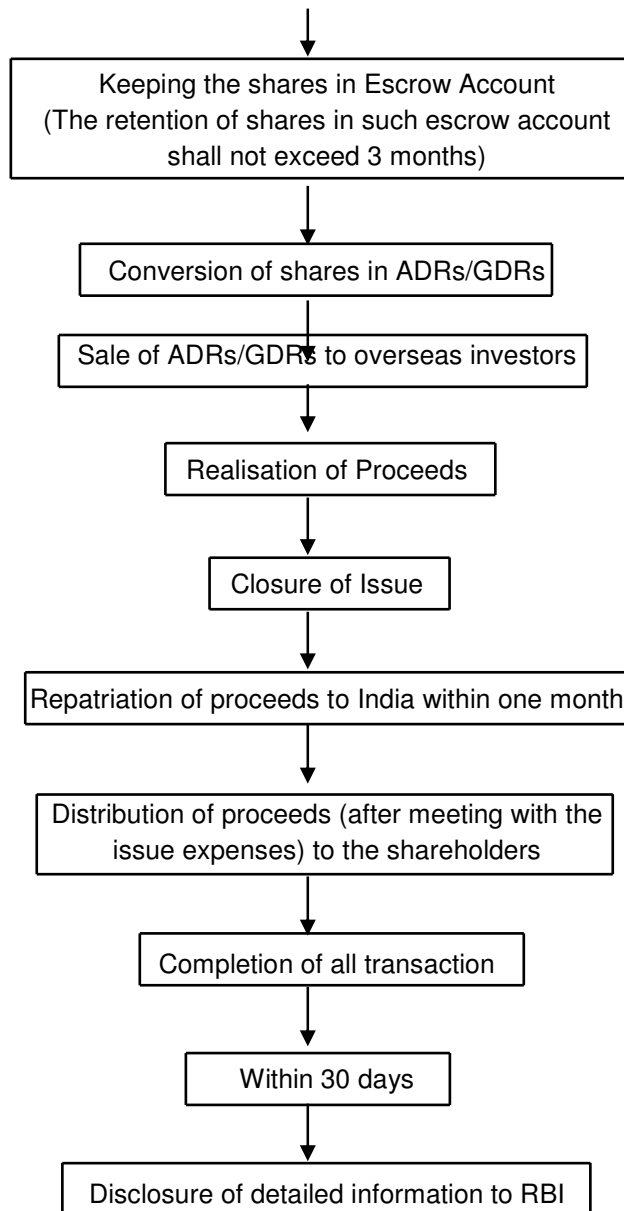
2. Indian custodian (DCB) would keep these securities in his custody.
3. The investment banker would organize road shows for marketing the issue.
4. The foreign Depository would issue dollar denominated GDRs to foreign investors.
5. Listing of GDRs in American and European Stock Exchanges would take 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.**





**Issue of shares by Indian Companies under ADR / GDR – Compliance requirements (Based on the Master circular issued by RBI on July 01, 2015.**

(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 (INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS)/FATF (FINANCIAL ACTION TASK FORCE) 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 under 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 only 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 Bank 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.

(Please refer to point 2 (c) under types of depository receipts at the beginning of this chapter)

**(xi) Sponsored ADR/GDR issue**

(Please refer to point 2 (b) under types of depository receipts at the beginning of this chapter)

**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.

**Some of the features of Depository Receipts Scheme, 2014:**

- (1) This Scheme applies only to GDR issue and not FCCB issue which is still governed under 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.
- (2) Any Indian company whether listed or otherwise, whether public or private, any other issuer of permissible securities and any person holding permissible securities can issue GDRs as long as they are not specifically prohibited from accessing capital market or dealing in securities.
- (3) As per the definition of Depository Receipt, it covers only those DRs issued by a foreign depository in permissible jurisdiction. Permissible jurisdiction means a foreign jurisdiction which is a member of the Financial Action Task Force on Money Laundering; and the regulator of the securities market in that jurisdiction is a member of the International Organisation of Securities Commissions. Schedule 1 to this Scheme provides for a list of 34 nations under permissible jurisdiction.
- (4) The aggregate of permissible securities which may be issued or transferred to foreign depositories for issue of depository receipts, along with permissible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such permissible securities under the Foreign Exchange Management Act' 1999.
- (5) The permissible securities shall not be issued to a foreign depository for the purpose of issuing DRs at a price less than the price applicable to corresponding mode of issue to domestic investors
- (6) The foreign depository is entitled to voting rights if any, associated with those permissible securities

whether pursuant to voting instructions from the holders of depository receipts or otherwise.

- (7) GDR issue does not require any approval from Government authority if it is as per this scheme. However, if any approval is necessary for issue or transfer of permissible securities to a person resident outside India (under FEMA 1999), then it shall be taken before issue of GDRs.

### **Checklist under Companies (Issue of Global Depository Receipts) Rules, 2014**

#### **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 as well as 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 any of the above persons so appointed 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 in 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. In case of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank accounts 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 Rule 13 of the 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 invest 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.

“**Merchant Banker**” means a Merchant Banker as defined in sub-regulation (cb) of regulation 2 of the Securities and Exchange Board (Merchant Bankers) Regulations, 1992.

“**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.

(The Explanation provided under this sub rule gives meaning of Domestic Depository, Merchant Banker and Overseas Custodian Bank in this connection)

#### **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.
- (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 X of 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 non-institutional 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 may be permitted to other categories.

- (f) At any given time, there shall be only one denomination of IDR of the issuing company.
- (g) the issuing company shall ensure that the underlying equity shares against which IDRs are issued have been or will be listed in its home country before listing of IDRs in stock exchange(s).
- (h) the issuing company shall ensure that the underlying shares of IDRs shall rank *pari-passu* with the existing shares of the same class.

**Minimum subscription**

*For non-underwritten issues*

- (a) If the issuing company does not receive the minimum subscription of ninety percent of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. After the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
- (b) If the issuing company fails to refund the entire subscription amount within fifteen days from the

date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

*For underwritten issues*

If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

**Fungibility:**

The Indian Depository Receipts shall be fungible into underlying equity shares of the issuing company in the manner specified by the Board and Reserve Bank of India, from time to time.

**Filing of draft prospectus, due diligence certificates, payment of fees and issue advertisement for IDR**

The issuing company shall appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker and shall enter into an agreement with the merchant banker on the lines of format of agreement as specified in **Schedule II**. 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 I**.

The issuing company shall file a draft prospectus with the Board through a merchant banker along with the requisite fee, as prescribed in the Indian Depository Receipts Rules.

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 V**.

(5) The lead merchant bankers shall:

- (a) Submit a due diligence certificate as per specified format given in **Part C of Schedule XIX** 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 given in **Part C of Schedule XIX**, at the time of filing the prospectus with the Registrar of the Companies.
- (d) Furnish a certificate as per specified format given in **Part C of Schedule XIX**, 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 given in **Part C of Schedule XIX**, after the issue has opened but before it closes for subscription.

(6) The issuing company shall make arrangements for specified mandatory collection centres as specified in **Schedule III**

(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 given in **Part A of Schedule XIII**.



### **Agreements with other intermediaries and others**

The issuing company shall appoint a registrar and transfer agent which has connectivity with all the depositories. The issuing company shall enter into an agreement with overseas custodian bank and domestic depository.

The lead merchant banker, after independently assessing the capability of other intermediaries and others to carry out their obligations, shall advise the issuing company on their appointment.

### **Display of bid data and issue of allotment letter**

The stock exchange(s) 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 in Part B(2) of Schedule XI, from the date of opening of the bids till at least three days after closure of bids.

The issuing company shall ensure that letter of allotment for the IDRs are issued simultaneously to all allottees and that in the event of it being impossible to issue letters of regret at the same time, a notice to that effect be issued in the media so that it appears on the morning after the letters of allotment have been dispatched.

### **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 the Indian Depository Receipts Rules; and
- (b) the specified disclosures as given in **Part A of Schedule XIX**.

(3) The abridged prospectus for issue of Indian Depository Receipts shall contain the specified disclosures as given in **Part B of Schedule XIX**

### **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 devolvment to the Board on the lines of the format specified in **Schedule XVII**.

### **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 issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in **Schedule XV**.

**Rights Issue of Indian Depository Receipts-Salient Features (CHAPTER XA)****Eligibility**

No issuer shall make a rights issue of IDRs:

- (a) if at the time of undertaking the rights issue, the issuer is in breach of ongoing material obligations under the IDR Listing Agreement as may be applicable to such issuer or material obligations under the deposit agreement entered into between the domestic depository and the issuer at the time of initial offering of IDRs; and
- (b) unless it has made an application to all the recognised stock exchanges in India, where its IDRs are already listed, for listing of the IDRs to be issued by way of rights and has chosen one of them as the designated stock exchange.

**Record Date**

A listed issuer making a rights issue of IDRs shall in accordance with provisions of the listing agreement, announce a record date for the purpose of determining the shareholders eligible to apply for IDRs in the proposed rights issue.

**Disclosures in the offer document and the addendum for the rights offering**

The offer document for the rights offering shall contain disclosures as required under the home country regulations of the issuer.

Apart from the disclosures as required under the home country regulations, an additional wrap (addendum to offer document) shall be attached to the offer document to be circulated in India containing information as specified in **Part A of Schedule XXI** and other instructions as to the procedures and process to be followed with respect to rights issue of IDRs in India.

**Filing of draft offer document and the addendum for rights offering**

(1) The issuer shall appoint one or more merchant bankers, one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.

(2) The issuer shall, through the lead merchant banker, file the draft offer document prepared in accordance with the home country requirements along with an addendum containing disclosures as specified in **Part A of Schedule XXI** with the SEBI, as a confidential filing accompanied with fees as specified in **Part A of Schedule IV**.

(3) The Board may specify changes or issue observations, if any, on the draft offer document and the addendum within thirty days or from the following dates, whichever is later:

- (a) the date of receipt of the draft offer document prepared in accordance with the home country requirements along with an addendum under sub-regulation (2); or
- (b) the date of receipt of satisfactory reply from the lead merchant bankers, where SEBI has sought any clarification or additional information from them; or
- (c) the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency; or
- (d) the date of receipt of a copy of in-principle approval letter issued by the recognized stock exchanges.

(4) If SEBI specifies changes or issues observations on the draft offer document and the addendum under sub-regulation(3), the issuer and the merchant banker shall file the revised draft offer document and the updated addendum after incorporating the changes suggested or specified by the SEBI.

(5) The issuer shall also submit an undertaking from the Overseas Custodian and Domestic Depository addressed to the issuer, to comply with their obligations with respect to the said rights issue under their respective agreements entered into between them, along with the offer document.

(6) The issuer shall ensure that the Compliance Officer, in charge of ensuring compliance with the obligations under this Chapter, functions from within the territorial limits of India.

**RELEVANT ADDITIONAL PROVISIONS as per the Master Circular issued by RBI on 1.7.2015:**

Indian Depository Receipts (IDRs) can be issued by non resident companies in India subject to and under the terms and conditions of the Indian Depository Receipts Rules and subsequent amendment made thereto and the SEBI (ICDR) Regulations, 2009, as amended from time to time.

These IDRs can be issued in India through Domestic Depository to residents in India as well as SEBI registered FIIs/Registered Foreign Portfolio Investors (RFPIs) and NRIs.

In case of raising of funds through issuances of IDRs by financial/banking companies having presence in India, either through a branch or subsidiary, the approval of the sectoral regulator(s) should be obtained before the issuance of IDRs.

A limited two way fungibility for IDRs (similar to the limited two way fungibility facility available for ADRs/GDRs) has been introduced which would be subject to the certain terms and conditions. Further, the issuance, redemption and fungibility of IDRs would also be subject to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time as well as other relevant guidelines issued in this regard by the Government, the SEBI and the RBI from time to time.

IDRs shall not be redeemable into underlying equity shares before the expiry of one year period from the date of issue of the IDRs.

At the time of redemption / conversion of IDRs into underlying shares, the Indian holders (persons resident in India) of IDRs shall comply with the provisions of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 notified vide Notification No. FEMA 120 / RB-2004 dated July 7 2004, as amended from time to time. Accordingly, the following guidelines shall be followed, on redemption of IDRs:

- (i) Listed Indian companies and SEBI registered Indian Mutual Funds may either sell or continue to hold the underlying shares subject to the terms and conditions as prescribed by RBI from time to time.
- (ii) Other persons resident in India including resident individuals are allowed to hold the underlying shares only for the purpose of sale within a period of 30 days from the date of conversion of the IDRs into underlying shares.

The proceeds of the issue of IDRs shall be immediately repatriated outside India by the eligible companies issuing such IDRs.

The IDRs issued should be denominated in Indian Rupees.

**SECURITIES AND EXCHANGE BOARD OF INDIA has notified SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015 on 2<sup>nd</sup> September 2015 in which CHAPTER VII contains obligations of listed entity which has listed its Indian Depository Receipts.**

#### **Disclosure of material events or information (Regulation 68)**

Check whether the listed entity promptly inform to the stock exchange(s) of all events which are material, all information which is price sensitive and/or have bearing on performance/operation of the listed entity.

Check whether the listed entity made the disclosures as specified in Part C of Schedule III. (*Annexure A*)

#### **Indian Depository Receipt holding pattern & Shareholding details (Regulation 69)**

Check whether the listed entity file with the stock exchange the Indian Depository Receipt holding pattern on a quarterly basis within fifteen days of end of the quarter in the format specified by the SEBI.

Check whether the listed entity file the Shareholding Pattern; and Pre and post arrangement share holding pattern and Capital Structure in case of any corporate restructuring like mergers / amalgamations with the stock exchange.

#### **Periodical Financial Results (Regulation 70)**

Check whether the listed entity shall file periodical financial results with the stock exchange in a specified manner.

Check whether the listed entity complied with the requirements with respect to preparation and disclosures in financial results as specified in Part B of Schedule IV. (*Annexure B*)

#### **Annual Report (Regulation 71)**

Check whether the listed entity submit to stock exchange an annual report at the same time as it is disclosed to the security holder where such securities are listed.

Check whether the annual report contains the following annexure along with the Annual Report:

- (a) Report of board of directors;
- (b) Balance Sheet;
- (c) Profit and Loss Account;
- (d) Auditors Report;
- (e) All periodical and special reports (if applicable);
- (f) Any such other report which is required to be sent to security holders annually.

#### **Corporate Governance (Regulation 72)**

Check whether the listed entity submit to stock exchange a comparative analysis of the corporate governance provisions that are applicable in its home country and in the other jurisdictions in which its equity shares are listed along with the compliance of the same vis-à-vis the corporate governance requirements applicable under Regulation 17 to Regulation 27 of SEBI (LODR) Regulations, 2015, to other listed entities.

*(Annexure C)*

### **Documents and Information to IDR Holder (Regulation 73)**

Check whether the listed entity disclose/send the following documents to IDR Holders, at the same time and to the extent that it discloses to security holders:

- (a) Soft copies of the annual report to all the IDR holders who have registered their email address(es) for the purpose
- (b) Hard copy of the annual report to those IDR holders who request for the same either through domestic depository or Compliance Officer
- (c) the pre and post arrangement capital structure and share holding pattern in case of any corporate restructuring like mergers / amalgamations and other schemes

### **Equitable Treatment to IDR Holders (Regulation 74)**

Check if the listed entity's equity shares or other securities representing equity shares are also listed on the stock exchange(s) in countries other than its home country, it shall ensure that IDR Holders are treated in a manner equitable with security holders in home country.

Check whether the listed entity ensures that for all corporate actions, except those which are not permitted by Indian laws, it shall treat IDR holders in a manner equitable with security holders in the home country.

Check in case of take-over or delisting or buy-back of its equity shares, the listed entity, while following the laws applicable in its home country, give equitable treatment to IDR holders vis-à-vis security holder in home country.

Check whether the listed entity ensures protection of interests of IDR holders particularly with respect to all corporate benefits permissible under Indian laws and the laws of its home country and shall address all investor grievances adequately.

### **Advertisements in Newspapers (Regulation 75)**

Check whether the listed entity publish the following information in the newspaper at one English national daily newspaper circulating in the whole or substantially the whole of India and in one Hindi national daily newspaper in India:

1. Periodical financial results required to be disclosed;
2. Notices given to its IDR Holders by advertisement;

### **Terms of Indian Depository Receipts (Regulation 76)**

Check whether the listed entity pay the dividend as per the timeframe applicable in its home country or other jurisdictions where its securities are listed, whichever is earlier, so as to reach the IDR Holders on or before the date fixed for payment of dividend to holders of its equity share or other securities.

Check whether the listed entity not forfeited unclaimed dividends before the claim becomes barred by law in the home country of the listed entity, as may be applicable, and that such forfeiture, when effected, shall be annulled in appropriate cases.

Check whether the Indian Depository Receipts have two-way fungibility in the manner specified by the Board from time to time.

**Structure of Indian Depository Receipts (Regulation 77)**

Check whether the listed entity ensures that the underlying shares of IDRs shall rank *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 listed entity in the annual report.

Check whether the listed entity not exercise a lien on the fully paid underlying shares, against which the IDRs are issued, and that in respect of partly paid underlying shares, against which the IDRs are issued and shall also not exercise any lien except in respect of moneys called or payable at a fixed time in respect of such underlying shares.

Check Whether the listed entity, subject to the requirements under the laws and regulations of its home country, if any amount be paid up in advance of calls on any underlying shares against which the IDRs are issued, shall stipulate that such amount may carry interest but shall not in respect thereof confer a right to dividend or to participate in profits.

**Record Date (Regulation 78)**

Check whether the listed entity, give notice in advance of at least four working days to the recognised stock exchange(s) of record date specifying the purpose of the record date.

**Voting (Regulation 79)**

Check whether the listed entity, either directly or through an agent, send out proxy forms to IDR Holders in all cases mentioning that a security holder may vote either for or against each resolution and whether the voting rights of the IDR Holders exercised in accordance with the depository agreement.

**Delisting of Indian Depository Receipt (Regulation 80)**

Check whether the listed entity, if it decides to delist Indian Depository Receipts, give fair and reasonable treatment to IDR holders.

Check whether the listed entity after delisting, has cancelled the Indian Depository Receipts.

Check whether the listed entity has complied with such norms and conditions for delisting Indian Depository Receipts as specified by the Board or stock exchange in this regard.

**OTHER IMPORTANT ASPECTS****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.

**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.

**Equivalent Information**

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

international exchanges.

### **General Obligations of listed entity (Regulation 67)**

Check whether all correspondences filed with the stock exchange(s) and those sent to the IDR Holders are in English. Check whether the listed entity complied with the rules/regulations/laws of the country of origin.

Check whether the listed entity undertake that the competent Courts, Tribunals and regulatory authorities in India shall have jurisdiction in the event of any dispute, either with the stock exchange or any investor, concerning the India Depository Receipts offered or subscribed or bought in India.

Check whether the listed entity forward, on a continuous basis, any information requested by the stock exchange, in the interest of investors from time to time.

Check Whether in case of any claim, difference or dispute under the provisions of this chapter and other provisions of these regulations applicable to the listed entity, the same shall be referred to and decided by arbitration as provided in the bye-laws and regulations of the stock exchange(s).

## **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 twenty five 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 for a term which may extend to ten years or fine which may extend to twenty five crore rupees or both for non-compliance of conditions of listing. This punishment is without prejudice to any award of penalty by the Adjudicating Officer under the Act.

- Section 23E of SCRA, 1956 – failure to comply with conditions of listing or delisting or committing a breach thereof – Fine not exceeding Rupees twenty five crores.

**(c) Foreign Exchange Management Act, 1999**

Non-compliance of FEMA provisions attracts the following:

- (1) As per Section 13 (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) As per Section 13 (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.

## ANNEXURES

### Annexure A

#### **Part – C of Schedule III of SEBI (LODR) Regulations, 2015 provides Disclosures of Material Events or Information: Indian Depository Receipts [Regulation 68(2)]**

The listed entity shall promptly inform to the stock exchange(s) of all events which are material and/or all information which are price sensitive or have bearing on performance/operation of the listed entity at the same time and to the extent it intimates to the listing authority or any other authority in its home country or other jurisdictions where its securities may be listed or other stock exchange(s) in its home country or other jurisdictions where its securities may be listed including:

- (1) any action or investigations initiated by any regulatory or statutory authority and the purpose for which it was initiated.
- (2) any attachment or prohibitory orders restraining the listed entity from transferring securities out of the names of the registered holders and particulars of the registered holders thereof.
- (3) the meeting of the board of directors which has been held to consider or decide on the following:
  - (a) all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend



or cash bonus;

- (b) the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for any dividend, even if this calls for qualification that such information is provisional or subject to audit;
- (c) the recommendation or declaration of dividend or rights issue or issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend
- (d) any decision on buy back of equity shares of the listed entity,;

(4) Change in

- (a) board of directors of listed entity by death, resignation, removal or otherwise;
- (b) managing director;
- (c) auditors appointed to audit the books and accounts;
- (d) the compliance officer;
- (e) the registrar to an issue and/or share transfer agent, domestic depository or the overseas custodian bank;

(5) any change in the rights attaching to any class of equity shares into which the Indian Depository Receipts are exchangeable;

(6) short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by rights issue of equity shares, or in any other manner;

(7) 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;

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

(9) in the event of the listed entity granting any options to purchase any Indian Depository Receipts the following particulars:

- (a) the number of Indian Depository Receipts covered by such options, terms thereof and the time within which they may be exercised;
- (b) any subsequent changes or cancellation or exercise of such options;

(10) Notices, resolutions, circulars, call letters or any other circulars etc. issued or advertised anywhere with respect to:

- (a) proceedings at all annual and extraordinary general meetings of the listed entity, including notices of meetings and proceedings of meeting;
- (b) amendments to its constitutional documents as soon as they have been approved by the listed entity in general meeting;
- (c) compliance with requirements in home country or in other jurisdictions where such securities are listed;

- (d) any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement involving the listed entity including meetings of equity shareholders, IDR Holders or any class of them and proceedings at all such meetings;

(11) any other information necessary to enable the IDR Holders to appraise the listed entity's position and to avoid the establishment of a false market in IDRs;

## ***Annexure B***

### **Part B of Schedule IV of SEBI (LODR) Regulations, 2015 contains provisions of Preparation and Disclosures in Financial Results of Listed Entity which has Listed its Indian Depository Receipts [Regulation 70(2) and 71(3)]**

The listed entity shall comply with the following requirements while preparing the financial results:-

#### **A. Periodicity of Disclosure of Financial Results**

Financial results may be given on annual, half yearly and/or quarterly basis, as required under the requirements of the home country.

#### **B. Accounting Principle to be used in preparation and disclosure of financial Results:**

- (1) The listed entity may prepare and disclose its financial results in accordance with Indian GAAP or International Financial Reporting Standards IFRS or US GAAP
- (2) In case the listed entity prepares and discloses the financial results as per US GAAP, a reconciliation statement vis-a-vis Indian GAAP and summary of significant differences between the Indian GAAP and US GAAP has to be annexed.
- (3) If financial results are prepared in accordance with IFRS, then listed entity shall annex only the summary of significant differences between the Indian GAAP and IFRS.
- (4) If the listed entity is shifting from IFRS to US GAAP or vice versa then the accounts relating to the previous period shall be properly restated for comparison;
- (5) The Accounting / Reporting Standard followed for any interim results shall be consistent with that of the Annual results.
- (6) The financial results so submitted shall be based on the same set of accounting policies as those followed in the previous year provided that in case, there are changes in the accounting policies, the results of previous year shall be restated as per the present accounting policies, to make it comparable with current year results;

#### **C. Auditing/Limited Review**

- (1) In case the listed entity prepares and discloses the financial results as per Indian GAAP, the listed entity shall ensure that the annual, half yearly and/or quarterly results, as required under the laws, rules or regulations of home country, shall be audited or subject to limited review by a Chartered Accountant in accordance with Auditing and Assurance Standards.
- (2) In case the listed entity prepares and discloses the financial results as per US GAAP or IFRS, the listed entity shall ensure that the annual, half yearly and/or quarterly results, as required under the laws, rules or

regulations of home country shall be audited or subject to limited review by professional accountant or certified public accountant in accordance with the International Standards on Auditing. The auditor's report shall also be prepared in accordance with the International Standards on Auditing.

#### **D. Disclosures**

(1) The listed entity shall disclose the audit qualification(s) or any other audit reservation(s) along with the financial results in addition to the explanatory statement as to how audit qualification(s) or any other audit reservation(s) in respect of the audited accounts of the previous accounting year have been addressed in the financial results;

(2) Format

- (a) The listed entity shall ensure that, if Indian GAAP is followed in preparation of the financial results the format of the disclosure of financial results shall be as prescribed by the Board.
- (b) In case if Indian GAAP is not followed, the format of such disclosure shall be as per the disclosure requirements of the listed entity in the home country where the listed entity is listed.

(3) The listed entity shall make disclosures of its financial information in its functional currency/reporting currency/national currency and the reporting currency shall be restricted to Sterling Pound/Euro/Yen/US Dollar.

(4) The listed entity shall provide convenient translation into Indian Rupees of the latest year's/periods statements (as the case may be) of consolidated profit and losses, assets and liabilities and cash flows, at the closing rate of exchange, as at the date on which the financial information is presented.

(5) The listed entity shall provide convenient translations in English and other notes such that the IDR Holders are able to understand such financial statements.

#### ***Annexure C***

#### **Some Corporate Governance Obligations of Listed Entity which has Listed its Specified Securities as given under Chapter IV of SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015**

##### **Board of Directors**

17. (1) The composition of board of directors of the listed entity shall be as follows:

- (a) board of directors 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 shall comprise of non-executive directors;
- (b) where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors and where the listed entity does not have a regular non-executive chairperson, at least half of the board of directors shall comprise of independent directors:

Provided that where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least half of the board of directors of the listed entity shall consist of independent directors.

*Explanation.*-For the purpose of this clause, the expression —related to any promoter" shall have the

following meaning:

- (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.
- (2) The board of directors shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.
- (3) The board of directors shall periodically review compliance reports pertaining to all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.
- (4) The board of directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointment to the board of directors and senior management.
- (5) (a) The board of directors shall lay down a code of conduct for all members of board of directors and senior management of the listed entity.
- (b) The code of conduct shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013.
- (6)(a) The board of directors shall recommend all fees or compensation, if any, paid to non-executive directors, including independent directors and shall require approval of shareholders in general meeting.
- (b) The requirement of obtaining 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.
- (c) The approval of shareholders mentioned in clause (a), shall specify the limits for the maximum number of stock options that may be granted to non-executive directors, in any financial year and in aggregate.
- (d) Independent directors shall not be entitled to any stock option.
- (7) The minimum information to be placed before the board of directors is specified in Part A of Schedule II.
- (8) The chief executive officer and the chief financial officer shall provide the compliance certificate to the board of directors as specified in Part B of Schedule II.
- (9) (a) The listed entity shall lay down procedures to inform members of board of directors about risk assessment and minimization procedures.
- (b) The board of directors shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity.
- (10) The performance evaluation of independent directors shall be done by the entire board of directors: Provided that in the above evaluation the directors who are subject to evaluation shall not participate:

#### **Audit Committee.**

**18.** (1) Every listed entity shall constitute a qualified and independent audit committee in accordance with the

terms of reference, subject to the following:

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

*Explanation (1).*-For the purpose of this regulation, —financially literate shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

*Explanation (2).*-For the purpose of this regulation, a member shall 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.

- (d) The chairperson of the audit committee shall be an independent director and he shall be present at Annual general meeting to answer shareholder queries.
- (e) The Company Secretary shall act as the secretary to the audit committee.
- (f) The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee:

Provided that occasionally the audit committee may meet without the presence of any executives of the listed entity

(2) The listed entity shall conduct the meetings of the audit committee in the following manner:

- (a) The audit committee shall meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings.
- (b) The quorum for audit committee meeting shall either be two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors.
- (c) The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

(3) The role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II.

### **Nomination and remuneration committee**

19. (1) The board of directors shall constitute the nomination and remuneration committee as follows:

- (a) the committee shall comprise of atleast three directors ;
- (b) all directors of the committee shall be non-executive directors; and
- (c) at least fifty percent of the directors shall be independent directors.

(2) The Chairperson of the nomination and remuneration committee shall be an independent director:

Provided that the chairperson of the listed entity, whether executive or non-executive, may be appointed as a member of the Nomination and Remuneration Committee and shall not chair such Committee.

(3) The Chairperson of the nomination and remuneration committee may be present at the annual general meeting, to answer the shareholders' queries; however, it shall be up to the chairperson to decide who shall answer the queries.

(4) The role of the nomination and remuneration committee shall be as specified as in Part D of the Schedule II.

### **Stakeholders Relationship Committee**

**20.** (1) The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into the mechanism of redressal of grievances of shareholders, debenture holders and other security holders.

(2) The chairperson of this committee shall be a non-executive director.

(3) The board of directors shall decide other members of this committee.

(4) The role of the Stakeholders Relationship Committee shall be as specified as in Part D of the Schedule II.

### **Risk Management Committee**

**21.** (1) The board of directors shall constitute a Risk Management Committee.

(2) The majority of members of Risk Management Committee shall consist of members of the board of directors.

(3) The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

(4) The board of directors shall define the role and responsibility 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.

(5) The provisions of this regulation shall be applicable to top 100 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

### **Vigil mechanism**

**22.** (1) The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns.

(2) The vigil mechanism shall provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

### **Related party transactions**

**23.** (1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions:

Explanation.- A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ten

percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

(2) All related party transactions shall require prior approval of the audit committee.

(3) Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions, namely-

- (a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;
- (b) the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;
- (c) the omnibus approval shall specify:
  - (i) the name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,
  - (ii) the indicative base price / current contracted price and the formula for variation in the price if any; and
  - (iii) such other conditions as the audit committee may deem fit:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.
- (d) The audit committee shall review, atleast on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.
- (e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year:

(4) All material related party transactions shall require approval of the shareholders through resolution and the related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not.

(5) The provisions of sub-regulations (2), (3) and (4) shall not be applicable in the following cases:

- (a) transactions entered into between two government companies;
- (b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

*Explanation.*-For the purpose of clause (a), "government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

(6) The provisions of this regulation shall be applicable to all prospective transactions.

(7) For the purpose of this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.

(8) All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first General Meeting subsequent to notification of these regulations.

**Corporate governance requirements with respect to subsidiary of listed entity**

**24.** (1) At least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, incorporated in India.

(2) The audit committee of the listed entity shall also review the financial statements, in particular, the investments made by the unlisted subsidiary.

(3) The minutes of the meetings of the board of directors of the unlisted subsidiary shall be placed at the meeting of the board of directors of the listed entity.

(4) The management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary.

*Explanation.*—For the purpose of this regulation, the term —significant transaction or arrangementll shall mean any individual transaction or arrangement that exceeds or is likely to exceed ten percent of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the unlisted material subsidiary for the immediately preceding accounting year.

(5) A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than fifty percent or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal.

(6) Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal.

(7) Where a listed entity has a listed subsidiary, which is itself a holding company, the provisions of this regulation shall apply to the listed subsidiary in so far as its subsidiaries are concerned.

**Obligations with respect to independent directors**

**25.** (1) A person shall not serve as an independent director in more than seven listed entities:

Provided that any person who is serving as a whole time director in any listed entity shall serve as an independent director in not more than three listed entities.

(2) The maximum tenure of independent directors shall be in accordance with the Companies Act, 2013 and rules made thereunder, in this regard, from time to time.

(3) The independent directors of the listed entity shall hold at least one meeting in a year, without the presence of non-independent directors and members of the management and all the independent directors shall strive to be present at such meeting.

(4) The independent directors in the meeting referred in sub-regulation (3) shall, *interalia*—

- (a) review the performance of non-independent directors and the board of directors as a whole;
- (b) review the performance of the chairperson of the listed entity, taking into account the views of executive directors and non-executive directors;
- (c) assess the quality, quantity and timeliness of flow of information between the management of the listed entity and the board of directors that is necessary for the board of directors to effectively and reasonably perform their duties.



(5) An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through processes of board of directors, and with his consent or connivance or where he had not acted diligently with respect to the provisions contained in these regulations.

(6) An independent director who resigns or is removed from the board of directors of the listed entity shall be replaced by a new independent director by listed entity at the earliest but not later than the immediate next meeting of the board of directors or three months from the date of such vacancy, whichever is later:

Provided that where the listed entity fulfils the requirement of independent directors in its board of directors without filling the vacancy created by such resignation or removal, the requirement of replacement by a new independent director shall not apply.

(7) The listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following:

- (a) nature of the industry in which the listed entity operates;
- (b) business model of the listed entity;
- (c) roles, rights, responsibilities of independent directors; and
- (d) any other relevant information.

#### **Obligations with respect to directors and senior management**

**26.** (1) A director shall not be a member in more than ten committees or act as chairperson of more than five committees across all listed entities in which he is a director which shall be determined as follows:

- (a) the limit of the committees on which a director may serve in 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;
- (b) for the purpose of determination of limit, chairpersonship and membership of the audit committee and the Stakeholders' Relationship Committee alone shall be considered.

(2) Every director shall inform the listed entity about the committee positions he or she occupies in other listed entities and notify changes as and when they take place.

(3) All members of the board of directors and senior management personnel shall affirm compliance with the code of conduct of board of directors and senior management on an annual basis.

(4) Non-executive directors shall disclose their shareholding, held either by them or on a beneficial basis for any other persons in the listed entity in which they are proposed to be appointed as directors, in the notice to the general meeting called for appointment of such director

(5) Senior management shall make disclosures to the board of directors relating to all material, financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the listed entity at large.

*Explanation.*- For the purpose of this sub-regulation, conflict of interest relates to dealing in the shares of listed entity, commercial dealings with bodies, which have shareholding of management and their relatives etc.

(6) No employee including key managerial personnel or director or promoter of a listed entity shall enter into any agreement for himself or on behalf of any other person, with any shareholder or any other third party with regard to compensation or profit sharing in connection with dealings in the securities of such listed entity, unless prior approval for the same has been obtained from the Board of Directors as well as public shareholders by way of an ordinary resolution:

Provided that such agreement, if any, whether subsisting or expired, entered during the preceding three years from the date of coming into force of this sub-regulation, shall be disclosed to the stock exchanges for public dissemination:

Provided further that subsisting agreement, if any, as on the date of coming into force of this sub-regulation shall be placed for approval before the Board of Directors in the forthcoming Board meeting:

Provided further that if the Board of Directors approve such agreement, the same shall be placed before the public shareholders for approval by way of an ordinary resolution in the forthcoming general meeting:

Provided further that all interested persons involved in the transaction covered under the agreement shall abstain from voting in the general meeting.

*Explanation* - For the purposes of this sub-regulation, 'interested person' shall mean any person holding voting rights in the listed entity and who is in any manner, whether directly or indirectly, interested in an agreement or proposed agreement, entered into or to be entered into by such a person or by any employee or key managerial personnel or director or promoter of such listed entity with any shareholder or any other third party with respect to compensation or profit sharing in connection with the securities of such listed entity.

### Other corporate governance requirements

27. (1) The listed entity may, at its discretion, comply with requirements as specified in Part E of Schedule II.

(2) (a) The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within fifteen days from close of the quarter.

(b) Details of all material transactions with related parties shall be disclosed along with the report mentioned in clause (a) of sub-regulation (2).

(c) The report mentioned in clause (a) of sub-regulation (2) shall be signed either by the compliance officer or the chief executive officer of the listed entity

## 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 United States of 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 Chapter VII of SEBI (LODR) Regulations, 2015, 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.

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# Lesson 6

## Due Diligence –Mergers and Amalgamations

### LESSON OUTLINE

- Introduction
- Due diligence process in M&A strategy
- Business Financial and Legal Due diligence
- Data Room Management
- Cultural Due diligence
- Corporate Governance Due diligence
- Due diligence on takeovers
- Impact of Due diligence on valuation

### LEARNING OBJECTIVES

The decision to merge or amalgamate has to be based on rational analysis, which can be formed only after evaluation of information and records available. Due Dilligence is the assessment process to judge the benefits vis-à-vis the threats that are likely in post merger scenario. In fact there are several factors financial/non financial/open/hidden factors that influence the ultimate choice of strategy. The process of analysis of strategic choices on various aspects for merger is done through due diligence process. This involves analysis of business, financial, legal, cultural, governance aspects. This lesson is based on Companies Act, 2013, as the provisions relating to Mergers and Acquisitions came into effect from 15-12-2016.

## INTRODUCTION

A company may decide to accelerate its growth by developing into new business areas, which may or may not be connected with its traditional business areas, or by exploiting some competitive advantage that it may have. Once a company has decided to enter into a new business area, it has to explore various alternatives to achieve its aims.

Basically, there can be three alternatives available to it:

- (i) the formation of a new company;
- (ii) the acquisition of an existing company;
- (iii) merger with an existing company.

The decision as to which of these three options are to be accepted, will depend on the company's assessment of various factors including in particular:

- (i) the cost that it is prepared to incur;
- (ii) the likelihood of success that is expected;
- (iii) the degree of managerial control that it requires to retain.

For a firm desiring immediate growth and quick returns, mergers can offer an attractive opportunity as they obviate the need to start from 'scratch' and reduce the cost of entry into an existing business. However, this will need to be weighed against the fact that unless the shareholders of the transferor company (merging company) are paid the consideration in cash, part of the ownership of the existing business remains with the former owners.

Merger with an existing company will, generally, have the same features as an acquisition of an existing company. However, identifying the right candidate for a merger or acquisition is an art, which requires sufficient care and calibre.

Once an organization has identified the various strategic possibilities, it has to make a selection amongst them. There are several factors financial/non financial/ open/hidden factors that influence the ultimate choice of strategy. The process of analysis of strategic choices on various aspects for merger is done through due diligence process.

### Due Diligence Process in the M&A Strategy

Stages	For Buyer	For seller
Preparation Stage	<ul style="list-style-type: none"> <li>➤ M&amp;A Strategy formulation</li> <li>➤ Preparation of List of potential targets</li> <li>➤ Appoint external advisor for evaluation of targets</li> <li>➤ Short list targets</li> <li>➤ Create Due diligence team</li> </ul>	<ul style="list-style-type: none"> <li>➤ Structure a Business plan</li> <li>➤ Preparation of list of potential buyers</li> <li>➤ Appoint external advisor</li> <li>➤ Shortlist buyers</li> </ul>
Pre diligence	<ul style="list-style-type: none"> <li>➤ Approach targets</li> <li>➤ Negotiation of initial terms</li> <li>➤ Execute Non Disclosure Agreement</li> </ul>	<ul style="list-style-type: none"> <li>➤ Approach buyers</li> <li>➤ Negotiate initial terms</li> <li>➤ Execution of Non-</li> </ul>

	➤ Compilation of list of data required	Disclosure agreement ➤ Creation of Data room
Due diligence	➤ Inspection of Data room ➤ Analysis of private documents ➤ Evaluation of risk and return ➤ Structure the terms and conditions	➤ Assistance in data room ➤ Setting deadlines for offer
Negotiations	➤ Make final offer ➤ Negotiate and agree on terms	➤ Compile final offers ➤ select best offer ➤ negotiations
Post diligence	➤ Post merger integration and cultural adjustments	➤ Termination of data room and ownership exchange

### ACTIVITY SCHEDULE FOR PLANNING A MERGER

As there are two steps of process of M&A, filing of 1<sup>st</sup> motion application (Take permission/ instruction for holding of Meetings) with NCLT and filing of 2<sup>nd</sup> motion petition (Scheme of M&A) with NCLT. Each step includes number of activities and processes as defined as under:

<b>Sl.</b>	<b>Activity</b>	<b>Action to be taken for completion of activity</b>
<b>(1)</b>	<b>(2)</b>	<b>(3)</b>
1.	Objects clause to be examined	Check the object clause of Memorandum of Association of all the Companies with regard to the power of amalgamation.
		Check the object clause of the transferee company regarding power to carry on the business of the transferor company; if it is not then it is necessary to amend the Objects Clause to add objects of transferor Companies.
		Check if authorized share capital of the transferee company is sufficient; if not then it is necessary to amend the capital clause of the Company.
2.	Preparation of Draft Scheme of Amalgamation	Aspects of Business Valuation, calculation of Swap ratio etc. are being carried out during this process.
3.	Board meeting of the transferor and transferee companies to be held.	Notice, Agenda, notes to Agenda and draft resolution of the Board Meeting to be sent. Board Meeting to be held. Agenda for Board Meeting will include the following items: <ul style="list-style-type: none"> <li>• Effective date to be announced:</li> <li>• Approval of the scheme of amalgamation</li> <li>• Approval of Ratio</li> <li>• Directors/Officers to be empowered to make application to appropriate Tribunal and to take necessary action.</li> </ul>
4.	Stock Exchange	Immediately after the board meeting approving the scheme/ exchange ratio, both companies will have to inform the respective stock exchanges.

5.	Press Release	The news may be released to the press for information and others.
6.	Financial Institutions/ Banks/Trustees to Debenture holders, if any, to be formally advised their consent sought.	Financial institutions/trustees to Debenture holders, if any to be formally advised and their consent sought.
7.	<p>Application to the Tribunal</p> <p>If there are any calls in arrears of transferor company, the Tribunal direction to be sought specifically.</p> <p>In case of a merger of a potentially sick company with a healthy company, the possibility of reducing the share capital of the sick company to the extent of losses to be considered and procedure for reduction to be undertaken. This would have an effect on the EPS of the merged company.</p>	<p>An application to the Tribunal concerned both to the transferor and transferee companies will have to be made under Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. It shall be made in Form NCLT-1 along with a notice of admission in Form NCLT-2, for direction to convene the meeting.</p> <p>Affidavit in support of application will be in Form NCLT-6 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.</p> <p>After considering the application in NCLT-1, tribunal can give the following instructions regarding holding and concluding of Meeting. Fixing the time and place of the meeting or meetings, appointing a Chairperson, the procedure to be followed at the meeting, including voting in person or by proxy or by postal ballot or by voting through electronic means, The time within which the chairperson of the meeting is required to report the result of the meeting to the Tribunal and Such other matters as the Tribunal may deem necessary.</p> <p>The Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent. value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement,</p>
8.	Notices of Extra Ordinary General Meeting.	<p><b><u>Person entitled to receive the notice:</u></b> The notice shall be sent individually to each of the Creditors or Members and the debenture-holders at the address registered with the company.</p> <p><b><u>Person authorized to send the notice:</u></b></p> <ul style="list-style-type: none"> <li>Chairman of the Company, or</li> <li>If tribunal so direct- by the Company or its liquidator or by any other person</li> </ul>

		<p><b><u>Modes of Sending of notice:</u></b></p> <ul style="list-style-type: none"> <li>• By Registered post, or by Speed post, or by courier, or</li> <li>• By e-mail, or by hand delivery, or by any other mode as directed by the tribunal</li> </ul> <p>Notice should be accompanied with:</p> <ul style="list-style-type: none"> <li>— The statement.</li> <li>— a copy of the scheme</li> <li>— form of proxy</li> </ul> <p>The Notice of the meeting shall be advertised in Form CAA-2 at least in one English Newspaper and in at least one vernacular language newspaper. It shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.</p> <ul style="list-style-type: none"> <li>• Such Newspaper advertisement shall be published on the website of the company at least 30 days before the date fixed for meeting, as directed by tribunal. (Section 230(3))</li> <li>• In case of Listed Company, such notice and other documents shall also be published on the website of SEBI and stock exchange where securities of the Company are listed.</li> </ul>
9.	<ul style="list-style-type: none"> <li>• Notice to Statutory Authorities</li> </ul>	<p>A notice in Form CAA-3 along with Copy of Scheme of C&amp;A, the explanatory statement and Disclosures mentioned in Annexure A, shall also be sent to followings:</p> <ul style="list-style-type: none"> <li>• The Central Government, The Registrar of Companies and The income-tax authorities, in all cases</li> <li>• The Reserve Bank of India, the Securities and Exchange Board of India, the Competition Commission of India, and the stock exchanges, as may be applicable.</li> </ul> <p>Other Sectoral Regulators or authorities, as required by Tribunal</p> <p>Notice shall be sent to the office of the authority after sending of notice to members or creditors of the Company by Registered post, or by Speed post, or by courier, or by hand delivery</p>
10.	Meetings of Members	<p>The meetings will be held as scheduled. The management will answer the queries of the members, permitted by the Chair.</p> <p>The voting at the meeting or meetings held in pursuance of the directions of the Tribunal on all resolutions shall take place by poll or by voting through electronic means. Approval is required of a majority in number of persons present and voting representing three-fourths in value of the members.</p>



		The Chairperson of the meeting shall, within the time fixed by the Tribunal, or where no time has been fixed, within 3 (Three) days after the conclusion of the meeting, submit a report to the Tribunal on the result of the meeting in Form CAA.4.
11	Petition to Tribunal	The Company shall, within 7 (seven) days of the filing of the report by the Chairperson, present a petition to the Tribunal in Form CAA.5 for sanction of the scheme of compromise or arrangement.
12	Directions on the Petition by tribunal	<p>The Tribunal shall fix a date for the hearing of the petition. The notice of the hearing of the petition shall also be served by the Tribunal;</p> <ul style="list-style-type: none"> <li>▪ To the Objectors or</li> <li>▪ To Their Representatives under sub-section (4) of section 230 of the Act and</li> <li>▪ To the Central Government and</li> <li>▪ Other Authorities who have made representation under Rule 8 and have desired to be heard in their representation.</li> </ul>
13	Publication of notice of the hearing	The notice of the hearing shall be advertised in the same newspaper in which the notice of the meeting was advertised or in such other newspaper as the Tribunal may direct, at least 10 (ten) days before the date fixed for the hearing.
14.	Hearing and Order.	<p>Any person interested including creditors and employees may appear before the tribunal and make submissions.</p> <p>Where the Tribunal sanctions the Merger &amp; Amalgamation, An order made under Section 232 read with Section 230 of the Act shall be in Form CAA.6 &amp; CAA 7 with such variation as the circumstances may require.</p> <p>The order may include an order for dissolution of the transferor company, if the Official Liquidator has submitted the report.</p> <p>The Court may make any provision for any person who dissents from the scheme.</p> <p>The order will not have any effect till a certified copy is filed with the Registrar.</p>
15.	Filing/Annexing	<p>The order of the Tribunal shall be filed with the Registrar by the company in Form INC-28 within a period of thirty days of the receipt of the copy of order, or such other time as may be fixed by the Tribunal.</p> <p>In computing the period of 30 days the time taken in obtaining certified copy has to be excluded.</p> <p>A copy of the Tribunal order will be annexed to every copy of the memorandum and articles of association of the transferee company.</p>

16	FEMA	Approval of Reserve Bank of India will be obtained for allotment of shares to non-residents under FEMA, wherever required.
17	Effective Date	As soon as the scheme has become effective, particulars will be intimated through press and to the government authorities, banks, creditors, customers and others. Certified copy of the Court order will be given where necessary.
18	Compliance until completion of scheme	Every company in relation to which the order is made shall, until the completion of the scheme, file a statement in Form CAA.8 within two hundred and ten days from the end of each financial year with the Registrar every year, duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

**Annexure- A:****INFORMATION REQUIRED TO BE CIRCULATED ALONG WITH THE NOTICE**

- (a) Details of the order of the Tribunal directing the calling, convening and conducting of the meeting:-
- Date of the Order;
  - Date, time and venue of the meeting.
- (b) Details of the company including:
- Corporate Identification Number (CIN) or Global Location Number (GLN) of the company;
  - Permanent Account Number (PAN);
  - Name of the company;
  - Date of incorporation;
  - Type of the company (whether public or private or one person company);
  - Registered office address and email address;
  - Summary of main object as per the memorandum of association; and main business carried on by the company;
  - Details of change of name, registered office and objects of the company during the last five years;
  - Name of the stock exchange (s) where securities of the company are listed, if applicable;
  - Details of the capital structure of the company including authorised, issued, subscribed and paid up share capital; and
  - Names of the promoters and directors along with their addresses.
- (c) Relationship in case of Combined Application: if the scheme of compromise or arrangement relates to more than one company, then the fact and details of any relationship subsisting between such companies who are parties to such scheme of compromise or arrangement, including holding, subsidiary or of associate companies.
- (d) Disclosure about effect of M&A on material interests of directors, Key Managerial Personnel (KMP)

and debenture trustee.

(e) Details of Board Meeting:

- The date of the board meeting at which the scheme was approved by the board of directors
- The name of the directors who voted in favour of the resolution,
- The name of the directors who voted against the resolution and
- The name of the directors who did not vote or participate on such resolution

(f) Explanatory Statement disclosing details of the scheme of compromise or arrangement including:

- Parties involved in such compromise or arrangement;
- Appointed date, effective date, share exchange ratio (if applicable) and other considerations, if any;
- Summary of valuation report (if applicable) including basis of valuation and fairness opinion of the registered valuer, if any, and the declaration that the valuation report is available for inspection at the registered office of the company;
- Details of capital or debt restructuring, if any;
- Rationale for the compromise or arrangement;
- Benefits of the compromise or arrangement as perceived by the Board of directors to the company, members, creditors and others (as applicable);
- Amount due to unsecured creditors.

(g) Disclosure about the effect of the Merger & Amalgamation (C&A) on: Section 230(3)

- Key Managerial Personnel;
- Directors;
- Promoters;
- Non-Promoter Members;
- Depositors;
- Creditors;
- Debenture holders;
- Deposit trustee and debenture trustee;
- Employees of the company;
- Shareholders of the Company

(h) A report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;

(i) Below Mentioned Details: Following below mentioned details

- Investigation or proceedings, if any, pending against the company under the Act.
- Details of approvals, sanctions or no-objection(s), if any, from regulatory or any other governmental authorities required, received or pending for the proposed scheme of compromise

or arrangement

- A statement to the effect that the persons to whom the notice is sent may vote in the meeting either in person or by proxies, or where applicable, by voting through electronic means
  - A copy of the valuation report, if any Section 230(3)
- (j) Details of availability of documents: Details of the availability of the following documents for obtaining extract from or for making or obtaining copies of or for inspection by the members and creditors, namely
- Latest audited financial statements of the company including consolidated financial statements;
  - Copy of the order of Tribunal in pursuance of which the meeting is to be convened or has been dispensed with;
  - Copy of scheme of Merger & Amalgamation (C&A);
  - Contracts or agreements material to the Merger & Amalgamation (C&A);
  - The certificate issued by Auditor of the company to the effect of the accounting treatment, if any,
  - Proposed scheme of Merger & Amalgamation (C&A) is in conformity with the Accounting Standards prescribed under Section 133 of the Companies Act, 2013; and
  - Such other information or documents as the Board or Management believes necessary and relevant for making decision for or against the scheme;
- (k) Some Other documents: Where an order has been made by the Tribunal under Section 232(1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following:
- The draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;
  - Confirmation that a copy of the draft scheme has been filed with the Registrar;
  - The report of the expert with regard to valuation, if any;
  - Supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme

Explanation- For the purposes of above disclosure required to be made by a company, these shall be made in respect of all the companies which are part of the compromise or arrangement.

## PREPARATION OF SCHEME OF AMALGAMATION

The scheme of amalgamation to be prepared by the company should contain *inter-alia* the following information:

1. Definitions of transferor and transferee as well as the definition of the undertaking of the transferor company.
2. Authorised, issued and subscribed capital of transferor and transferee companies.
3. Basis of scheme should be explained briefly on the recommendation of valuation report, covering transfer of assets/liabilities, specified date, reduction or consolidation of capital, application to

financial institutions as lead institution for permission, etc.

4. Change of name, object and accounting year.
5. Protection of employment.
6. Dividend position and prospects.
7. Management structure, indicating the number of directors of the transferee company and the transferor company.
8. Applications under Sections 230 and 230 of the Companies Act, 2013 to obtain approval from the Tribunal.
9. Expenses of amalgamation.
10. Conditions of the scheme to become effective and operative and the effective date of amalgamation.

The basis of the scheme should be framed on the reports of valuers, auditors and chartered accountants of assets of both the merger partner companies. The underlying idea is to ensure that the scheme is just and equitable to the shareholders and employees of each of the amalgamating companies and to the public at large. It should be ensured that common yardstick is adopted for valuation of shares of each of the amalgamating company for fixing rate of exchange of shares on merger.

#### **A. Information Required by the Professional Generally**

##### **Cross holding of the Directors of the Transferee and Transferor Companies.**

1. Relationship between the directors of the transferee and transferor companies under the Companies Act, 2013.
2. Names of the officers of both the transferee and transferor companies who are to be authorised to sign the Application, Affidavit and Petition. (The companies concerned can authorise any one person to act on behalf of them, who may be from either of the companies).
3. Names of the English and regional language newspapers in which notices are to be published.
4. Names in preferential order as to the chairmen of the meetings of the transferee and transferor companies. (The chairman in this case need not be a director on the board of directors of the company concerned or even a member of the company).
5. List of creditors and their dues. List of individual cases to be given, as well as categorisation in various slabs.

#### **B. Information/Documents that may be required by the Regional Director, Ministry of Corporate Affairs, in Connection With Amalgamation.**

1. Balance sheets for last five years of the transferee company.
2. Balance sheets for last five years of the transferor company.
3. Two copies of the valuation report of the chartered accountants.
4. List of top shareholders of the transferee company.

5. List of top shareholders of the transferor company.
6. List of directors of the transferor company and their other directorships.
7. List of directors of the transferee company and their other directorships.
8. Number and percentage of NRI and foreign holding in the transferee and transferor companies.
9. Rights/Bonus/Debentures Issues made by the transferee and the transferor companies in the last five years.

**C. The Following Information is required to be furnished to the Auditors Appointed by the Official Liquidator.**

From the transferor company

1. Certified true copy of the scheme of amalgamation alongwith the petition.
2. Certified true copy of the Memorandum and Articles of Association of the company.
3. List of shareholders of the company with their shareholding. Any changes during the last five years to be indicated.
4. Accounts of the company made upto the appointed day of amalgamation.
5. Address of the registered office of the company.
6. Present authorised and paid-up share capital of the company.
7. Changes in the Board of directors during the last five years alongwith list of present Board of directors.
8. List of associated concern in which directors are interested.
9. List of various appeals pending under Income-tax, Sale Tax, Excise Duty, Custom Duty, FEMA, etc.
10. Details of loans and advances given to the associated concern/companies under the same management during the last five years.
11. Details of revaluation of assets.
12. Details of any allegations and/or complaints against the company.
13. Details of amount paid to the managing director, directors or any relative of the directors during the last five years.
14. Comparative statement of profit and loss account and balance sheet for the last five years.
15. Details of bad debts written off during the last five years.
16. List of all charges registered with the Registrar of Companies and the amount secured against the same.
17. Copy of the latest annual return filed with the Registrar of Companies alongwith Annexures.

18. Details of all the subsidiary companies as under:

- (a) Authorised and paid-up share capital of the company.
- (b) List of present shareholders alongwith details of changes in the shareholding patterns during the last five years.

The following information of the transferee company is required by the auditor:

- 1. Names of the existing directors of the company.
- 2. List of common shareholders of the companies involved in the amalgamation with individual shareholding.
- 3. Authorised and paid up capital of the company.
- 4. Copy of latest audited balance sheet.

The auditors may also require the following records of the transferor company for examination:

- 1. Books of accounts and relevant records for the last five years.
- 2. Minutes book of Board and General Meetings.

## **IMPACT OF DUE DILIGENCE ON VALUATION**

To arrive at a value of the target company we need to analyze aspects viz. how much should we pay for the target company, how much is the target worth, how does this compare to the current market value of the target company, etc.

Senior management at the acquiring company will delegate the M&A process to a special team of experts responsible for assessing the value of the target company. The composition of the buyer's team is likely different from that of the seller's team because of the buyer's motivation, depending on whether the buyer is strategic or financial. After inspecting the relevant documents, the functional due diligence team provides a summary of findings regarding his or her area of expertise. These summaries are then collected and incorporated into a diligence synthesis and a technical and financial analysis of the target. Expert recommendations are then summarized into an integration recommendation.

As we are aware that the due diligence process helps in identifying the hidden risks/ litigations etc, it helps in arriving at a right price after valuation process by discounting for the risks identified and vice versa. The techniques of valuations are dealt in Corporate Restructuring, Valuations and Insolvency study material.

## **DATA ROOM MANAGEMENT IN STRATEGIC DECISIONS**

As regards data room management, security is a critical issue in managing the data room, as sensitive information should not be leaked to the people not covered by non-disclosure or confidentiality agreements executed between the parties. Such information leaks can have detrimental effects on the entire transaction process, and may adversely affect the consideration being paid by a buyer, or the consideration being exchanged in a merger, if either party senses a process damaged or tainted by leaks. A person is generally employed as a coordinator for this purpose and is assigned to manage the operation of the data room by minimizing security and information leaks, recording data room attendance, and searching briefcases and other bags as attendees leave the data room.

The process of collecting the necessary data room documents and information is extensive and time consuming. Data must be compiled, indexed and properly organized and this process takes up valuable resources. Function-wise contact persons are assigned to manage the data room information from their areas. They ensure that their operational area provides the information needed, indexes the relevant documents and information, coordinates with management regarding documents that may be copied, and verifies that information that cannot be copied. Similarly under virtual data room copying or printing of documents may be delayed.

## HR AND CULTURAL DUE DILIGENCE IN BUSINESS TRANSACTIONS

Culture is a complex system with a multitude of interrelated processes and mechanisms based on which the organisation functions. It includes vision/mission of the organisation, work flow process, communication mechanism, formal procedures, informal practices, strategy setting mechanism and so on.

Corporate Culture is embedded deeply in the organization and in the behavior of the people there. It is not necessarily equal to the image the company gives itself in brochures and on the website. Therefore, it is difficult to determine an organization's culture from the outside. Especially in pre-merger negotiations – when time and confidentiality are critical factors while trust still needs to be established – it can be a challenging task to find out if the cultures of the potential partners fit together.

The issues of cultural integration and the issues of human behaviour need to be addressed simultaneously if not well before the issues of financial and legal integration are considered. Implementation of structural nature may be financially and legally successful. But if cultural issues are ignored, the success may only be transient.

According to KPMG Study 83% of all mergers and acquisitions failed to produce any benefit for the shareholders and over half actually destroyed value. It revealed that the overwhelming cause for failure is the people and cultural difference. Difficulties encountered in M & As are amplified in cross-cultural situations, when the companies involved are from two or more countries.

Culture of an organization means the sum total of things the people do and the things the people do not do. Behavioral patterns get set because of the culture. These patterns create mental blocks for the people in the organization. Pre-merger survey and summarization of varying cultures of different companies merging, needs to be carried out. People belonging to each defined culture need to be acquainted with other cultures of other merging companies. They need to be mentally prepared to adopt the good points of other cultures and shed the blockades of their own cultures. Such an open approach will make the fusion of cultures and ethos easy and effective.

The successful merger demands that strategic planners are sensitive to the human issues of the organisations. For the purpose, following checks have to be made constantly to ensure that:

- sensitive areas of the company are pinpointed and personnel in these sections carefully monitored;
- serious efforts are made to retain key people;
- a replacement policy is ready to cope with inevitable personnel loss;
- records are kept of everyone who leaves, when, why and to where;
- employees are informed of what is going on, even bad news is systematically delivered. Uncertainty is more dangerous than the clear, logical presentation of unpleasant facts;



- training department is fully geared to provide short, medium and long term training strategy for both production and managerial staff;
- likely union reaction be assessed in advance;
- estimate cost of redundancy payments, early pensions and the like assets;
- comprehensive policies and procedures be maintained up for employee related issues such as office procedures, new reporting, compensation, recruitment and selection, performance, termination, disciplinary action etc.;
- new policies to be clearly communicated to the employees specially employees at the level of managers, supervisors and line manager to be briefed about the new responsibilities of those reporting to them;
- family gatherings and picnics be organised for the employees and their families of merging companies during the transition period to allow them to get off their inhibitions and breed familiarity.

### **Why is corporate culture that important?**

Corporate culture influences the performance of an organization, since it determines

- Style of tackling problems
- Method or style of communication
- Adaptability of employees
- Organization commitment to strategies and ultimately to vision and mission etc

A perfect integration would develop a new culture from both former cultures of the partners. Ideally, this new culture should include the best elements from both organizations.

Corporate culture influences the performance of an organization, since it determines:

1. Style of organizational functioning
2. Adaptability of people to changes
3. The way people interact with each other
4. The way the organization interacts with stakeholders
5. Level of commitment

### **Types of Cultural differences**

There are three types of cultural differences:

1. Cross-national differences (especially in cross-border mergers),
2. Cross-organizational differences,
3. Cross-functional differences.

Areas of differences in cultural aspects:

- Organizational values
- Management culture and leadership styles

- Organizational myths and stories
- Organizational taboos, rituals
- Cultural symbols

Ideally, this new culture should include the best elements from both organizations.

### **Survey by Accenture and Economist Intelligence Unit**

Accenture and the Economist Intelligence Unit in the first half of 2006, surveyed senior executives in North America, Europe and Asia on their mergers and acquisitions (M&A) activities and their experience in integrating companies. Similar survey was also administered to 156 executives based in India during the fourth quarter of 2006.

Of the total respondents in India, 40% were senior-level. About 64% were from companies that had global annual revenues of US\$100m or more and 36% had revenues of US\$1bn or more. 45% executive mainly played roles in strategy and business development and 42% in general management. Their companies were from a wide range of industries, including financial services (25%), IT and technology (21%) and professional services (13%).

### **The Key findings of the Survey**

#### ***Human and Cultural Factors***

Accenture Survey points out that for integrating a cross border company, 43%, respondents found addressing cultural issues as critical. The real challenge, after an acquisition is, therefore, the integration of the two companies. That is why the integration should be given a focused attention. There should be a focus on aligning the acquired company's processes through the business excellence model.

#### ***Human Factor***

Studies on post-acquisition performance have primarily been a centre of interest of researchers in strategy, economics and finance. The identified factors of performance variations have usually ranged from the industry match (complementary of assets, similarities of markets and products, synergies in production, strategic orientation, etc.), pricing policy, financing and size of the operation and type of the transaction, bidding conditions, etc.

By contrast to quantitative measurements from finance and economics, the research, which has focused on the organizational and human side of M & As, has mostly dealt with identifying factors that might have played a role in the integration process of the merging entities and led to successful outcomes. Despite the absence of a direct causal correlation, several dimensions have been identified as having an important impact on M&A performance, these include psychological, cultural and managerial factors, knowing that the human factor covers at the same time employees and managers of the companies.

#### ***Psychological Factors***

A large part of the existing research has looked at the psychological effects of M&A on employees. Scholars have pointed out that strong impact that the operations could have on employees, in particular the resulting increase in stress and anxiety due to changes in work practices and tasks, managerial routines, colleagues environment, the hierarchy, etc. Further, merger and acquisitions often introduce an environment of uncertainty among employees about job losses and future career development. It has been pointed out that stress and insecurity may lead to employee resistance to change, absenteeism and lack of commitment to

work and the organisation. Employee resistance prevents the building up of a well functioning organisation and constructive cooperative environment. Lack of work commitments have a negative impact on individual and organizational performance measured in terms of productivity, quality, and service. Moreover, a relationship between organizational and financial performance has also been identified which may have consequences for the market value of company.

On the other hand, it has been argued that satisfied employees are presumed to work harder, better, and longer with higher productivity records. Even though a direct relationship between job satisfaction and corporate performance remains to be established with certainty, it appears that lower job satisfaction is a cause of higher absenteeism, which, in turn is shown to have a negative influence on organizational performance.

### ***Cultural factors***

Cultural differences look like playing both ways. Although distant cultural environments make the integration process harder, the lack of culture-fit or cultural compatibility has often been used to explain M&A failure. Cultural differences have also been considered a source of lower commitment to work, making co-operation more difficult, particularly from employees of the acquired company. In this regard, scholars have largely given account of the lack of co-operation momentum stemming from a “we” versus “them” attitude, resulting in hostility among employees.

It is, therefore, no surprise that strong cultural differences are usually associated with a negative impact on M&A performance, since the integration process is less easy and deals with higher employee resistance, communication problems, and lower interest in co-operation. Noticeably, cultural clashes are likely to be more prominent in cross-national than domestic acquisitions, since such mergers bring together not only two companies that have different organizational cultures but also organizational cultures rooted in national diversity. The scholars have identified building up of a common culture as essential for the success of merger and acquisitions. Researchers have found that high levels of employees' social identification with the organization's identity results in increased work effort, higher performance, reduced staff turnover and more frequent involvement in positive organizational citizenship.

## **Cultural Due Diligence**

Cultural Due Diligence (CDD) is the process of identifying, assessing, investigating, evaluating and defining the cultures of two or more distinct corporates through a cultural analysis so that the similarities and differences that impact the merged organization are identified and remedial actions are taken well in advance. It should be carried along with M&A due diligence stage itself. The findings of cultural due diligence would be the base for post integration strategies.

## **Scope of Cultural Due diligence**

### **The Cultural Due Diligence process covers**

1. Leadership, Strategies and Governing principles: It covers vision, mission, values, business strategy development, leadership effectiveness, ethics, board room practices, role of independent directors etc.
2. Relationships and behaviors: It covers trust, inter/intra group relationships, community and customers
3. Communication: feedback, information sharing, employee trust in information
4. Infrastructure: formal procedures, processes, systems, policies, structure and teams

5. Involvement & Decision Making: authority levels, accountability, expectations and the decision making process
6. Change Management: creativity, innovation, recognition, continuous learning and diversity
7. Communication platforms
8. Finance: perception of financial health and the role of the employee and the level of financial comprehension and impact on the business

**Cultural Due Diligence is the process which analyzes the cultural aspects which includes:**

- leadership vision
- management practices,
- governing principles,
- policies and procedures
- informal practices,
- relationship management,
- employee satisfaction,
- customer satisfaction,
- key business drivers,
- organizational characteristics,
- organizational perceptions
- communication mechanism etc.

**Questions being analysed in Cultural Due Diligence**

The following questions are being analysed for determining the different corporate culture.

1. What are the primary issues driving the business strategy?
2. What are the levels of relationship with the board and the senior management?
3. What is the nature of the relationship between groups and units in the organization?
4. What formal and informal systems are in place and what part do they play in the daily life of doing the work?
5. How do people dress and address each other?
6. How do the office ambience differ?
7. What are the working hours?
8. What are the variation in utilization of technology in daily routine?

9. How actual work is performed?
10. How authority and responsibility is allocated?
11. How the performance evaluation is done and reward is granted?
12. What are the reporting relationship in the organization?
13. What are the supervisory practices in the organization?

The above questions indicate that the corporate culture is basically focused on:

1. Leadership style and management practices.
2. Manner of organizational functioning.
3. Employees.

#### **How to address Cultural Differences during merger?**

1. Formation of strategies for cultural integration.
2. Analyzing the existing cultures.
3. Identifying common aspects and differences.
4. Decide if you want to go on with one of the existing cultures or if you prefer an integration culture.
5. Establish 'bridges' between both companies.
6. Establish a basis and mechanisms for the new culture.
7. Extensive interaction with people.

The following mechanism may help in resolving cultural differences:

1. Newsletters and hotlines.
2. Workshops.
3. Surveys, questionnaires and feedback analysis.
4. Synergy teams.
5. Continuous interactions.

### **CORPORATE GOVERNANCE DUE DILIGENCE**

#### **FACTORS INFLUENCING QUALITY OF CORPORATE GOVERNANCE**

Quality of governance primarily depends on following factors:

- (i) Integrity of the management;
- (ii) Ability of the Board;
- (iii) Adequacy of the processes;
- (iv) Commitment level of individual Board members;

- (v) Quality of corporate reporting;
- (vi) Participation of stakeholders in the management.

While corporate governance is an important element affecting the long-term financial health of companies, it is only part of the larger economic context in which companies operate. The corporate governance framework depends on the legal, regulatory and institutional environment, business ethics and awareness of the environmental and societal interests of the constituencies in which it operates.

The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for taking key investment decisions. International flow of capital enables companies to seek financing from a larger pool of investors. If companies are to reap the full benefits of the global capital market, capture efficiency gains, benefit by the economies of scale and attract long term capital, adoption of corporate governance standards must be credible, consistent, coherent and inspiring.

As the final analysis the factors which add greater value through Good Governance, may be summarized as follows:

- Adoption of good governance practices provides stability and growth to the enterprise.
- Good governance system, demonstrated by adoption of good corporate governance practices, builds confidence amongst stakeholders as well as prospective stakeholders.
- Investors pay higher price to the corporates demonstrating strict adherence to internationally accepted norms of corporate governance.
- Effective governance reduces perceived risks, consequently reduces cost of capital and enables Board of directors to take quick and better decisions which ultimately improves bottom line of the corporates.
- Adoption of good corporate governance practices provides long-term sustainability and strengthens stakeholders' relationship.
- A good corporate citizen becomes an icon and enjoys a position of respect.
- Potential stakeholders aspire to enter into relationships with enterprises whose governance credentials are exemplary.

The following compliances can be checked in this regard.

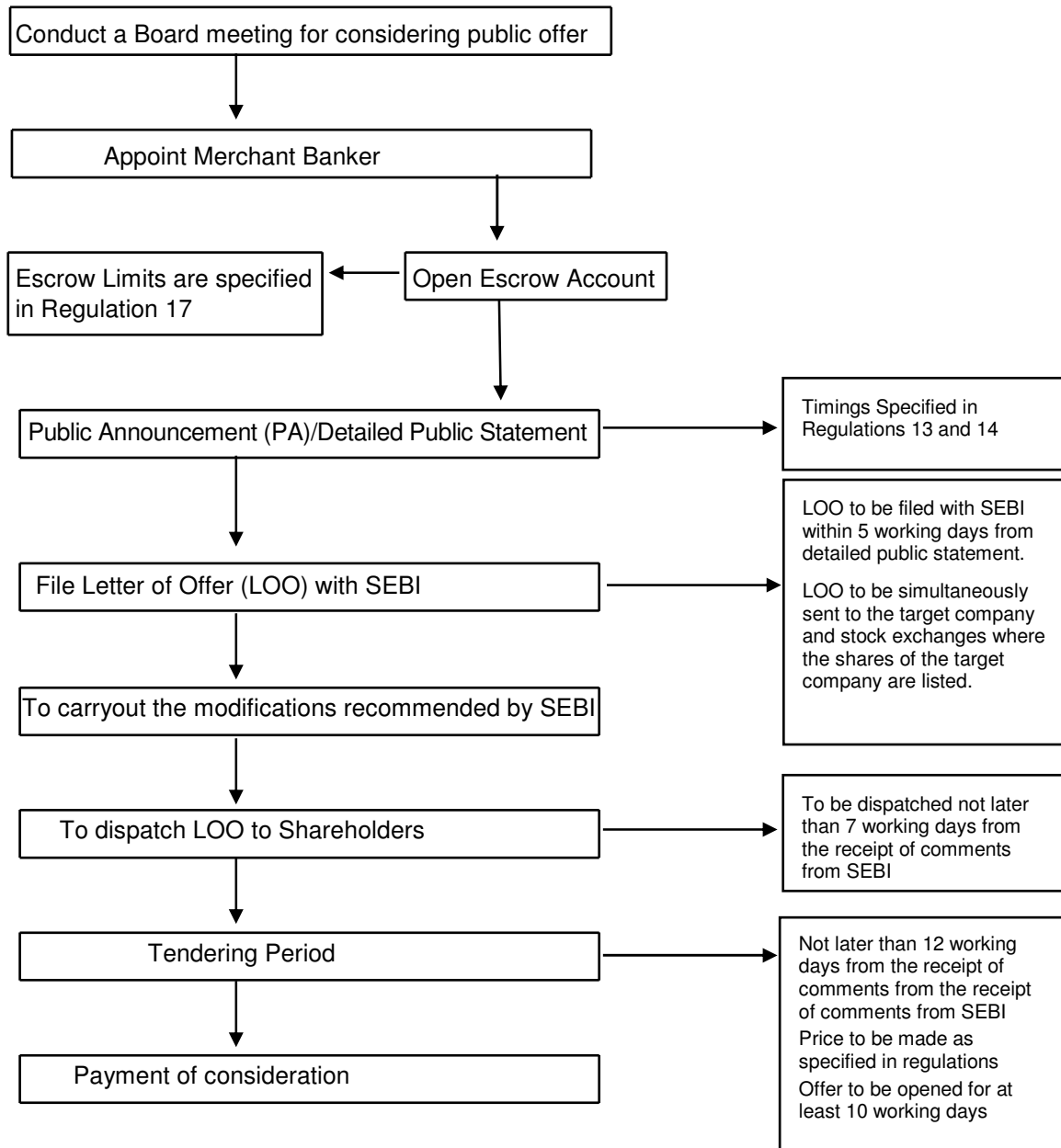
1. Board structure and composition
2. Board committees
3. Annual Report disclosures
4. Board Processes
5. Corporate social responsibilities

## TAKEOVERS DUE DILIGENCE

### Takeover process under SEBI (SAST) Regulation 2011 – An Overview

#### SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of the Listing Agreements with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The compliances under the regulations include event based/continual disclosures, open offer requirements including public announcement, escrow account, obligations of acquirer/target company/merchant banker, undertaking/authorization, offer price etc.



**Note:****Exception from the applicability**

The regulations shall not apply to direct and indirect acquisition of shares or voting rights in, or control over a company listed without making a public issue, on the institutional trading platform of a recognised stock exchange.

**CHECKLISTS ON TAKEOVERS**

Checklist for Compliances under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

1. Whether any acquisition/transfer has triggered open offer?
2. Ensure that a merchant banker of Category I has been appointed who is not an associate of or group of acquirer or the target company.
3. Ensure that an escrow account has been opened with the required deposit.
4. the consideration payable under the open offer shall be calculated at the offer price, assuming full acceptance of the open offer, and in the event the open offer is subject to differential pricing, shall be computed at the highest offer price, irrespective of manner of payment of the consideration (computed as per sub regulation (2) of regulation 16 )
5. A letter duly authorizing target company to realize the value of escrow account as specified in these regulations.
6. An undertaking from the target company that none of the Acquirer/Persons Acting in Concert have been prohibited by SEBI from dealing in securities, in terms of direction issued under Section 11B of SEBI Act.
7. An undertaking from the sellers, promoters, directors of the target company that they have not been prohibited by SEBI from dealing in securities, in terms if direction issued under section 11B of SEBI Act.
8. An undertaking from the target company that it has complied with the provisions of Listing Agreement, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.
9. An undertaking from the target company that it has complied with the provisions of these regulations, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.
10. A public announcement of an open offer to the shareholder of the target company has been given and detailed public statement has been published as per the prescribed timeline in case of Acquirer acquires the shares or voting rights of the target company in excess of the limits prescribed under Regulation 3 and 4 of these regulations.
11. The public announcement has been sent to all the stock exchanges on which the shares of the target company are listed, to SEBI and to the target company at its registered office within one working day of the date of the public announcement. The time within which the public announcement is required to be made to the Stock Exchanges under different circumstances is tabulated below. It is to be checked that following compliances have been made by the company.



12. A detailed public statement has been published by the acquirer through the Manager to the Open Offer within maximum 5 working days from the date of public announcement as provided in regulation 13(4).
13. In case of indirect acquisition where none of condition specified in regulation 5(2) are satisfied, the detailed public statement has been published not later than five working days of the completion of the primary acquisition of shares or voting rights in or control over the company or entity holding shares or voting rights in, or control over the target company.
14. The compliances relating to publication of public announcement and detailed public statement by the acquirer has been complied under regulation 14.
15. The public announcement contains the information as provided in regulation 15.
16. The acquirer through the manager to the offer has filed a draft letter of offer along with the fee as prescribed in regulation 16, with SEBI for its observations within 5 working days of publication Detailed Public Statement.
17. The offer price is not less than the price as calculated under regulation 8 for frequently or infrequently traded shares.
18. The minimum of 26% of voting capital of the company is being offered subject to minimum public holding requirements.
19. The acquirer has made complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange or transfer of securities, to all shareholders who have tendered shares in acceptance of the open offer, within ten working days of the expiry of the tendering period.
20. The unclaimed balances, if any, lying to the credit of the special escrow account at the end of seven years from the date of deposit thereof, has been transferred to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.
21. Ensure that:
  - (a) any person, who along with PACs crosses the threshold limit of 5% of shares or voting rights, has disclosed his aggregate shareholding and voting rights to the Target Company at its registered office and to every Stock Exchange where the shares of the Target Company are listed within 2 working days of acquisition as per the format specified by SEBI. (Regulation 29(1) read with Regulation 29(3))
  - (b) any person, who together with persons acting in concert with him, holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, has disclosed the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below five per cent, if there has been change in such holdings from the last disclosure made under sub-regulation (1) or under this sub regulation; and such change exceeds two per cent of total shareholding or voting rights in the target company, in such form as may be specified. (Regulation 29(2) read with Regulation 29(3))
22. Continual disclosures of aggregate shareholding has been made within 7 days of financial year ending on March 31 to the target company at its registered office and every stock exchange where the shares of the Target Company are listed by:
  - (a) Shareholders (along with PACs, if any) holding shares or voting rights entitling them to exercise

25% or more of the voting rights in the target company.

- (b) Promoter (along with PACs, if any) of the target company irrespective of their percentage of holding.

23. The promoter (along with PACs) of the target company has disclosed details of shares encumbered by them or any invocation or release of encumbrance of shares held by them to the target company at its registered office and every stock exchange where shares of the target company are listed, within 7 working days of such event.

#### A. Checklist for Acquirer

##### ***Preliminary Examination of a target company:***

The acquirer has to undertake a preliminary study on the target company, before taking any action for taking over a company. He may consider the following points.

It may be noted that this list is not an exhaustive checklist and it varies depends on size of the company nature of industry

- (a) Information has to be collected on Target Company and to be analysed on financial and legal angle.
- (b) Register of members to be examined to verify the profile of the shareholders.
- (c) Title of the target company with respect to immovable properties may be verified.
- (d) Financial statements of Target Company have to be examined.
- (e) Examination of Articles and Memorandum of Association of the Company.
- (f) Examination of charges created by the Company
- (g) Applicability of FEMA provisions if any relating to FDI has to be looked into.
- (h) Import and Export of technology if any
- (i) Business prospects etc.

***A merchant Banker of Category I have to be appointed.*** It has to be ensured that the merchant banker is not an associate of or group of acquirer or the target company

##### ***Escrow Account:***

- (1) (i) An escrow account has to be opened and the following sum has to be deposited.
- (ii) The escrow amount shall be calculated in the following manner, as specified in regulation 17,—

For consideration payable under the public offer,—

On the first 500 crores	25 per cent; of the consideration
On the balance consideration	An additional amount equal to 10% of balance consideration.

If, an open offer is made conditional upon minimum level of acceptance, hundred percent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, shall be deposited in cash in the escrow account.

(2) The consideration payable under the open offer shall be computed as provided for in sub-regulation (2) of regulation 16 and in the event of an upward revision of the offer price or of the offer size, the value of the escrow amount shall be computed on the revised consideration calculated at such revised offer price, and the additional amount shall be brought into the escrow account prior to effecting such revision.

(3) The escrow account referred to in sub-regulation (1) may be in the form of,—

- (a) cash deposited with any scheduled commercial bank;
- (b) bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or
- (c) deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin:

Provided that securities sought to be provided towards escrow account under clause (c) shall be required to conform to the requirements set out in sub-regulation (2) of regulation 9.

Regulation 9(2) specifies the following requirements.

- (a) such class of shares are listed on a stock exchange and frequently traded at the time of the public announcement;
- (b) such class of shares have been listed for a period of at least two years preceding the date of the public announcement;
- (c) the issuer of such class of shares has redressed at least ninety five per cent. of the complaints received from investors by the end of the calendar quarter immediately preceding the calendar month in which the public announcement is made;
- (d) the issuer of such class of shares has been in material compliance with the listing agreement for a period of at least two years immediately preceding the date of the public announcement:

Provided that in case where the Board is of the view that a company has not been materially compliant with the provisions of the listing agreement, the offer price shall be paid in cash only;

- (e) the impact of auditors' qualifications, if any, on the audited accounts of the issuer of such shares for three immediately preceding financial years does not exceed five per cent. of the net profit or loss after tax of such issuer for the respective years; and
- (f) the Board has not issued any direction against the issuer of such shares not to access the capital market or to issue fresh shares.

(4) In the event of the escrow account being created by way of a bank guarantee or by deposit of securities, the acquirer shall also ensure that at least one per cent of the total consideration payable is deposited in cash with a scheduled commercial bank as a part of the escrow account.

(5) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the acquirer shall while opening the account, empower the manager to the open offer to instruct the bank to issue a banker's cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account, in accordance with requirements under these regulations.

(6) For such part of the escrow account as is in the form of a bank guarantee, such bank guarantee shall be in favour of the manager to the open offer and shall be kept valid throughout the offer period and for an additional period of thirty days after completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer.

(7) For such part of the escrow account as is in the form of securities, the acquirer shall empower the manager to the open offer to realise the value of such escrow account by sale or otherwise, and in the event there is any shortfall in the amount required to be maintained in the escrow account, the manager to the open offer shall be liable to make good such shortfall.

(8) The manager to the open offer shall not release the escrow account until the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, save and except for transfer of funds to the special escrow account as required under regulation 21.

(9) In the event of non-fulfillment of obligations under these regulations by the acquirer the Board may direct the manager to the open offer to forfeit the escrow account or any amounts lying in the special escrow account, either in full or in part.

(10) The escrow account deposited with the bank in cash shall be released only in the following manner,—

- (a) the entire amount to the acquirer upon withdrawal of offer in terms of regulation 23 as certified by the manager to the open offer:

Provided that in the event the withdrawal is pursuant to clause (c) of sub-regulation (1) of regulation 23, the manager to the open offer shall release the escrow account upon receipt of confirmation of such release from the Board;

- (b) for transfer of an amount not exceeding ninety per cent of the escrow account, to the special escrow account in accordance with regulation 21;
- (c) to the acquirer, the balance of the escrow account after transfer of cash to the special escrow account, on the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer;
- (d) the entire amount to the acquirer upon the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, upon certification by the manager to the open offer, where the open offer is for exchange of shares or other secured instruments;
- (e) the entire amount to the manager to the open offer, in the event of forfeiture for non-fulfillment of any of the obligations under these regulations, for distribution in the following manner, after deduction of expenses, if any, of registered market intermediaries associated with the open offer,—
  - (i) one third of the escrow account to the target company;
  - (ii) one third of the escrow account to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009; and
  - (iii) one third of the escrow account to be distributed pro-rata among the shareholders who have accepted the open offer.

***Undertakings/Authorisation:***

Ensure to obtain following undertakings/authorization.

1. A letter duly authorizing Target Company to realize the value of escrow account in terms of Takeover Regulations.
2. An undertaking to Target Company that none of the Acquirer/Persons Acting in Concert have been

prohibited by SEBI from dealing in securities, in terms of direction issued under Section 11B of SEBI Act.

3. An undertaking from the sellers, promoters, directors of the Target Company that they have not been prohibited by SEBI from dealing in securities, in terms of direction issued under Section 11B of SEBI Act.
4. An undertaking from the Target Company that it has complied with the provisions of Listing Agreement, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.

### **Public announcement (PA):**

#### **1. Public announcement.**

SEBI (SAST) Regulation, 2011 provides that whenever Acquirer acquires the shares or voting rights of the Target Company in excess of the limits prescribed under Regulation 3 and 4, than Acquirer is required to give a Public Announcement of an Open Offer to the shareholder of the Target Company. During the process of making the Public Announcement of an Open Offer, the Acquirer is required to give Public Announcement and publish Detailed Public Statement. The regulations have prescribed the separate timeline for Public Announcement as well as for Detailed Public Statement.

- (i) Public Announcement
- (ii) Detailed Public Statement

No person who is a wilful defaulter shall make a public announcement of an open offer for acquiring shares or enter into any transaction that would attract the obligation to make a public announcement of an open offer for acquiring shares under SEBI (SAST) Regulations, 2011. However, this shall not prohibit the wilful defaulter from making a competing offer in accordance with Regulation 20 upon any other person making an open offer for acquiring shares of the target company.

As per SEBI (SAST) Regulations, 2011, wilful defaulter means any person who is categorized as a wilful defaulter by any bank or financial institution or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India and includes any person whose director, promoter or partner is categorized as such.

#### **Timing of Public Announcement**

The Public Announcement shall be sent to all the stock exchanges on which the shares of the target company are listed. Further, a copy of the same shall also be sent to the Board and to the target company at its registered office within one working day of the date of the public announcement. The time within which the Public Announcement is required to be made to the Stock Exchanges under different circumstances is tabulated below:

<b>Applicable Regulation</b>	<b>Particulars</b>	<b>Time of making Public Announcement to Stock Exchange</b>
13(1)	Agreement to Acquire Shares or Voting Rights or Control Over The Target Company	On the same day of entering into agreement to acquire share, voting rights or control over the Target Company.
13(2)(a)	Market Purchase of shares	Prior to the placement of purchase order with the stock broker.

13(2)(b)	Acquisition pursuant to conversion of Convertible Securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares	On the same day when the option to convert such securities into shares is exercised.
13(2)(c)	Acquiring shares or voting rights or control pursuant to conversion of Convertible Securities with a fixed date of conversion	On the second working day preceding the scheduled date of conversion of such securities into shares.
13(2)(d)	In case of disinvestment	On the date of execution of agreement for acquisition of shares or voting rights or control over the Target Company.
13(2)(e)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are not met	Within four working days of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(f)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are met	On the same day of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(g)	Acquisition of shares, voting rights or control over the Target Company pursuant to Preferential Issue	On the date on which the board of directors of the target company authorizes such preferential issue.
13(2)(h)	Increase in voting rights pursuant to a buy-back not qualifying for exemption under Regulation 10	Not later than 90th day from the date of closure of the buyback offer by the target company.
13(2)(i)	Acquisition of shares, voting rights or control over the Target Company where the such acquisition is beyond the control of acquirer	Not later than two working days from the date of receipt of such intimation.

13(3)	Voluntary Offer	On the same day when the Acquirer decides to make Voluntary Offer.
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### Timing of Detailed Public Statement

In terms of Regulation 13(4) of SEBI (SAST) Regulations, 2011, a Detailed Public Statement shall be published by the acquirer through the Manager to the Open Offer within maximum 5 working days from the date of Public Announcement.

However in case of Indirect Acquisition where none of condition specified in Regulation 5(2) are satisfied, the Detailed Public Statement shall be published not later than five working days of the completion of the primary acquisition of shares or voting rights in or control over the company or entity holding shares or voting rights in, or control over the target company.

### Publication of Public Announcement and Detailed Public Statement

Regulation 14 of SEBI (SAST) Regulation, 2011 provides the requirements relating to publication of Public Announcement and Detailed Public Statement which are tabulated below:

<b>Regulation</b>	<b>Particulars</b>	<b>Time</b>	<b>To whom</b>
14(1)	Public Announcement	On the same day	All the stock exchanges on which the shares of the target company are listed.  The stock exchanges shall forthwith disseminate such information to the public.
14(2)	Public Announcement	One working day of the date of the public announcement	Board and to the target company at its registered office
14(3)	Detailed Public Statement	5 working days from the date of Public Announcement.	Publication in the following newspaper: (a) One Hindi national language daily with wide circulation (b) One English national language daily with wide circulation (c) One regional national language daily with wide circulation language at a place where registered office of the company is situated. (d) One regional language daily with wide circulation at the place of the stock exchange where the

			maximum volume of trading in the shares of the target company is recorded during the sixty trading days preceding the date of the public announcement.
14(4)	Detailed Public Statement	Simultaneously with publication of such detailed public statement in the newspapers.	A copy of 'Detailed Public Statement shall be sent to followings: (a) Board (b) All the stock exchanges in which the shares of the target company are listed (c) The target company at its registered office

### Contents of Public announcement (Regulation 15)

The public announcement shall contain such information as may be specified, including the following,—

- (a) name and identity of the acquirer and persons acting in concert with him;
- (b) name and identity of the sellers, if any;
- (c) nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;
- (d) the consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;
- (e) the offer price, and mode of payment of consideration; and
- (f) offer size, and conditions as to minimum level of acceptances, if any.

(2) The detailed public statement pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.

(3) The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations shall not omit any relevant information, or contain any misleading information.

### Filing Draft Letter of offer (Regulation 16)

Within 5 working days of publication Detailed Public Statement, the acquirer through the manager to the offer is required to file a draft letter of offer with SEBI for its observations.

The Board shall give its comments on the draft letter of offer as expeditiously as possible but not later than fifteen working days of the receipt of the draft letter of offer and in the event of no comments being issued by the Board within such period, it shall be deemed that the Board does not have comments to offer:

Provided that in the event the Board has sought clarifications or additional information from the manager to the open offer, the period for issuance of comments shall be extended to the fifth working day from the date



of receipt of satisfactory reply to the clarification or additional information sought.

Provided further that in the event the Board specifies any changes, the manager to the open offer and the acquirer shall carry out such changes in the letter of offer before it is dispatched to the shareholders.

### **Offer price**

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

If the target company's shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- Volume weighted average market price for sixty trading days preceding the PA.

If the target company's shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples, and such other parameters that are customary for valuation of shares of such companies.

It may be noted that the Board may at the expense of the acquirer, require valuation of shares by an independent merchant banker other than the manager to the offer or any independent chartered accountant in practice having a minimum experience of 10 years.

The shares of the target company will be deemed to be frequently traded if the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month, in which the PA is made, is at least 10% of the total number of shares of the target company. If the said turnover is less than 10%, it will be deemed to be infrequently traded.

### **Minimum size:**

It has to be ensured that minimum of 26% of voting capital of the company is being offered subject to minimum public holding requirements.

### **Date of opening of offer:**

The date of opening of offer has to be not later than the 12 working days from the date of receipt of recommendation from SEBI.

#### **Period of offer:**

The offer to acquire should remain open for a period of minimum 10 days.

#### **Competitive Bid and Revision:**

Ensure to revise the offer price in consultation with merchant bankers in case of competitive bid if any.

#### **Payment of consideration (Regulation 21)**

For the amount of consideration payable in cash, the acquirer shall open a special escrow account with a banker to an issue registered with the Board and deposit therein, such sum as would, together with cash transferred under clause (b) of sub-regulation (10) of regulation 17, make up the entire sum due and payable to the shareholders as consideration payable under the open offer, and empower the manager to the offer to operate the special escrow account on behalf of the acquirer for the purposes under these regulations.

(2) Subject to provisos to sub-regulation (11) of regulation 18, the acquirer shall complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange or transfer of securities, to all shareholders who have tendered shares in acceptance of the open offer, within ten working days of the expiry of the tendering period.

(3) Unclaimed balances, if any, lying to the credit of the special escrow account referred to in sub-regulation (1) at the end of seven years from the date of deposit thereof, shall be transferred to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.

#### **Completion of acquisition (Regulation 22)**

The acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period:

**Provided** that in case of an offer made under sub-regulation (1) of regulation 20, pursuant to a preferential allotment, the offer shall be completed within the period as provided under sub-regulation (1) of regulation 74 of Securities and Exchange Board of India (Issue of Capital and Disclosure) Regulations, 2009.

**Provided further** that in case of a delisting offer made under regulation 5A, the acquirer shall complete the acquisition of shares attracting the obligation to make an offer for acquiring shares in terms of regulations 3, 4 or 5, only after making the public announcement regarding the success of the delisting proposal made in terms of sub-regulation (1) regulation 18 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009.

(2) Notwithstanding anything contained in sub-regulation (1), subject to the acquirer depositing in the escrow account under regulation 17, cash of an amount equal to one hundred per cent of the consideration payable under the open offer assuming full acceptance of the open offer, the parties to such agreement may after the expiry of twenty-one working days from the date of detailed public statement, act upon the agreement and the acquirer may complete the acquisition of shares or voting rights in, or control over the target company as contemplated.

(2A) Notwithstanding anything contained in sub-regulation (1), an acquirer may acquire shares of the target company through preferential issue or through the stock exchange settlement process, other than through bulk deals or block deals, subject to , -

- (i) such shares being kept in an escrow account,
- (ii) the acquirer not exercising any voting rights over such shares kept in the escrow account:

Provided that such shares may be transferred to the account of the acquirer, subject to the acquirer complying with requirements specified in sub-regulation (2).

(3) The acquirer shall complete the acquisitions contracted under any agreement attracting the obligation to make an open offer not later than twenty-six weeks from the expiry of the offer period:

**Provided** that in the event of any extraordinary and supervening circumstances rendering it impossible to complete such acquisition within such period, the Board may for reasons to be published, may grant an extension of time by such period as it may deem fit in the interests of investors in securities and the securities market.

#### **Withdrawal of open offer (Regulation 23)**

23.(1) An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances,—

- (a) statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer;
- (b) the acquirer, being a natural person, has died;
- (c) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or
- (d) such circumstances as in the opinion of the Board, merit withdrawal.

*Explanation.*— For the purposes of clause (d) of sub-regulation (1), the Board shall pass a reasoned order permitting withdrawal, and such order shall be hosted by the Board on its official website.

Provided that an acquirer shall not withdraw an open offer pursuant to a public announcement made under clause (g) of sub-regulation (2) of regulation 13, even if the proposed acquisition through the preferential issue is not successful.

(2) In the event of withdrawal of the open offer, the acquirer shall through the manager to the open offer, within two working days,—

- (a) make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer; and
- (b) simultaneously with the announcement, inform in writing to,—
  - (i) the Board;

- (ii) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public; and
- (iii) the target company at its registered office.

#### **Directors of the target company (Regulation 24)**

(1) During the offer period, no person representing the acquirer or any person acting in concert with him shall be appointed as director on the board of directors of the target company, whether as an additional director or in a casual vacancy:

Provided that after an initial period of fifteen working days from the date of detailed public statement, appointment of persons representing the acquirer or persons acting in concert with him on the board of directors may be effected in the event the acquirer deposits in cash in the escrow account referred to in regulation 17, one hundred per cent of the consideration payable under the open offer:

Provided further that where the acquirer has specified conditions to which the open offer is subject in terms of clause (c) of sub-regulation (1) of regulation 23, no director representing the acquirer may be appointed to the board of directors of the target company during the offer period unless the acquirer has waived or attained such conditions and complies with the requirement of depositing cash in the escrow account.

(2) Where an open offer is made conditional upon minimum level of acceptances, the acquirer and persons acting in concert shall, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to regulation 17, not be entitled to appoint any director representing the acquirer or any person acting in concert with him on the board of directors of the target company during the offer period.

(3) During the pendency of competing offers, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to in regulation 17, by any acquirer or person acting in concert with him, there shall be no induction of any new director to the board of directors of the target company:

Provided that in the event of death or incapacitation of any director, the vacancy arising therefrom may be filled by any person subject to approval of such appointment by shareholders of the target company by way of a postal ballot.

(4) In the event the acquirer or any person acting in concert is already represented by a director on the board of the target company, such director shall participate in any deliberations of the board of directors of the target company or vote on any matter in relation to the open offer.

#### **Obligation of Target Company (Regulation 26)**

Once a Public Announcement is made, the board of directors of the Target Company is expected to ensure that the business of the target company is conducted in the ordinary course. Alienation of material assets, material borrowings, issue of any authorized securities, announcement of a buyback offer etc. is not permitted, unless authorized by shareholders by way of a special resolution by postal ballot.

- The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders and a list of persons whose applications, if any, for registration of transfer of shares, in case of physical shares, are pending with the target company.
- After closure of the open offer, the target company is required to provide assistance to the acquirer in verification of the shares tendered for acceptance under the open offer, in case of

physical shares.

- Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations and such committee shall be entitled to seek external professional advice at the expense of the target company. The recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer. The recommendation will also be sent to SEBI, Stock Exchanges and the Manager to the offer.

#### **Obligations of the Acquirer (Regulation 25)**

(1) Prior to making the public announcement of an open offer for acquiring shares under these regulations, the acquirer shall ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

(2) In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company or of any of its subsidiaries whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period:

Provided that in the event the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall inter alia contain reasons as to why such alienation is necessary.

(3) The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.

(4) The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.

(5) The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under these regulations

#### **Obligations of the manager to the open offer (Regulation 27)**

(1) Prior to public announcement being made, the manager to the open offer shall ensure that,—

- (a) the acquirer is able to implement the open offer; and
- (b) firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

(2) The manager to the open offer shall ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post offer advertisement are true, fair and adequate in all material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under these regulations.

- (3) The manager to the open offer shall furnish to the Board a due diligence certificate along with the draft letter of offer filed under Regulation 16.
- (4) The manager to the open offer shall ensure that market intermediaries engaged for the purposes of the open offer are registered with the Board.
- (5) The manager to the open offer shall exercise diligence, care and professional judgment to ensure compliance with these regulations.
- (6) The manager to the open offer shall not deal on his own account in the shares of the target company during the offer period.
- (7) The manager to the open offer shall file a report with the Board within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements.

**Consequences of Violation of obligations SEBI (SAST) Regulations, 2011 (Regulation 32)**

SAST Regulations, 2011 have laid down the general obligations of acquirer, Target Company and the manager to the open offer. For failure to carry out these obligations as well as for failure / non-compliance of other provisions of these Regulations, penalties have been laid down there under. These consequences include:

- directing the divestment of shares acquired;
- directing the transfer of the shares / proceeds of a directed sale of shares to the investor protection fund;
- directing the target company / any depository not to give effect to any transfer of shares;
- directing the acquirer not to exercise any voting or other rights attached to shares acquired;
- debarring person(s) from accessing the capital market or dealing in securities;
- directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
- directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;
- directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;
- directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the open offer consideration;
- directing the acquirer to pay interest of for delayed payment of the open offer consideration;
- directing any person to cease and desist from exercising control acquired over any target company;
- directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

## LESSON ROUND UP

- M&A Due Diligence involves preparation stage, Pre diligence, diligence, negotiations, post diligence.
- Due diligence impacts valuation in Mergers
- Business, legal, financial, HR/Cultural and corporate governance aspects are analysed in M&A due diligence process.
- Data room management is an important function in due diligence process.
- Data security is crucial in data room management.
- Many mergers and acquisitions fail due to cultural mismatch.
- SEBI (SAST) Regulations, 2011 regulate takeovers covering open offer requirements, disclosure mandates etc.

## SELF TEST QUESTIONS

1. What are the stages of M&A due diligence?
2. Prepare a check list for M&A due diligence
3. How does due diligence impact valuations?
4. Describe corporate governance due diligence?
5. How HR/Cultural issues are addressed in mergers?
6. What is the process involved in takeover?

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# Lesson 7

## Competition Law Due Diligence

### LESSON OUTLINE

- Introduction
- Competition Act, 2002- An overview
- Need to comply with competition law
- Due diligence of competition law relating to:
  - various agreements (both existing and proposed)
  - dominance and its likely abuse if any, (existing)
  - Combinations (i.e. effect of proposed mergers & Acquisition)
- Competition Compliance Programme

### LEARNING OBJECTIVES

Ensuring compliance with competition law, rules etc. is crucial, during strategic business decisions, as the consequences of non-compliance may be serious for concerned companies in terms of investigation by Competition Commission of India (CCI), hefty financial penalties, agreements being unenforceable and void, adverse publicity, damages, possibility of being sued for damages by those harmed by unlawful behaviour and what not.

Due diligence of competition law involves examination of the current/proposed operations and practices of an enterprise to determine the extent of its compliance with the competition law and to identify potential risks and liabilities, and assessment of the adherence to and effectiveness of the company's competition law compliance programme. This process includes examination of business/trade agreements, analysis of proposed mergers/combination, check into the dominance of an organization so that the same is not abused etc.,

After reading this chapter you will be able to understand the broad aspects of due diligence relating to competition law including anti-competitive agreement, abuse of dominance, regulation of combinations, and the relevant checklists, importance of competition compliance programme etc.



## I. INTRODUCTION

In the light of international economic development, there was a need felt to shift the focus from curbing monopolies to promoting competition. Further, in the wake of economic reforms in 1991 in tune with international environment, a high level committee on competition law and policy was constituted under the chairmanship of Shri S.V.S. Raghavan to examine the provisions of MRTP Act, and to propose modern competition law in view of liberalization of economy. The Committee brought out its report on 22<sup>nd</sup> May, 2000 and the Central Government after a detailed consultative process with Chamber of Commerce, trade associations, professional bodies and general public, enacted the Competition Act, 2002 which received the president's assent on January 13, 2003.

The Competition Act seeks to ensure fair competition by providing for

- (a) Prohibition of Anti-Competitive Agreements;
- (b) Prohibition of Abuse of Dominance;
- (c) Regulation of combinations, acquisitions, mergers etc;
- (d) Competition Advocacy.

To fulfill the objectives of the Act, government established Competition Commission of India with effect from October 14, 2003. This has replaced the MRTP Commission, which has been dissolved with effect from October 14, 2009.

### Need for compliance of Competition Law

The basic purpose of the competition law is to ensure that markets remain competitive, to the benefit of both business and consumers. The compliance by the market participants of competition law, rules and directions issued by competition authorities, is a precondition in achieving the purpose of law.

### Why Comply?

Business community needs to be fully aware that while anti competitive business practices may bring about short-term profits to individual corporations, in the long run they in fact become less competitive. Genuine business competitiveness is demonstrated through fierce competition in individual markets, and only competitiveness that survives market competition can sustain itself in the long term.

All businesses have a duty to act lawfully, but there are more practical reasons why compliance with competition law is particularly important. On a broad level, the main aim of competition law is to ensure that markets remain competitive. Compliance ensures that this aim is achieved to the benefit of both business and consumers. At an individual level, businesses that comply with the law could avoid the various consequences of non-compliance.

Further, compliance with competition law is more than just good corporate governance, as it reduces the risk of the company being subject to an investigation by the Competition authorities. In the event of violation of competition law, business can face significant financial penalties, third party actions and loss of reputation and goodwill.

In an era of global competition, voluntary compliance with competition law is becoming a global standard led

by the world's most prominent international corporations. This is due to the growing recognition that breach of competition law brings about managerial burdens rather than market benefits to individual companies. Corporations are thus obliged to firmly build up a business philosophy of abiding by established rules of fair market competition. In recognition of these facts, it becomes essential that all companies strive for voluntary observance of fair market discipline, and in the process help lay a cornerstone for a mature culture of corporate compliance.

## COMPETITION ACT, 2002 – A BIRD'S EYE VIEW

### Anti-competitive agreements (Section 3)

#### What are Anti Competitive Agreements?

These are agreements between enterprises or association of enterprises in respect of production, supply, distribution, storage, acquisition or control of goods or provisions of services, which cause or likely to cause an appreciable adverse effect on competition within India.

#### How to determine appreciable adverse effect?

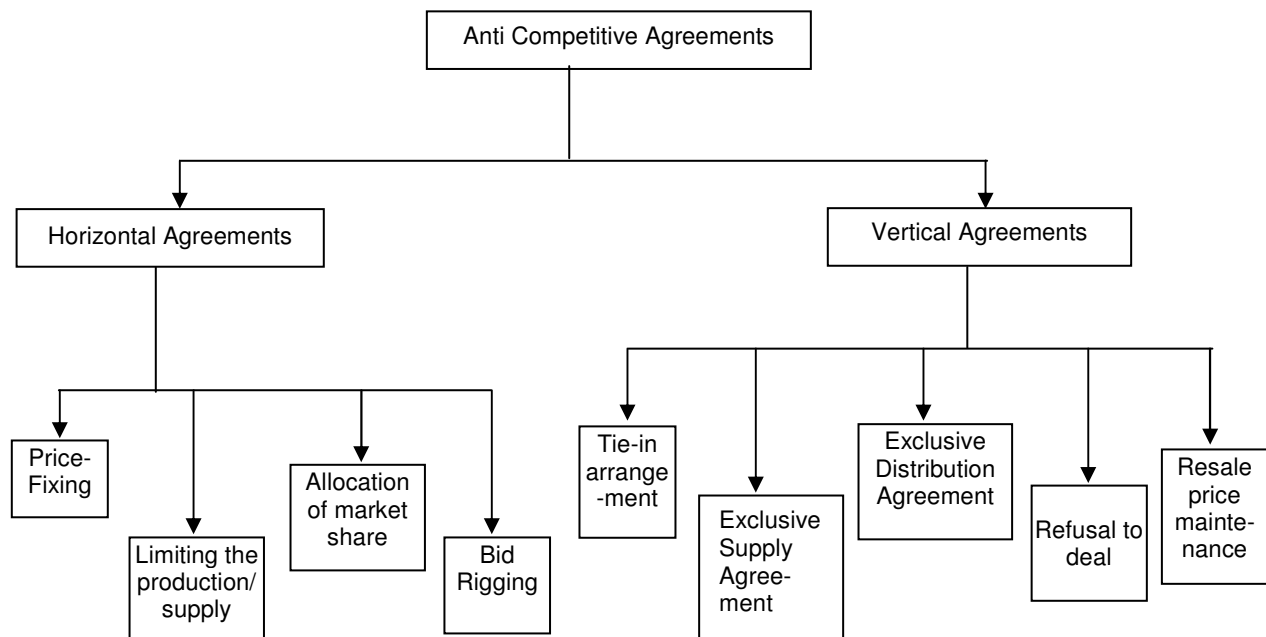
The Commission has been put under obligation, while determining whether an agreement has an appreciable adverse effect on competition under section 3, to have due regard to all or any of the following factors, namely:—

- (a) creation of barriers to new entrants in the market;
- (b) driving existing competitors out of the market;
- (c) foreclosure of competition by hindering entry into the market;
- (d) accrual of benefits to consumers
- (e) improvements in production or distribution of goods or provision of services;
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

#### What is an Enterprise?

"Enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

## Anti Competitive Agreements are void Section 3(2)



### Horizontal Agreements [Section 3(3)]

#### Price Fixing (Section 3(3)(a))

Price fixing occurs when two or more firms agree to raise or fix the prices in order to increase their profits by reducing competition. It is an attempt at forming a collective monopoly.

#### Limiting the Production or supply [Section 3(3)(b)]

The object of these agreements or arrangements is to eliminate the competition by limiting the quantity.

#### Allocation of Market Share [Section 3(3)(c)]

It means agreement among enterprises that will have exclusive or preferential rights in a designated area for sale, production or provision of services or otherwise.

#### Bid Rigging (Section [3(3)(d)]

An agreement, between enterprises or persons engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding. Bid rigging is a particular form of collusive price-fixing behaviour by which firms coordinate their bids.

### Vertical Agreements [Section 3(4)]

These are agreement between enterprises that are at different stages or levels of production chain and therefore in different markets. These agreements are not considered anti-competitive per se as in the case of horizontal agreements and have to be judged by the rule of reason.

#### Tie in arrangement [Section 3(4)(a)]

It an agreement requiring a purchaser of goods as a condition of such purchase, to purchase some other goods.

**Exclusive Supply agreement (Section 3(4)(b))**

Exclusive supply agreement or exclusive dealings means an arrangement or practice whereby a manufacturer or supplier requires his dealers to deal exclusively in his products and not in the products of his competitors.

**Exclusive Distribution Agreement (Section 3(4)(c))**

Exclusive distribution agreement or exclusive territory includes agreement between enterprises that will have exclusive or preferential rights in a designated area for sales production, performance of services.

**Refusal to Deal (Section 3(4)(d))**

The practice of restricting persons or class of persons to whom the goods are sold or from whom the goods are bought.

**Resale price Maintenance (Section 3(4)(e))**

It is a situation in which the supplier forces the distributor/retail seller to sell the good to the customer at prices stipulated by the supplier.

**Case Studies on Anti-Competitive Agreement****Case Studies- I**

**Competition Commission of India (CCI) finds cement companies guilty of anti-competitive agreements-cartelization, collusive price, dispatch and supplies parallelism, creating artificial scarcity by limiting output to raise prices**

**Facts**

Information was filed under section 19 of the Competition Act, 2002 by the Builders' Association of India ('the informant') against the Cement Manufacturers' Association (CMA) 11 cement manufacturing companies for alleged violation of section 3 (Anti-competitive agreements) and section 4 (Abuse of dominant position) of the Competition Act, 2002.

**Held**

- Mere examination of data belonging to period prior to 20-5-2009 cannot be construed to mean that provisions of the Act have been applied retrospectively. Moreover, if the effects of an act/conduct, prior to 20-5-2009 continue post notification of the date of coming into force of provisions relating to anti-competitive agreements, the CCI has the necessary jurisdiction to look into such conduct.
- Section 3(3)(a) deals with any agreement which directly or indirectly determines the purchase or sale prices, section 3(3)(b) deals with any agreement which limits or controls production, supply, markets, technical development, investment or provision of services.
- The word 'agreement' used in section 3(3) has been defined in section 2(b). The definition is inclusive and inter-alia includes any arrangement, understanding or action in concert irrespective of whether it is written/formal or otherwise or intended to be legally enforceable. Thus, there is no need for an explicit agreement. The same can be inferred from the intention or conduct of the parties.
- Parties to an anti-competitive agreement will not come out in open and reveal their identity to be punished by the competition agencies. This is also the reason why the legislature in its wisdom has made the definition

of 'agreement' wide and inclusive and not restricted it to a documented written agreement between parties.

- In cases of conspiracy or existence of any anti-competitive agreement, proof of formal agreement may not be available and may be established by circumstantial evidence alone.
- In addition to the exchange of information on prices and production using CMA as platform, there were other 'plus' or 'facilitating' factors over and above the existence of price parallelism which indicated collusive behaviour among the cement companies. One of the 'plus' factors that suggested a concerted action among the cement companies is the finding by the Director General (DG) as regards the overall low capacity utilisation and lower supply of cement. The overall capacity utilisation of cement companies dropped from 83% in 2009-10 to 73% during 2011-12. The companies were not able to substantiate their low capacity utilisation even during the period as per their version.
- The act of these Cement Companies in limiting and controlling supplies in the market and determining prices through an anti-competitive agreement is not only detrimental to the cause of the consumers but also to the whole economy since cement is a crucial input in construction and infrastructure industry vital for economic development of the country.
- The Cement Manufacturers were directed to deposit the penalty of ₹6,300 crores (Approx) within 90 days. They were also directed to 'cease and desist' from indulging in any activity relating to agreement, understanding or arrangement on prices, production and supply of cement in the market.
- CMA was directed to disengage and disassociate itself from collecting wholesale and retail prices through the member cement companies and also from circulating the details on production and dispatches of cement companies to its members.
- Aggrieved by CCI's orders, the Respondents appealed before the Competition Appellate Tribunal ("COMPAT"), on the grounds of violation of principles of natural justice.
- COMPAT noted that thorough consideration was not given to the report of the Director General ("DG"), parties' submissions and interlocutory orders. COMPAT observed that procedural defect in nature of non-observance of principles of natural justice cannot be cured in appeal, because if natural justice is violated in the first stage, the same cannot be given as true right in an appeal.
- Accordingly, the COMPAT set aside the impugned orders and remitted the matter to the CCI for fresh adjudication of the issues relating to the alleged violation of Section 3(3)(a) and 3(3)(b) read with Section 3(1) of the Act.
- CCI pursuant to the directions issued by COMPAT, has imposed penalties of Rs. 1147.59 crores (ACC), Rs. 1163.91 crores (ACL), Rs. 167.32 crores (Binani), Rs. 274.02 crores (Century), Rs. 187.48 crores (India Cements), Rs. 128.54 crores (J K Cements), Rs. 490.01 crores (Lafarge), Rs. 258.63 crores (Ramco), Rs. 1175.49 crores (UltraTech) and Rs. 1323.60 crores (Jaiprakash Associates Limited) have been imposed by CCI. In addition, a penalty of Rs. 0.73 crore has also been imposed on CMA. While imposing penalties, the Commission noted the action of the cement companies and CMA as being not only detrimental to the interests of consumers but also as detrimental to the whole economy, as cement is a critical input in construction and infrastructure industry – and thus vital for the economic development of the country. CCI has also imposed a penalty of Rs. 397.51 crore upon Shree Cement Limited vide a separate order.

**Case Study- II**

The Competition Commission of India imposed a penalty on public sector insurance companies - National Insurance Co. Ltd, New India Assurance Co. Ltd, Oriental Insurance Co. Ltd and United India Insurance Co. Ltd at the rate of 2% of their average turnover of the last three financial years based on the financial statements filed by them for the impugned conduct in contravention of the provisions of section 3(1) read with section 3(3)(d) of the Act by engaging in Anti-Competitive practices and bid rigging in public procurement for social welfare schemes.

**Facts:**

The case was taken up by the Commission *suo moto* pursuant to an anonymous information alleging cartelization by four public sector insurance companies in relation to a tender issued by the Government of Kerala for the implementation of RSBY (Rashtriya Swasthya Bima Yojna) and CHIS (Comprehensive Health Insurance Scheme) schemes.

A copy of the minutes of the ICCC meeting dated 07.12.2009 attended by the company officials of the above-named public sector insurance companies was enclosed with the anonymous information. These minutes reveal that the 'winner' of said tender was pre-decided by the public sector insurance companies. The Commission directed the DG to conduct an investigation into the allegations. The DG conducted a detailed investigation and found cartelization by these companies during the periods between 2010-11 and 2012-13.

**Held:**

The Commission directed these public sector insurance companies to cease and desist from indulging in the practices which have been found to be anti-competitive under the provisions of section 3(1) read with section 3(3)(d) of the Act.

The Commission imposed a sum of Rs. 162.80 crore on OP- 1, Rs. 251.07 crore on OP-2, Rs. 100.56 crore on OP-3 and Rs. 156.62 crore on OP-4 as penalties for the impugned conduct in contravention of the provisions of section 3(1) read with section 3(3)(d) of the Act and ordered them to deposit the penalty amount within 60 days of receipt of the order.

**Abuse of Dominance (Section 4)**

As regards Competition Act, 2002, the following points are significant to understand the concept of 'Abuse of Dominance'

**1. What is Dominance?**

Explanation to Section 4(2) of the Competition Act, 2002 defines dominant position (dominance) in terms of a position of strength enjoyed by an enterprise, in the relevant market in India, which enables it to:

- (a) operate independently of the competitive forces prevailing in the relevant market; or
- (b) affect its competitors or consumers or the relevant market in its favour.

**2. What is relevant market?**

The definition of the term 'Dominant Position' contains the term 'Relevant Market' which is very significant to identify whether an enterprise is in a dominant position or not.

The Competition Act, 2002 defines the term 'Relevant Market' also.

**"relevant market"** means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;

**"relevant geographic market"** means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas;

**"relevant product market"** means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use;

### **Dominance as such is not bad**

Dominance of market as such is not bad under Competition Act, but its' abuse is prohibited under the Act.

The Act gives an exhaustive list of practices that constitute abuse of dominant position and, therefore, are prohibited. Such practices shall constitute abuse only when adopted by an enterprise enjoying dominant position in the relevant market in India.

### **When Dominance gets abused?**

Abuse of dominance is judged in terms of the specified types of acts committed by a dominant enterprise alone or in concert. Such acts are prohibited under the law. Section 4 (2) of the Act specifies the following practices by a dominant enterprises or group of enterprises as abuse of dominant position:

- directly or indirectly imposing unfair or discriminatory condition in purchase or sale of goods or service;
- directly or indirectly imposing unfair or discriminatory price in purchase or sale (including predatory price) of goods or service;
- limiting or restricting production of goods or provision of services or market;
- limiting or restricting technical or scientific development to the prejudice of consumers;
- denying market access in any manner;
- making conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts;
- Using its dominant position in one relevant market to enter into, or protect, other relevant market.

The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under section 4, have due regard to all or any of the following factors, namely:—

- (a) market share of the enterprise;
- (b) size and resources of the enterprise;
- (c) size and importance of the competitors;
- (d) economic power of the enterprise including commercial advantages over competitors;
- (e) vertical integration of the enterprises or sale or service network of such enterprises;
- (f) dependence of consumers on the enterprise;

- (g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
- (h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
- (i) countervailing buying power;
- (j) market structure and size of market;
- (k) social obligations and social costs;
- (l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;
- (m) Any other factor which the Commission may consider relevant for the inquiry.

### **A Case Study - Intel**

The European Commission imposed a fine of €1.06 Billion on Intel Corporation for violating EC Treaty antitrust rules on the abuse of a dominant market position by engaging in anti-competitive practices and for excluding competitors from the market for computer chips called x86 central processing units (CPUs).

#### **Facts of the case**

Throughout the period October 2002-December 2007, Intel had a dominant position in the worldwide x86 CPU market (at least 70% market share).

The Commission found that Intel engaged in two specific forms of illegal practice.

- First, Intel gave wholly or partially hidden rebates to computer manufacturers on condition that they bought all, or almost all, their x86 CPUs from Intel. Intel also made direct payments to a major retailer on condition to stock only computers with Intel x86 CPUs. Such rebates and payments effectively prevented customers - and ultimately consumers - from choosing alternative products.
- Second, Intel made direct payments to computer manufacturers to halt or delay the launch of specific products containing competitors' x86 CPUs and to limit the sales channels available to these products.

The Commission found that these practices constituted abuse by Intel of its' dominant position on the x86 CPU market that harmed consumers throughout the European Economic Area. By undermining its competitors' ability to compete on the merits of their products, Intel's actions undermined competition and innovation.

The Commission has also ordered Intel to cease ongoing abusive practices immediately.

#### **A brief Analysis of Intel case under Competition Act, 2002**

- In the above mentioned case the relevant market is 'Relevant Product Market', and to be more specific, 'Computer Chip Market'
- The dominance is abused on the grounds of 'Denial of Market Access' which is listed as one of the grounds of abuse of dominance, under Section 4(2)(c) of Competition Act, 2002



**A Case Study - DLF****Facts:**

DLF launched a Group Housing Complex (The Belaire) in Gurgaon, planned to construct 5 multistoried residential buildings. The informant filed an instant case under Section 19(1) (a) of the Competition Act, 2002 and alleged that DLF, by abusing its dominant position, imposed highly arbitrary, unfair and unreasonable conditions on the informant through its agreements. As a matter of fact, the rights of the informant in this agreement were affected by the DLF.

The Informant further, alleged that the various clauses of the house agreement had imposed unilateral and one sided clauses and the action of DLF pursuant thereto was prima facie unfair and discriminatory, thus attracting the provisions of Section 4 (2) (a) of the Act.

The CCI asked Director General (DG) to investigate the allegations on DLF, as a dominant player in market and whether there exist a relevant market. The DG's investigation report observed that allegations made by the informant were true and the Act was applicable in this respective case. It was observed that DLF in exercise of its market power and dominance violated the Section 19 (4) and also has imposed unfair conditions of sale to consumers, which violated Section 4(2) (a) (i) of the Act.

**Held:**

CCI held that DLF has contravened the Section 4 (2) (a) (i) and (ii), directly and indirectly, imposing unfair or discriminatory conditions in the sale of services. CCI found DLF guilty of abusing its dominant position in the market and imposed a penalty of Rs. 630 crores on DLF. The CCI further directed DLF to cease and desist from formulating and imposing such unfair conditions in its Agreement with buyers in Gurgaon and to suitably modify unfair conditions imposed on its buyers as referred to above, within 3 months of the date of receipt of the order on DLF.

DLF challenged the CCI order before COMPAT which granted stay order against the CCI order of imposing penalty under section 27 (b) of the Act subject to DLF furnishing an undertaking to pay 9% interest on the amount of penalty to be determined by COMPAT for the period from the date of order by CCI till the date of payment by DLF. Further, COMPAT ordered that the directions of CCI for modifications of terms of the Agreement shall remain in abeyance. However, the direction of CCI to "cease and desist" with the implementation of the Agreement was not stayed.

**Regulation of Combinations (Section 5)****Combination under Competition Act, 2002**

Combination means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The thresholds are unambiguously specified in the Act in terms of assets or turnover in India and abroad. Entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India is prohibited and such combination would be void.

**Sections 5 and 6 of the Competition Act, 2002 came into force with effect from 1 June 2011**

**Combinations – Thresholds**

The current thresholds for the combined assets/turnover of the combining parties are as follows:

- **Individuals:** Either the combined assets of the enterprises are more than ₹2,000 crore in India or the combined turnover of the enterprise is more than ₹6,000 crore in India. In case either or both of the enterprises have assets/turnover outside India also, then the combined assets of the enterprises are more than US \$ 1 billion, including at least ₹1000 crore in India, or turnover is more than US\$ 3 billion, including at least ₹3,000 crore in India.
- **Group:** The group to which the enterprise whose control, shares assets or voting rights are being acquired would belong after the acquisition or the group to which the enterprise remaining the merger or amalgamation would belong has either than ₹8,000 crore in India or turnover more than ₹24,000 crore in India. Where the group has presence in India as well as outside India then the group has assets more than US \$ 4 billion including at least ₹1,000 crore in India or turnover more than US\$ 12 billion including at least ₹3,000 crore in India.
- In term Group has been explained in the Act. Two enterprises belong to a “Group” if one is in position to exercise at least 26 percent voting rights or appoint at least 50 per cent of the directors or controls the management or affairs in the other. Vide notification S.O. 481 (E) dated 4 March, 2011, Government has exempted “Group” exercising less than fifty per cent of voting rights in other enterprise from the provisions of section 5 of the Act for a period of five years.
- The above thresholds are presented in the form of a table below:

In India	Applicable to	Assets		Turnover	
	Individual	₹2,000 Cr.		₹6,000 Cr.	
	Group	₹ 8,000 Cr.		₹24,000 Cr.	
In India an outside	Applicable to	Assets		Turnover	
		Total	Minimum Indian Component	Total	Minimum Indian Component out of Total
	Individual parties	\$ 1 bn.	RS 1,000 cr.	\$ 3 bn.	Rs 3,000 cr.
	Group	\$ 4 bn.	Rs 1,000 cr.	\$ 12 bn.	Rs 3,000 cr.

1,000 Crore = 1 billion

The turnover shall be determined by taking into account the values of sale of goods or services. The value of assets shall be determined by taking the book value of the assets as shown in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed combination falls, as reduced by any depreciation. The value of assets shall also include the brand value, value of goodwill, or intellectual Property Rights etc. referred to in explanation (c) to section 5 of the Act.

### Regulation of combinations

Section 6 of the Competition Act, 2002 prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be void.

However, any person or enterprise, who or which proposes to enter into a combination shall give notice to

the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within thirty days of—

- (a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the **board of directors** of the enterprises concerned with such merger or amalgamation, as the case may be;
- (b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

As per Regulation 5, sub-regulation 7 of Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011, Board of Directors shall mean and include

- (a) the individual himself or herself including a sole proprietor of a proprietorship firm;
- (b) the karta in case of a Hindu Undivided Family (HUF);
- (c) the board of directors in case of a company registered under the Companies Act, 1956;
- (d) in case of a corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 or an association of persons or a body of individuals, whether incorporated or not, in India or outside India or anybody corporate incorporated by or under the laws of a country outside India or a cooperative society registered under any law relating to cooperative societies or a local authority, the person or the body so empowered by the legal instrument that created the said bodies;
- (e) in the case of a firm, the partner(s) so authorized;
- (f) in the case of any other artificial juridical person not falling within any of the preceding sub- clauses, by that person or by some other person competent to act on his behalf.

## **COMPETITION COMMISSION OF INDIA (PROCEDURE IN REGARD TO THE TRANSACTION OF BUSINESS RELATING TO COMBINATIONS) AMENDMENT REGULATIONS, 2016**

### **Form of notice for the proposed combination.-**

Enterprise to give notice

Any enterprise which proposes to enter into a combination shall give notice of such combination to the Commission in accordance with sub-section (2) of section 6 of the Act and these regulations.

Notice to be given in Form I

The notice under sub-section(2) of section 6 of the Act, shall ordinarily be filed in Form I as specified in schedule II to these regulations, duly filled in and accompanied by evidence of payment of requisite fee by the parties to the combination.

### **COMBINATIONS IN RESPECT OF WHICH NOTICE NEED TO BE NORMALLY FILED IN FORM II**

- (a) the parties to the combination are engaged in production, supply, distribution, storage, sale or trade of similar or identical or substitutable goods or provision of similar or identical or substitutable services and the combined market share of the parties to the combination after such combination is more than fifteen percent (15%) in the relevant market;
- (b) the parties to the combination are engaged at different stages or levels of the production chain in

different markets, in respect of production, supply, distribution, storage, sale or trade in goods or provision of services, and their individual or combined market share is more than twenty five percent (25%) in the relevant market.

The parties to the combination shall give notice in Form I or Form II, as the case may be, in accordance with the notes to Form I and Form II issued by the Commission and published on its official website, from time to time.

## **DUE DILIGENCE OF COMPETITION LAW ASPECTS**

Due diligence on competition law aspects is an examination of the actual operations and practices of an enterprise to determine the extent of its compliance with the competition law and to identify potential risks and liabilities, and assess the adherence to and effectiveness of the company's competition law compliance policy and training program.

Primary components of Competition Law due diligence are:

- An examination of selected company documents.
- Interviews with selected company personnel.
- Identify specific business activities that potentially could create antitrust exposure for the company.
- The results of the due diligence may suggest an enterprise to have an effective competition law compliance programme.
- The results of the due diligence may result in variation of deal value, withdrawal of deal and also make suggestions to structure a compliance program.

### **How to go about the process of due diligence of competition law?**

Due diligence of competition law may be made under the following heads:

- (a) Due diligence of various agreements (both existing and proposed)
- (b) Due diligence on dominance and its likely abuse if any, (existing)
- (c) Due diligence on combinations (i.e. effect of proposed mergers & Acquisition)
- (d) Competition law compliance programme of an enterprise

### **Due Diligence of various agreements include**

- agreements relating to production, supply and distribution of goods or services.
- agreement if any with competitor relating to production, marketing or bidding, price etc.
- agreements with customers and distributors.
- purchase agreements.
- non-compete covenants.
- technology transfer/technical know-how agreements.
- Concession agreements

### **Due diligence on abuse of dominance if any includes**

- Examination as to the existence of dominance

- Examination of relevant market, whether product or geographical
- Cases of abuse if any.

### **Due diligence on regulation of combinations**

The following aspects are to be analysed during due diligence process:

- What is the nature of combination? Whether it is acquisition of share, voting rights, assets or control or merger/amalgamation etc?
- Examination of total value of Assets or Turnover and the valuation methodology.
- Status of merger notification to be filed with CCI
- Status of dominance after merger.

## **DUE DILIGENCE CHECKLIST FOR COMPLIANCE WITH COMPETITION ACT, 2002**

### **I CHECKLIST FOR ANTI COMPETITIVE AGREEMENTS**

Section 3 of the Competition Act, 2002 dealing with anti-competitive agreements prohibits such agreements or practices, or decision taken which causes or is likely to cause an appreciable adverse effect on competition within India.

An enterprise might enter into horizontal<sup>1</sup> or vertical<sup>2</sup> agreements during the ordinary course of business. However, when agreements are entered to prevent the competition, such agreements are not in accordance with the principles of fair play in the market, hence anti-competitive.

In this context, it is important to note that the term Agreement<sup>3</sup> would include any arrangement or understanding or action in concert whether or not it is formal or in writing; or it is intended to be enforceable by legal proceedings. This definition is an inclusive one and covers not only an agreement as understood in the conventional sense under the Indian Contract Act, but any arrangement or understanding or action in concert. In other words, the form of agreement is of no importance. Not only written agreements are deemed to come within the scope of competition law but also verbal agreements or so-called co-ordinated policies, i.e. deliberate and intended collaboration between individual companies for the purpose of eliminating or restricting competition in a certain market.

Following general checklist may be followed while carrying out assessment of agreements including horizontal and vertical agreements such as tie-in arrangements, exclusive supply agreement, exclusive distribution agreement, refusal to deal, resale price maintenance from competition law compliance perspective:

1. The company has not jointly determined selling or purchase prices
2. The company has not jointly agreed on rebates, discounts
3. The company has not granted discounts or special deals on a published list price or ruling price

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1 Horizontal agreements mean agreements between companies acting on the same marketing stage, e.g. agreements with competing manufacturers.

2 Vertical agreements mean agreements between companies acting on different marketing stages, e.g. agreements with distributors and customers, licensees, suppliers or licensors.

3 Section 2 (b) of The Competition Act, 2002

4. The company has not accepted recommendations of a trade association in relation to price
5. The company has not indulged in collective price-fixing or price co-ordination of any product
6. The company has not fixed /exchanged any price related conditions including discussions related to aspects of pricing with competitors
7. The company has not shared information about prices, discounts, profit margins, cost structures, during meetings of a trade association
8. The company has not mutually agreed not to supply certain customers or not to purchase from certain suppliers
9. The company has not agreed with competitors to make the supply or purchase of goods subject to certain mutually agreed conditions.
10. The company has not shared or allocated markets between competitors in respect of specific territories, products, customers or sources of supply.
11. The company has not fixed production/output, buying and selling quotas between competitors.
12. The company has not brought multiple bids to a bid opening and submits its bid only after coming to know as to who else is bidding.
13. The company has not made a statement indicating advance knowledge of the offers of the competitors.
14. The company has not made a statement that a bid is a 'complementary', 'token 'or' cover' bid.
15. The company has not made a statement that the bidders have discussed prices and reached an understanding.
16. The company has not given a false impression that the enterprise is a party to any anticompetitive agreement.
17. The company has not discussed among competitors of such matters as need for changes in price levels, prospective production plans, allocation of markets, action aimed at hindering the prospects of competitors, or the like.
18. The company has not agreed in writing or in any other way on prices or pricing policy.
19. The company has not restricted the liberty of competitors to promote and sell products at independently determined prices and conditions.
20. The company has not restricted the possibilities of competitors to use a common quality label.
21. The company has not entered into standardisation agreements with competitors that might make entry for new entrant in the market more difficult.
22. The company has not restricted import or export or the type of customers.
23. In case of exclusive distribution, the company has not restricted passive sales.
24. In case of selective distribution, the company has not restricted sales inside the system.

### **WHILE DEALING WITH COMPETITORS (HORIZONTAL AGREEMENTS)**

25. The company has not agreed to adopt the same price list.
26. The company has not discussed future prices, price changes, or price formulas.
27. The company has not discussed terms and conditions of business.
28. The company has not discussed marketing programmes or allowances.
29. The company has not shared or partition markets or customers.
30. The company has not agreed to limit output or investment.
31. The company has not discussed or agreed about bids/tendering arrangements.
32. The company has not discussed or exchange confidential business information.

### **WHILE BIDDING IN A TENDER**

33. The company has not agreed to submit identical bids.
34. The company has not agreed as to who shall submit the lowest bid, agreements for the submission of cover bids (voluntarily inflated bids).
35. The company has not agreed not to bid against each other.
36. The company has not agreed on common norms to calculate prices or terms of bids.
37. The company has not agreed to squeeze out outside bidders.
38. The company has not agreed on designating bid winners in advance on a rotational basis, or on a geographical or customer allocation basis.
39. The company has not agreed as to the bids which any of the parties may offer at an auction for the sale of goods or any agreement through which any party agrees to abstain from bidding for any auction for the sale of goods or any agreement through which any party agrees to abstain from bidding for any auction for the sale of goods, which eliminates or distorts competition.

### **WHILE WRITTEN COMMUNICATIONS**

40. The company has not used misleading language.
41. The company has not used ambiguous language that may convey suspicious anti- competitive conduct such as "please destroy or delete after reading", "no copies to be made", "the main purpose of this transaction/conduct is oust competitor".
42. The company has not use phrases that suggest that competitors/distributors will follow price rise, stick to agreed price.
43. The company has not used any expressions which are hyperbole and slangs.

## **II CHECKLIST FOR ABUSE OF DOMINANT POSITION**

Competition Act, 2002 does not prohibit the mere possession of dominant position, but only its abuse, thus recognizing that a dominant position may have been achieved through superior economic performance. Once it is determined that an enterprise is in dominant position, then the next question that arises is whether

there has been an abuse of dominant position. In particular Section 4(2) states that there shall be an abuse of dominant position if an enterprise indulges in any of the activities listed in the sub-section, these being unfair or discriminatory condition or price including predatory pricing, limiting or restricting production or technical or scientific development, denying market access, imposing supplementary obligations having no connection with the subject of the contract, or using dominance in one market to enter into or protect another relevant market. Thus, the Act provides for five kinds of abuses and the list of abuses is exhaustive, and not merely illustrative.

Following general checklist may be followed while carrying out assessment of abuse of dominant position from competition law compliance perspective:

1. The company has not imposed unfair or discriminatory condition in purchase or sale; or price in purchase or sale of goods or services (including predatory price) of goods or service.
2. The company has not indulged in practice or practices resulting in denial of market access in any manner.
3. The company has not made conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
4. The company has not used dominant position in one relevant market to enter into, or protect, other relevant market.
5. The company has not discriminated between different customers.
6. The company has not discriminated prices or rebates between similar customers.
7. The company has not abruptly refused to provide services.
8. The company has not provided Discriminatory differential bonus or discount based on quantity.
9. The company has not operated the pricing mechanism in such manner that as and when there is a rise in cost of production, the sale price should be changed proportionately.
10. The company has not discriminated in relation to prices, terms of sale, or the quality or quantity of what is supplied, and may extend to refusal to sell.
11. The company has not discriminated in terms and conditions in the supply or purchase of goods or services, for example, extension of discriminated credit facilities or ancillary services.
12. The company has not imposed discriminatory or unfair conditions to any category of users, or any other enterprise having contractual relationship with the dominant enterprise.

### III CHECKLIST FOR REGULATION OF COMBINATIONS

According to the provisions of the Competition Act, 2002, combinations are discouraged, if they reduce or harm competition. Act does not provide for monitoring all kinds of combinations by the CCI, for the reason that very few Indian companies are of international size and that in the light of continuing economic reforms, opening up of trade and foreign investment, a great deal of corporate restructuring is taking place in the country and that there is a need for mergers, amalgamations etc. as part of the growing economic process before India can be on an equal footing to compete with global giants, as long as the mergers are not prejudicial to consumer interest.



It is in this context, the provisions relating to combinations in the Act are fairly liberal, in the sense that the thresholds are relatively high, and if the Commission fails to complete the investigation and pass an order regarding the combination within the prescribed time period, the combination is deemed to have been approved.

The Competition Act, 2002 regulates those combinations which, in certain circumstances, causes or is likely to cause an appreciable adverse effect on competition within relevant market in India and renders such a combination as void.

Following general checklist may be followed while carrying out assessment of combinations from competition law compliance perspective at the earliest of deal/transaction negotiation process:

- Check whether mergers, acquisitions and amalgamations (as the case may be) qualifies as combination under the Act i.e. whether they are within the foot-print of Section 5 thresholds. These thresholds determine whether the proposed combination would qualify as a “combination” and be then covered by the regulatory and operative provisions of Section 6. The current thresholds appearing in Section 5 of the Act are as follows:

**Individual:** Either the combined assets of the enterprises are more than Rs. 1,500 crores in India or the combined turnover of the enterprise is more than Rs. 4,500 crores in India. In case either or both of the enterprises have assets/ turnover outside India also, then the combined assets of the enterprises are more than US\$ 750 millions, including at least 750 crores in India, or turnover is more than US\$ 2250 millions, including at least 2,250 crores in India.

**Group :** The group, to which the enterprise whose control, shares, assets or voting rights are being acquired would belong after the acquisition or the group to which the enterprise remaining the merger or amalgamation would belong has either assets of more than 6000 crores in India or turnover more than Rs. 18000 crores in India. Where the group has presence in India as well as outside India then the group has assets more than US\$ 3 billion including at least 750 crores in India or turnover more than US\$ 9 billion including at least 2250 crores in India.

Check whether mergers, acquisitions and amalgamations (as the case may be) fall within any special exemptions provided therein, and unless exempted, the proposed transaction will have to be notified to the CCI.

Subject to certain requirements, a “combination” resulting from a transaction involving share subscription, financing facility or acquisition by a Public Financial Institution, Foreign Institutional Investor, Bank or Venture Capital Fund is exempt from scrutiny by the CCI.

## EXEMPTION NOTIFICATIONS

- In exercise of the powers conferred by clause (a) of Section 54 of the Act, the Central Government, in public interest, has exempted enterprises being parties to-
  - a) any acquisition referred to in clause (a) of section 5 of the Competition Act;
  - b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, referred to in clause (b) of section 5 of the Competition Act; and
  - c) any merger or amalgamation, referred to in clause (c) of section 5 of the Competition Act, where the value of assets being acquired, taken control of, merged or amalgamated is not more than

rupees 350 crores in India or turnover of not more than rupees 1000 crores in India, from the provisions of section 5 of the said Act for a period of five years.

Where a portion of an enterprise or division or business is being acquired, taken control of, merged or amalgamated with another enterprise, the value of assets of the said portion or division or business and or attributable to it, shall be the relevant assets and turnover to be taken into account for the purpose of calculating the thresholds under section 5 of the Act.

It may be noted that the value of the said portion or division or business shall be determined by taking the book value of the assets as shown, in the audited books of accounts of the enterprise or as per statutory auditor's report where the financial statement have not yet become due to be filed, in the financial year immediately preceding the financial year in which the date of the proposed combination falls, as reduced by any depreciation. The turnover of the said portion or division or business shall be as certified by the statutory auditor on the basis of the last available audited accounts of the company.

- A banking company in respect of which the Central Government has issued a notification under Section 45 of the Banking Regulation Act, 1949, from the application of the provisions of Sections 5 and 6 of the Act for a period of five years.

### **COMBINATIONS IN RESPECT OF WHICH NOTICE NEED NOT NORMALLY BE FILED**

Regulation 4 of the Procedural Regulations clarify that since the categories of combinations mentioned in Schedule I are ordinarily not likely to cause an appreciable adverse effect on competition in India, notice under sub-section(2) of section 6 of the Act need not normally be filed.

- The Combination Regulations provide that notice in respect of certain combinations, specified under Schedule I, need not normally be filed with the Commission as those transactions are ordinarily not likely to cause appreciable adverse effect on competition in India.

### **SCHEDULE I TO THE COMBINATION REGULATIONS**

- (1) An acquisition of shares or voting rights, referred to in sub-clause (i) or sub-clause (ii) of clause (a) of section 5 of the Act, solely as an investment or in the ordinary course of business in so far as the total shares or voting rights held by the acquirer directly or indirectly, does not entitle the acquirer to hold twenty five per cent (25%) or more of the total shares or voting rights of the company, of which shares or voting rights are being acquired, directly or indirectly, or in accordance with the execution of any document including a share holders' agreement or articles of association, not leading to acquisition of control of the enterprise whose shares or voting rights are being acquired.

The acquisition of less than ten per cent of the total shares or voting rights of an enterprise shall be treated as solely as an investment.

Provided that in relation to the said acquisition,-

- (a) the Acquirer has ability to exercise only such rights that are exercisable by the ordinary shareholders of the enterprise whose shares or voting rights are being acquired to the extent of their respective shareholding; and
  - (b) the Acquirer is not a member of the board of directors of the enterprise whose shares or voting rights are being acquired and does not have a right or intention to nominate a director on the board of directors of the enterprise whose shares or voting rights are being acquired and does not intend to participate in the affairs or management of the enterprise whose shares or voting rights are being acquired.
- (1A) An acquisition of additional shares or voting rights of an enterprise by the acquirer or its group,

where the acquirer or its group, prior to acquisition, already holds twenty five per cent (25%) or more shares or voting rights of the enterprise, but does not hold fifty per cent (50%) or more of the shares or voting rights of the enterprise, either prior to or after such acquisition:

Provided that such acquisition does not result in acquisition of sole or joint control of such enterprise by the acquirer or its group.

- (2) An acquisition of shares or voting rights, referred to in sub-clause (i) or sub-clause (ii) of clause (a) of Section 5 of the Act, where the acquirer, prior to acquisition, has fifty percent (50%) or more shares or voting rights in the enterprise whose shares or voting rights are being acquired, except in the cases where the transaction results in transfer from joint control to sole control.
- (3) An acquisition of assets, referred to in sub-clause (i) or sub-clause (ii) of clause (a) of Section 5 of the Act, not directly related to the business activity of the party acquiring the asset or made solely as an investment or in the ordinary course of business, not leading to control of the enterprise whose assets are being acquired except where the assets being acquired represent substantial business operations in a particular location or for a particular product or service of the enterprise, of which assets are being acquired, irrespective of whether such assets are organized as a separate legal entity or not.
- (4) An amended or renewed tender offer where a notice to the Commission has been filed by the party making the offer, prior to such amendment or renewal of the offer:

Provided that the compliance with regulation 16 relating to intimation of any change is duly made.

- (5) An acquisition of stock-in-trade, raw materials, stores and spares, trade receivables and other similar current assets in the ordinary course of business.
- (6) An acquisition of shares or voting rights pursuant to a bonus issue or stock splits or consolidation of face value of shares or buy back of shares or subscription to rights issue of shares, not leading to acquisition of control.
- (7) Any acquisition of shares or voting rights by a person acting as a securities underwriter or a registered stock broker of a stock exchange on behalf of its clients, in the ordinary course of its business and in the process of underwriting or stock broking, as the case may be.
- (8) An acquisition of shares or voting rights or assets, by one person or enterprise, of another person or enterprise within the same group, except in cases where the acquired enterprise is jointly controlled by enterprises that are not part of the same group.
- (9) A merger or amalgamation of two enterprises where one of the enterprises has more than fifty per cent (50%) shares or voting rights of the other enterprise, and/or merger or amalgamation of enterprises in which more than fifty per cent (50%) shares or voting rights in each of such enterprises are held by enterprise(s) within the same group:

Provided that the transaction does not result in transfer from joint control to sole control.

- (10) A combination referred to in Section 5 of the Act taking place entirely outside India with insignificant local nexus and effect on markets in India.

## COMBINATION NOTICE

The review process for combination under the Act involves mandatory pre-combination notification to the Commission. Any person or enterprise proposing to enter into a combination shall give notice to the Commission in the specified form disclosing the details of the proposed combination within 30 days of the

approval of the proposal relating to merger or amalgamation by the board of directors or of the execution of any agreement or other document in relation to the acquisition, as the case may be. In case, a notifiable combination is not notified, the Commission has the power to inquire into it within one year of the taking into effect of the combination.

The Commission also has the power to impose a fine which may extend to one per cent of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the Commission of the combination.

Any combination for which notice has been filed with the Commission would not take effect for a period of 210 days from the date of notification or till the Commission passes an order, whichever is earlier. If the Commission does not pass an order during the said period of 210 days, the combination shall be deemed to have been approved.

#### **ACQUISITION OR FINANCING FACILITY BY PFIs, VCFs Etc .**

In case of share subscription or financing facility or any acquisition, inter alia, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement, details of such acquisition are required to be filed with the Commission within seven days from the date of acquisition.

#### **PROCEDURE FOR INVESTIGATION OF COMBINATIONS**

As per the Combination Regulations, the Commission shall form its prima facie opinion as to whether the combination is likely to cause or has caused appreciable adverse effect on competition within the relevant market in India within 30 days from the receipt of the notice. If the Commission is prima facie of the opinion that a combination has caused or is likely to cause adverse effect on competition in Indian markets, it shall issue a notice to show cause to the parties as to why investigation in respect of such combination should not be conducted. On receipt of the response, if Commission is of the prima facie opinion that the combination has or is likely to have appreciable adverse effect on competition, the Commission shall deal with the notice as per the provisions of the Act.

#### **CHECKLIST – REGULATION OF COMBINATIONS**

1. The transaction qualified as a “combination” under Section 5 of the Act, it will have to mandatorily be notified to the CCI, and the transaction has taken effect only after 210 days of such notification or from the date the CCI passes an order approving the proposed “combination”, whichever is earlier.
2. Mandatory notice to the CCI is filed, in case of merger or amalgamation, within 30 working days of approval of the proposal relating to merger or amalgamation by the board of directors of the enterprises concerned.
3. Mandatory notice to the CCI is filed, in case of acquisition or acquiring of control, within 30 days of execution of any agreement or other document. Such ‘other document’ is defined to include any binding document conveying an agreement or decision to acquire control.
4. Notice was given to CCI in terms of the Procedural Regulations issued by CCI
5. There is no premature pre-closing activity involving sharing of competitively sensitive information or joint marketing, production.
6. If, the transaction involves any substantive competition/antitrust risk, the risk is allocated amongst the parties to the transaction.

Under the provisions of Competition Act, 2002, no documents, are exempt from disclosure. All documents may be subject to production, including agenda, minutes of the meetings, annual reports, statements relating

to corporate information made, discussed at various forums. Hence, it is in the interest of the company to ensure that its employees comply with the Competition Act, 2002.

The above checklist is not to be regarded as covering all competition issues that can arise. Rather, they are intended to educate the officer or employee of the enterprise of some of the common situations in which competition issues may arise. It is pertinent to note that failure to comply with Competition Act, 2002 has serious consequences for the enterprise, its officers, and employees.

### **EVALUATION OF 'APPRECIABLE ADVERSE EFFECT ON COMPETITION'**

The Act envisages appreciable adverse effect on competition in the relevant market in India as the criterion for regulation of combinations.

In order to evaluate appreciable adverse effect on competition, the Act empowers the Commission to evaluate the effect of Combination on the basis of factors mentioned in sub section (4) of Section 20.

Factors to be considered by the Commission while evaluating appreciable adverse effect of Combinations on competition in the relevant market:

- (a) actual and potential level of competition through imports in the market;
- (b) extent of barriers to entry into the market;
- (c) level of concentration in the market ;
- (d) degree of countervailing power in the market;
- (e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
- (f) extent of effective competition likely to sustain in a market;
- (g) extent to which substitutes are available or are likely to be available in the market;
- (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- (j) nature and extent of vertical integration in the market;
- (k) possibility of a failing business;
- (l) nature and extent of innovation;
- (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;
- (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

### **APPEALS**

Under the relevant provisions of the Act, an appeal to NCLT may be filed within 60 days of receipt of the order /direction/decision of the Commission.

The Commission also has the power to impose a fine which may extend to one per cent of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the Commission of the combination.

## NEED FOR COMPETITION COMPLIANCE PROGRAMME

It goes without saying that prevention is always better than cure. When businesses fail to have a compliance program, or when it is ineffective, they are essentially relying on others to bring that failure to their attention. It is far better when companies discover a breach first and act to rectify the problem, rather than the competition authorities bringing the breach to the company's attention. Given today's rigorous competitive environment, a robust competition compliance programme is an absolute must for enterprises.

As every business is unique, so each company requires different steps to ensure compliance with competition law. These depend on a range of factors, including the size and nature of the business, and the frequency of contact of employees with their competitors. Businesses which are able to significantly affect the market in which they are operating or which have large market shares, may be more vulnerable to allegations of abuse of their strong position in the market. Their agreements may be more likely to have an appreciable adverse effect on competition in the market. Employees or directors of a business who have regular contact with competitors on a business or social basis may run a higher risk of colluding.

A compliance programme therefore provides a formal internal framework for ensuring that businesses, i.e., the management and individual employees, comply with competition law. It may include such elements as training to raise awareness of law, the use of checklists to ensure compliance by individual staff with company policies, recording systems to document any permitted contacts that employees have with competitors and independent reviews of agreements, behavior and staff to monitor ongoing compliance. It can also help identify actual or potential infringements at an early stage, enabling the company to take appropriate remedial action.

When considering whether it is necessary to implement a compliance programme, companies should bear in mind that if they do commit an infringement, the competition authorities may take a lenient view where they can show that they have taken adequate steps to achieve compliance. The larger the business and the greater the risk of infringement, the more likely it is that adequate steps will include the introduction of a compliance programme. As a starting point it is helpful to assess the extent to which competition law will affect the business and the risk of committing an infringement. In case the risk of infringement is high, more elaborate measures may be required to ensure compliance.

Further, if employees understand competition law, they will also be able to recognize when the business is a victim of anti-competitive agreements or conduct, and be better-placed to protect the business' interests by making a reasoned complaint to the Competition Commission.

Compliance programmes have following three main purposes:

- (i) they strive to prevent violation of law,
- (ii) promote a culture of compliance, and
- (iii) encourage good corporate citizenship.

As the consequences of infringement can be serious a compliance programme must be capable of meeting the changing requirements of business and must make efforts as part of the regular evaluation process to ensure that the compliance programme continues to be relevant.

Competition Compliance programme help reduce legal costs in the short run by enabling the enterprise to avoid violation of competition laws, while in the long run, they increase corporate competitiveness by raising the value of an enterprise. The prescription of behavioral standards under the compliance programme not only prevents officers and employees of an enterprise from unconsciously violating the competition laws, but at the same time, relieve the employees of the fear that accompanies breach of such laws. The enterprises also save time and money by securing the following benefits from compliance programme:

- Corporate officers and employees being well aware of the requirements of competition law may maintain legal transparency.
- Corporate officers have advance perception concerning the activity of employees that might violate competition laws.
- Corporate officers and employees can avoid civil and criminal liability resulting from violation of competition laws.

The costs of legal counseling and litigation incurred from investigation and prosecution of acts of violation, as well as penalties, negative publicity, and disruptions in normal corporate operation, can be reduced.

An effective compliance programme equips the enterprise with the capacity to demonstrate due diligence to the competition authorities. This is a benefit that can make the cost and effort in putting in place a compliance program seem the best possible investment by company. This is because the amount of time the corporate professionals, who have encountered regulatory action, have had to devote in dealing with enforcement action, when they could be better focussed on more constructive activities of the company. This is not to ignore the cost involved in employing lawyers or paying fines or damages, and the negative impact on the business brand if found to be in breach of the law. There is evidence to suggest a strong link between effective compliance programme and maintaining the reputation of an enterprise and its brands.

Compliance embodied by a well-managed and adequately resourced corporate governance system, is aimed at a business enabler. In a paper presented at an Australian compliance forum, the author summarises that the importance of a good governance system, a holistic approach to compliance, can not be over emphasised: in an increasingly responsive stakeholder environment managing regulatory risk and being committed to the principles of good governance is vital to overall strategic management.

One of the greatest potential benefits of a vigorous compliance program is the ability to protect the company from being a victim of waste, fraud and abuse. The very same techniques that help prevent a company from harming others, also helps protect the company from being victimised.

### **Advantages of Competition Compliance Programme**

Competition Compliance programme offers various advantages to the companies during its ordinary course of business. Broadly, the advantages of Competition Compliance programme can be classified as under:

#### **Positive Benefits to Business**

An effective compliance programme that embeds a culture of compliance throughout the organisation can be a business enhancer offering positive benefits to business. A superior knowledge of the risks faced by the organisation and of the measures in place to guard against those risks can provide a company with a competitive advantage. When employees are aware of their rights and obligations, customer service improves and the employees become more alert and better able to deal with unlawful conduct that the company may be subjected to. A company can obtain value from good governance and compliance, develop a better culture, sustain itself for long term and maintain its reputation, and may avoid or reduce the negative effects of litigation and regulatory intervention.

#### **Reputation and Goodwill**

Companies that contravene the competition law may suffer damage to their reputation, unraveling years of careful marketing and brand development. In the era of information age it is more difficult to escape events that in the past were consigned to fading memories and dusty library shelves. Information on past misconduct by companies can now be retrieved at the stroke of a keyboard.

### Mitigation of penalties

In the event, Competition Commission institutes proceedings, the verifiable presence of a compliance programme and culture, and its successful implementation, can be scrutinised by the competition authorities/courts when the quantum of penalty is determined.

### LESSON ROUND-UP

- All businesses have a duty to act lawfully, but there are more practical reasons why compliance with competition law is particularly important. On a broad level, the main aim of competition law is to ensure that markets remain competitive.
- The Competition Act, 2002 was passed to encourage competition in markets in India.
- The Competition Act broadly covers anti-competitive agreements, abuse of dominance and regulation of combinations.
- During combinations, i.e. mergers or takeovers, the businesses of the transferor and transferee are to be studied from the point of view of anti-trust aspects (i.e. Competition aspects). This process is competition law due diligence.
- Competition law due diligence involves examination of various agreements, check into the companies dominance and its' abuse if any, checking combination thresholds, implementing competition compliance programme help reduce legal costs in the short run by enabling the enterprise to avoid violation of competition laws, while in the long run, they increase corporate competitiveness by raising the value of an enterprise.

### SELF TEST QUESTIONS

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

1. Write briefly about the preamble of Competition Act, 2002.
2. What are the combination thresholds for domestic takeovers?
3. Write short notes on
  - (i) Anti competitive agreement
  - (ii) Relevant market
  - (iii) Abuse of dominance.
4. Why do we need to carry out competition law due diligence during strategic decisions?

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# Lesson 8

## Legal Due Diligence

### LESSON OUTLINE

- The concept, scope, objectives and process of legal due diligence
- General aspects to be looked during legal due diligence process
- Possible hurdles and Remedial actions in legal due diligence
- Role of Company Secretaries in legal due diligence

### LEARNING OBJECTIVES

As we are aware that due diligence involves investigative process that identifies hidden strength and weaknesses in a business transaction, which helps in evaluation of a business transaction.

Legal due diligence is investigation of legal aspects of business including regulatory compliance, contractual compliance, hidden liabilities etc., It involves detailed study of various legal documents of the company such as Memorandum & Articles of Association, Minutes of Meetings, Returns filed with regulators, notices issued by regulators if any, material contracts, Annual Reports, IPR & Patent Details, environmental clearances etc.,

Since the cost of non-compliance would negatively affect a business transaction, legal due diligence has to be carried out while evaluating the same. After reading this lesson you would be able to understand the concept, process, scope of legal due diligence, possible hurdles and remedial actions relating to legal due diligence etc.

## I. INTRODUCTION

A legal due diligence is scrutiny of all or specific parts of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters. It also improves the buyer's bargaining position and ensures that necessary precautions are taken in relation to the transaction proposed.

Due diligence is an art that requires expertise in asking gathering and reporting of sensitive information. It involves collecting information about complete details, which includes the products, marketing, financial status, legal issues, assets/liabilities, etc.

Legal due diligence is a precautionary operation through which one can know the strengths and weaknesses of the company through the maximum possible information available. This process reduces future problems and ensures safety.

## II. OBJECTIVES OF LEGAL DUE DILIGENCE

The objectives of a legal due diligence exercise may vary from case to case. However some of the common objectives in most of the cases would be as follows:

1. Gathering of information from the target company.
2. Uncovering of the risks of Target Company through a SWOT analysis.
3. Improving the bargaining position.
4. Cost benefit analysis.
5. Assessing the risk and liability on the cost of the transaction.
6. Mapping of compliance requirements of the target company and the actual status.

## III. SCOPE OF LEGAL DUE DILIGENCE

The scope of legal due diligence depends on the purpose and objectives which may vary from case to case. The scope of due diligence by a large institutional investor will vary from the scope of due diligence by the company which proposes to acquire a target company. Thus it is not possible to define the scope of due diligence specifically. However, certain mandatory issues that should be covered in any type of legal due diligence are as follows:

### 1. *Regulatory compliance*

It would include compliance requirements of the company under various applicable laws such as Companies Act, Income Tax Act, SEBI Act rules and regulations, employee related laws, other business related laws such as pollution control laws, patent laws, and applicable laws in the country where the target company is situated.

### 2. *Contractual compliance*

It would include the compliance by the company under various material contracts by the company with suppliers, customers, employees etc. and to verify whether the company has complied with the terms and conditions of different contracts.

### 3. *Compliance under intra-corporate aspects*

It would include the compliance by the company under the intra company documents such as Memorandum and Articles of Association, Corporate policies, procedures, code of conduct etc.

### 4. *Financial aspects*

It includes thorough reading of the balance sheet to identify the financial obligations of the company, penalties paid for violations of laws in the past etc.

### 5. *Non financial aspects*

It includes analysis/examination of aspects such as reputation and goodwill of the company.

### 6. *Cultural aspects*

Especially in case of cross border transactions, compatibility and adaptability of corporate cultures are to be analysed to eliminate the problems that may arise out of cultural differences.

The following are the various important aspects covered as scope of due diligence in general. However, the list provided herein is not an exhaustive list and the scope would vary according to the nature of business decision.

#### Under Companies Act:

- Compliance with provision of Articles of Association
- Related parties transaction
- Appointment of and remuneration to Directors
- Contracts with director
- Loans to Director
- Borrowings by the Company and securities covered
- Matters such as disclosure, prospectus, minimum subscription compliance with listing agreement etc. in case of listed company.
- Fixed deposits accepted and its repayments
- Distribution of dividend
- Maintenance of statutory registers, minutes books etc.
- Filing of necessary returns

#### Under Tax Laws

- Status of tax assessments
- Identification of potential tax liabilities
- Pending notices and demands
- Impact of business agreements on potential tax demands
- Aspects relating to double-taxation.

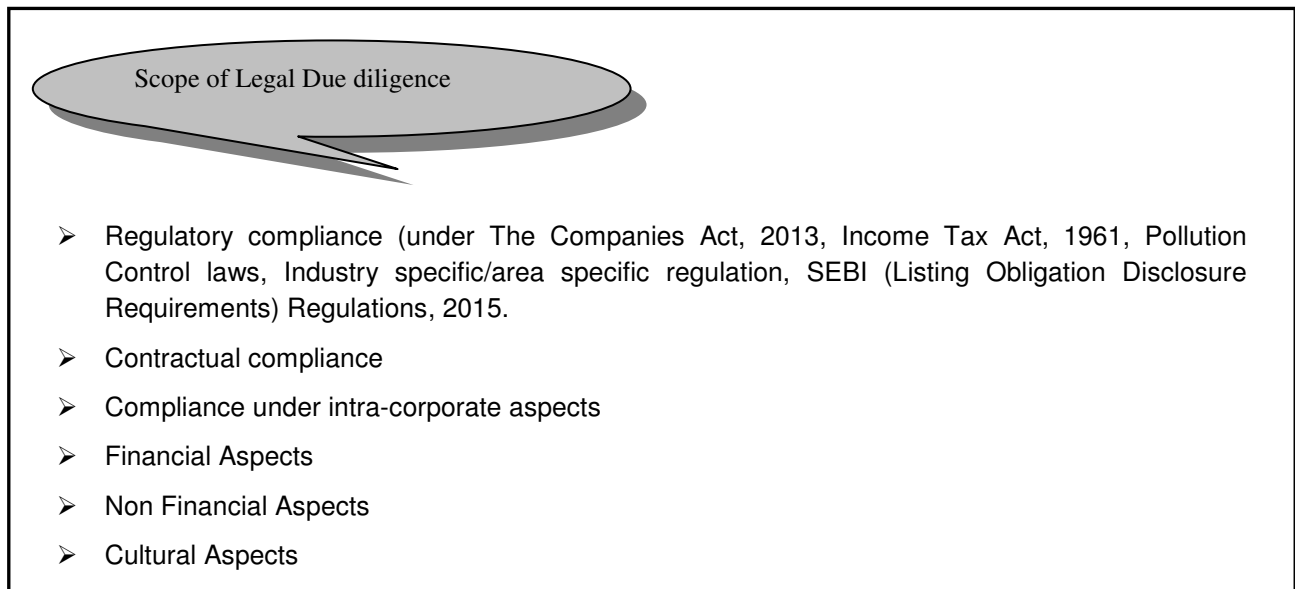
#### Under other business laws

- Registrations and approvals from various authorities and risks on non-compliance
- Compliance under pollution control laws
- IPR related matters

- Issues relating to immovable properties, title deeds etc.
- Compliance under FEMA, insurance laws etc.

The investigation or inspection also would cover aspects such as Compliance with local laws, assessment of feasibility of pursuing litigation, reputation and goodwill of the organization, cross-border and cultural issues, employee litigation etc.

#### IV. NEED OF LEGAL DUE DILIGENCE



Legal Due Diligence provides complete picture of a company through a methodical investigative process. Due Diligence investigations are good at finding liabilities in a company and to uncover the hidden risks. These investigations can help to negotiate a lower price in a business transaction negotiation.

Legal Due Diligence is an art of managing a risk of undertaking a major business transaction. It involves maintaining a methodical system for organizing and analyzing the documents, data and information provided by the information provider, and then quantitatively assessing the risks associated with any issues or problems discovered during the process. Only a careful and thorough Legal Due Diligence process will help to avoid legal difficulties, unintended transfer of legal property and other drawbacks.

Legal Due Diligence investigations allow getting the current information that is needed to make good business and financial decisions. These investigations help to avoid costly mistakes and can also help to avoid lawsuits caused by a bad business partnership. Investigations such as these can also be crucial in negotiations – by helping cut through business claims to the actual facts about a corporation, they help to get the proof needed to negotiate better terms.

The need for legal due diligence may occur in the following occasions

- Mergers/Acquisitions
- Corporate Restructuring
- Corporate Governance related matters
- IPOs/FPOs

- Private Equity
- General Compliance requirement.
- Commercial agreements
- Leveraged buy-outs
- Joint Ventures, etc.

## V. LEGAL DUE DILIGENCE PROCESS

There is no definitive process of a legal due diligence. The investigative aspects as well as Legal Due Diligence process varies depending upon the scope of work dictated by the client, the focus, special areas of weakness, the type of business, etc. In general, the following process involved in legal due diligence:

- Entering of Memorandum of Understanding between the transacting parties along with confidentiality agreement
- Determination of scope of Legal Due Diligence
- Calculation of time frame
- Drafting of various questionnaire and checklists
- Obtaining of access to records and data room agreement
- Interaction with management and key managerial persons with the questionnaires and checklists and for other material information
- Interaction with regulatory authorities for independent check
- Checking of regulatory and contractual compliance
- Analysis of financial and non financial information
- Collation with financial due diligence for confirmation of representations, warranties and liabilities
- Investigation of material issues
- Drafting of preliminary report
- Discussions with the management of the target company
- Finalisation of the Report
- Determination of strategy

## VI. GENERAL DOCUMENTS/ASPECTS TO BE COVERED

The following aspects would give a rough figure on the aspects/documents to be looked into in the process of legal due diligence. However, this is not an exhaustive list.

### 1. Organizational and internal Aspects

- Memorandum and Articles of Association of the Company
- Minutes of all meetings
- Organisational chart
- Statutory Registers

- Returns filed with Ministry of Corporate Affairs and other regulatory authorities.
- Search/status report if any
- Details of branches and subsidiaries
- Registrations documents under various laws
- Documents/reports filed with stock exchanges on shareholding pattern and other material information.

## **2. Financial Aspects**

- Financial Statements for the last five years
- Auditors Qualifications if any
- Recent unaudited financial statements
- Details of various financial reports published under listed agreement
- Capital Budgets and projections
- Details of fixed and variable expenses
- Internal Audit Report if any
- Strategic plans
- Details of internal control procedures.
- Unrecorded liabilities
- Commitments, contingencies
- Accounting policies
- Relationship between profit and operating cash flows
- Reliance on debt funds and usage of debt
- Debt repayment and potential debt trap
- Working capital lock up.

## **3. IPR/Patent/R&D Details**

- Schedule of trade marks/copyrights
- Details of Indian and international patents with the company
- Details of pending patent applications
- A schedule and copies of all consulting agreements, agreements regarding inventions, licenses, or assignments of intellectual property to or from the Company
- Details of threatened claims if any etc.

#### 4. Human Resource Aspects

- List of employees, their positions and salaries
- Details of options given/vested under ESOP scheme
- Bio-data of key managerial personnel
- Employee litigations
- Employee harassment reports if any.
- Cultural issues in case of cross border transactions.

#### 5. Environmental aspects

- Environmental audits reports, if any
- Details of environmental permits and licenses
- Hazardous substances used in the company's operations
- Copies of all correspondence with environment authorities
- Litigation or investigations if any on environmental issues
- Contingent environmental liabilities or continuing indemnification obligations, if any.

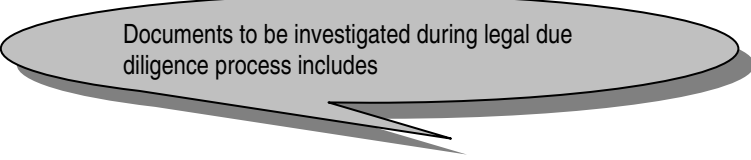
#### 6. Material Contracts

- A schedule of all subsidiary, partnership, or joint venture relationships and obligations with copies of all related agreements
- Copies of all contracts between the company and employees, shareholders and other affiliates
- Loan agreements, letter of credit, promissory notes, etc
- Security agreements, mortgages, etc. to which the company is a party
- Any distribution agreements, sales representative agreements, marketing agreements, etc.
- All non-disclosure or non-competition agreements
- Other material contracts.

#### 7. Other aspects

- Copies of any governmental licenses, permits, or consents
- Any correspondence or documents relating to any proceedings of any regulatory agency
- A list of all existing products or services and products or services under development
- Company's purchase policy/credit policy
- Details of largest customers
- Details of company's competitors
- Press releases relating to the company.





Documents to be investigated during legal due diligence process includes

- Organisational/internal aspects (MOA/AOA/Minutes/Statutory Registers documents filed with Regulatory Authorities, etc.)
- Financial aspects (financial statements, audit qualifications, internal audit report business projections etc)
- IPR/Patents/R&D Details etc.
- HR Aspects
- Environmental Aspects
- Material contracts
- Other relevant aspects as may be covered

## VII. POSSIBLE HURDLES IN CARRYING OUT A LEGAL DUE DILIGENCE AND REMEDIAL ACTIONS

### 1. Non availability of information:

In many occasions, when a person carries out due diligence, the required information may not be available or insufficient to derive a complete picture.

### 2. Unwillingness of target company's personnel in providing the complete information:

Non-cooperation of target company's personnel may also prove to be a major hurdle during due diligence process. Sometimes, the available information would be pretended as not available.

### 3. Providing of incorrect information:

Providing of incorrect information by the target personnel also acts as a major hurdle in the due diligence process.

### 4. Complex tax policies and hidden liabilities:

Complex tax policies & structures may create a number of hidden tax liabilities which may not be easy to track.

### 5. Multiple Regulations and its applicability:

Owing to the new and emerging legislations, it is difficult to interpret whether a specific legislation is applicable for business and getting legal opinion on the same would prove to be very costly.

### 6. Process in providing data:

Multiple Layers of review and scrutiny before data is provided for due diligence also hinders and delays the due diligence process.

### 7. Absence of proper MIS:

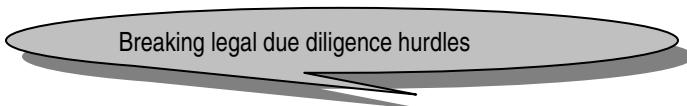
Due diligence process would become difficult if there is no proper MIS in the company.

#### Actions to break hurdles in due diligence


The following actions may break the aforesaid hurdles:

- Focus follow up questions.
- Ask several people the same questions and utilise appropriate professional skepticism.
- Polite persistence may help to overcome this attitude.
- Independent check with regulatory authorities.

Considering this hurdles, it is advisable to insert the necessary disclaimer clauses in the due diligence report.



Breaking legal due diligence hurdles



#### Hurdles

1. Non availability of information
2. Unwillingness of target company's personnel in providing the complete information
3. Providing of incorrect information
4. Complex tax policies and hidden liabilities
5. Multiple Regulations and its applicability
6. Process in providing data
7. Absence of proper MIS.

#### Actions to break hurdles in due diligence

The following actions may break the aforesaid hurdles:

- Focus follow up questions.
- Ask several people the same questions and utilise appropriate professional skepticism.
- Polite persistence may help to overcome this attitude.
- Independent check with regulatory authorities.

## VIII. ROLE OF COMPANY SECRETARIES IN LEGAL DUE DILIGENCE

Company Secretary is a competent professional who comes in existence after exhaustive exposure provided by the Institute through compulsory coaching, examinations, rigorous training and continuing education programmes. The course curriculum includes papers on subjects such as Financial Management, Financial Accounting, Company Accounts, Cost and Management Accounting, Financial Treasury and Forex Management, Security Laws and an exclusive paper on 'Due Diligence and Corporate Compliance Management'. Company Secretary, thus, has vast theoretical knowledge base and practical experience and exposure in various laws and financial aspects. As a Compliance Management specialist, a Company Secretary is competent to discharge the Legal Due diligence process efficiently.

Company Secretary while carrying out due diligence has to maintain confidentiality. Certain activities

conducted during due diligence may breach confidentiality that a transaction is being contemplated. Especially while interacting with external persons such as customers, suppliers, it is better to contact them under the disguise of being prospective supplier/customer which will help in maintaining confidentiality.

### LESSON ROUND UP

- A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters.
- The objectives of a legal due diligence exercise may vary from case to case.
- Legal Due Diligence is an art of managing risk of undertaking a major business transaction.
- The documents that is to be checked during legal due diligence may be financial information, statutory information, organizational matters, employee matters, etc.
- The process of legal due diligence involves various steps such as entering of MOU, preparations of questionnaires and checklists, interview with target company's personal, interaction with regulatory authorities, preparation and discussion of preliminary report, finalization of report and arriving of decision.
- The legal due diligence covers various laws such as Companies Act, Income Tax Act, other business laws, etc.
- The Company Secretary is a competent professional to conduct legal due diligence.

### SELF TEST QUESTIONS

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

1. What do you mean by legal due diligence and why does a person need to carry out legal due diligence?
2. Draft a legal due diligence programme for a corporate acquisition.
3. What is the process involved in legal due diligence?
4. What are the possible hurdles that may occur during legal due diligence process?

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# Lesson 9

## Due Diligence for Banks

### LESSON OUTLINE

- Introduction
- Need
- Due diligence for Banks-Format
- Point wise compliance checklists.

### LEARNING OBJECTIVES

Reserve Bank of India, with a view to facilitate industries, has liberalized the rules for consortium lending a little more than a decade back. Multiple banking as a concept had also started gaining ground at that time and many corporates opted for the multiple banking route presumably due to the perceived rigidity of the consortium arrangement. Unfortunately, exchange of information between banks was minimal and resultantly unscrupulous borrowers were able to take advantage of the information asymmetry that prevailed. The Central Vigilance Commission concerned at this development had attributed this phenomena to lack of effective sharing of information amongst banks. A need was felt, all along to have certification of statutory compliances by a Company through a professional such as a Company Secretary/Chartered Accountant/Cost Accountant so that the lending banks get the desired comfort. Accordingly, the Reserve Bank of India advised all the scheduled commercial banks to obtain regular certification (DILIGENCE REPORT) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue in the specified format. The Diligence Report broadly covers many critical and 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 regulations of SEBI (LODR) Regulations, 2015 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 Notification 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 Notification dated January 21, 2009 also advised all Primary Urban Co-operative Banks to obtain Diligence Report. Subsequently the RBI vide its Notifications 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 Notification 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 was 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 Notification 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 **as per Annexure 1 to the Notification** from the borrowers about the credit facilities already enjoyed by them from other banks. In 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 **as per Annexure 2 to the Notification** 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 **(as per specimen given in Annexure 3 to the Notification)**.
- (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 (**in total 25 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 SEBI (LODR) Regulations, 2015 in case of a listed company, etc. The compact structure of the Diligence Report under its twenty-five paragraphs makes it obligatory for a Practising Company Secretary to prepare the Report after critical examination of all relevant records and documents of the borrowing companies which demands a high degree of care, skill and knowledge.

The introduction of diligence reporting by Company Secretary in Practice is expected to lay down a strong foundation for good governance culture among borrowing corporates and correspondingly enhance the comfort level of the banks by reducing the information asymmetry prevailing currently.

## Scope of Diligence Report

The Practising Company Secretary (PCS) is required to certify compliance in respect of matters specified in the above RBI Notification as already stated in the prescribed format which has been subsequently revised and streamlined by RBI.

## Format of Diligence Report (ANNEXURE 3 TO THE NOTIFICATION)

### DILIGENCE REPORT<sup>1</sup>

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

<sup>1</sup> (As contained in RBI Notification No. DBOD. No. BP.BC. 110/08.12.001/2008-09 dated February 10, 2009 read with RBI Notification No. UBD.PCB.No. 49/13.05.000/2008-09 dated February 12, 2009)

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 (now to be in compliance with relevant sections of Companies Act, 2013) and other relevant statutes.
12. The Company has insured all its secured assets. (Now to be in compliance with relevant provisions of Chapter 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 relevant sections of 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 (Now to be in compliance with the SEBI ( LODR) Regulations, 2015).



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 and may be stated at the relevant paragraphs above place(s).

Place:  
Date

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

## GUIDANCE ON DILIGENCE REPORTING

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

### Period of Reporting

Annexure III to the above 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 he or she 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) disqualification 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 or she 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.

#### **Communication to earlier incumbent:**

As per 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 Company Secretary in whole-time practice is appointed in place of another Company 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).

#### **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****PARA NO. 10 OF THE REPORT:**

**Principal value of the forex exposure and Overseas Borrowings of the company as on ..... are as detailed in the Annexure under”**

**Format of Annexure ...**

<i>S. No.</i>	<i>Forex Exposure of the Company</i>	<i>Currency (US\$ Million)</i>	<i>Equ. Amount</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(4)</i>
A.	Funded Exposure		
1.	Foreign Currency Packing Credit		
2.	Foreign Currency Post Shipment Credit		
3.	External Commercial Borrowings		
4.	FCCB		
5.	ADR/GDR etc.		
6.	Other Loans, if any – Please specify		
	(a) Suppliers Credit		
	(b) Buyers Credit		
	(c)		
	(d)		
	Total Funded Exposure		
B.	Non Fund Based Exposure		
	of which :-		
1.	Import Letters of credit opened		
2.	Import Letters of credit accepted		
3.	Guarantees Issued		
4.	Standby letters of Credit		
5.	Others, if any – Please specify		
	(a)		
	(b)		
	(c)		
	Total Non Funded Exposure		
C.	Derivatives		
	(i) Plain Vanilla Contracts		
	1 Forex Forward Contracts		
	2 Interest Rate Swaps		
	3 Foreign Currency Options		
	4 Any other Contracts –		
	Please Specify		
	(ii) Complex Derivatives		
	1 Contracts involving only		

interest rate derivatives

2 Other Contracts including  
those involving FC derivatives

3 Any other derivatives –  
Please specify

(a)

(b)

(c)

Total Derivative Exposure

Grand Total of all Exposures

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**Unhedged Foreign Currency Exposures of the Company:  
Currency wise**

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<i>S. No.</i>	<i>Type of Exposure</i>	<i>Amount (US\$ Million)</i>
1	Short Terms (viz. < 1 year)	
	(a) Long Positions	
	(b) Short Positions	
	(c) Net Short term Exposures (a - b)	
2	Long Term (viz. > 1 year)	
	(a) Long Positions	
	(b) Short Positions	
	(c) Net Long term Exposures (a - b)	
3	Overall Net Positions (1–2)	
	for each currency (Please give overall Net Position in this format for each currency)	
4.	Overall Net Position across all Currencies	

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	<i>Currency</i>	<i>Amount</i>
Total Forex Exposure of the Company		
Fund Based Exposure		
Non-Fund Based Exposure		
Total Borrowing Limit of the Company		
External Commercial Borrowings of the Company		
Borrowing limit of the Company	Currency	Amount (₹)

---

Amount borrowed from Overseas Directors

Shri/Ms. ...

Shri/Ms. ...

Amount borrowed from Overseas Members

Shri/Ms. ...

Shri/Ms. ...

Amount borrowed from Overseas Public

Shri/Ms. ...

Shri/Ms. ...

Amount borrowed from Foreign  
financial institution(s)

M/s...

M/s...

Amount borrowed from Foreign banks

M/s...

M/s....

Amount borrowed from others

M/s...

Credit Linked Notes

Grand Total

Whether approval of RBI required for the above: Yes/No

If yes, date when approval was obtained \_\_\_\_\_ (date) vide Reference No.....

**Illustrative List of Foreign Currency Exposures with  
Source for Verification**

<i>Type of Exposure</i>	<i>Source for Verification</i>
<b>1. Packing credit in Foreign currency</b>	a. Packing credit loan ledger supported by Bank Advice for each disbursement. b. Internal MIS including Trial Balance.
<b>2. Post shipment credit in Foreign Currency</b>	a. Post shipment loan Ledger. b. Bill-wise advise from bank. c. Trial Balance/Internal MIS. d. Export Collection Bills e. Advance against FOBCs
<b>3. Foreign Currency Loans</b>	a. Last Audited Balance Sheet. b. Bank Advice for disbursement of the loan c. Loan Ledger d. Statement of Account from Lender (Bank)

- 4. External Commercial Borrowings**
  - a. Reporting of loan agreement details under FEMA, 1999
  - b. Form ECB-2 under FEMA, 1999 (Details of actual transaction of Foreign Currency Loan/ Financial Lease other than short-term Foreign currency Loans)
  - c. Last Interest fixation notification from the Lender
  - d. Loan Ledger
- 5. Foreign Currency Convertible Bond (FCCB)**
  - a. Issuance Approval (if applicable)
  - b. Form ECB-2 (if applicable)
  - c. Board Memorandum copy on FCCB reporting
  - d. Information filed with Stock Exchange
- 6. American Depository Receipt (ADR)**
  - 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)**
  - a. Statement of Account from the Bank

<b>Account)</b>	b. EEFC A/c Reconciliation Statement
<b>12. Balances in Bank Accounts held abroad</b>	<ul style="list-style-type: none"> <li>a. General Permission or Special Permission copy</li> <li>b. Statement of Account from the Overseas Bank</li> <li>c. Reconciliation Statement</li> <li>d. Ledger extract from Company's books</li> </ul>
<b>13. Investments made abroad</b>	<ul style="list-style-type: none"> <li>a. General or Specific approval copy</li> <li>b. Copy of document evidencing investment</li> <li>c. Ledger extract</li> </ul>
<b>14. Loans extended in Foreign Currency</b>	<ul style="list-style-type: none"> <li>a. General or Special Permission copy</li> <li>b. Copy of Loan Agreement</li> <li>c. Proof of remittance of foreign currency</li> <li>d. Ledger extract of Loan Account</li> </ul>
<b>15. Advance payments received against exports (exports not taken place)</b>	<ul style="list-style-type: none"> <li>a. Copy of Purchase or Sale contract as the case may be</li> <li>b. Copy of FIRC</li> <li>c. If credited to EEFC A/c cross reference so as to avoid double counting</li> </ul>
<b>16. Security Deposits received from Dealers /Distributors abroad</b>	<ul style="list-style-type: none"> <li>a. Copy of appointment letter</li> <li>b. Copy of FIRC</li> <li>c. Copy of Ledger extract</li> </ul>
<b>17. Security Deposit paid for overseas officer but parked in Indian Books in respect of</b>	<ul style="list-style-type: none"> <li>a. Copy of relevant agreement</li> <li>b. Bank Advice copy for remittance</li> <li>c. Ledger extract</li> </ul>
<ul style="list-style-type: none"> <li>(i) Premises</li> <li>(ii) Other utilities</li> <li>(iii) Refundable Regulatory Payment</li> </ul>	
<b>18. Capital/Loans/Advances extended to overseas branches or Joint Ventures (JVs) or Wholly Owned Subsidiaries (WOSs).</b>	<ul style="list-style-type: none"> <li>a. Copy of agreement for each loan</li> <li>b. Proof of disbursement</li> <li>c. Ledger extract</li> </ul>
<b>19. Forward Contracts Booked [Both Purchases and Sales]</b>	<ul style="list-style-type: none"> <li>a. Copy of Contract Note</li> <li>b. Verification of underlying(i.e. export bill, export LC, Import bill, Import LC, Purchase Order, Sales Contract etc.)</li> </ul>
<b>20. Bid Bonds Performance Guarantees Retention Money Guarantees</b>	<ul style="list-style-type: none"> <li>a. Copy of each Guarantee with supporting documents</li> <li>b. Bank Advice or Bank Correspon-</li> </ul>

**Advance Payment Guarantees  
or any other Guarantees issued  
and outstanding**

dence for each instrument

**21. Derivative Transactions**

- Options
- Foreign Currency Swaps etc.
- Exchange Traded Currency  
Futures  
(Broker/Bank Contract Note  
for each deal)

- a. Term sheet for each contract
- b. Board Resolution

**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.**

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**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
- The current Foreign Trade Policy as applicable
- Foreign Contribution Regulation Act, 2010
- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974
- Uniform Customs and Practice for Documentary Credits (UCPDC ICC 600)
- FEDAI Rules
- SEBI guidelines
- ODA Guidelines
- Investment abroad – both Assets side and Liabilities side
- Accounting Standards (AS 11, IAS 39, FASB, GAAP norms).



**PARA NO. 12 OF THE REPORT:**

**The Company has insured all its secured assets.**

Particulars of Insurance cover obtained by the Company are as under:-

<i>Sl. No.</i>	<i>Particulars of Asset Insured</i>	<i>Value of Asset (₹)</i>	<i>Sum Insured (₹)</i>	<i>Risk Covered</i>	<i>Amount of Policy</i>	<i>Insurance Company</i>	<i>Insurance Policy Number</i>
1.						M/s ...	
2.						M/s ...	
3.						M/s ...	

**Note:** Insert a remark, whether all the assets have been insured and provide a list of assets that haven't been insured.

**Compliance Inputs**

- Original insurance policies
- Register of Assets
- Collateral Security offered to the lenders
- Stock Statement
- Premium payment receipts

**Checklist for Insurance Policies**

- (a) Verify the original insurance policies and check carefully the details of assets covered by the policy.
- (b) Check that the Company has taken a Policy from a General Insurance Co. registered with IRDA.
- (c) Check the period of the policy. Policies are generally issued for a period of one year. Sometimes, short period policies for less than one year are also issued.
- (d) Generally, Fire Insurance policies cover immovable properties, stocks etc. Earthquake, Terrorism etc. are given as add on covers. Vehicles should have Valid Comprehensive Insurance Policies.
- (e) Check that the sum insured represents the Market value/Replacement value as the case may be (not book value) or else, under insurance will be applicable. Name, address, situation (with Building No. etc.) of the Company should tally with the records.
- (f) Verify the name of the mortgagee.
- (g) Verify any endorsement during the policy period, noting the changes in the sum insured, situation, risk etc.

### Checklist for Compliance of Terms of Insurance

Check the following in regard to compliance of terms of insurance:

- (a) the company's assets have been insured comprehensively. Where a joint insurance on plant and buildings has been taken, the value thereof has been apportioned in the manner prescribed/approved;
- (b) the insurance policy has been taken in the joint names of the company and the bank(s)/financial institution(s) ;
- (c) the policy has been kept alive for such full value, as has been determined by the bank(s)/financial institution(s) , all premia are being paid on time, and the company has not done any such act as would render the policy void or voidable;
- (d) the policy has been taken from an insurance office of repute, as determined by the bank(s)/financial institution(s); and
- (e) all moneys received under the insurance policies are held in trust for better securing to the bank(s)/financial institution(s) , the payment of all moneys secured under the indenture agreement.

### PARA NO. 13 OF THE REPORT:

**The Company has complied with the terms and conditions, set forth by the lending bank/financial institution at the time of availing any facility and also during the currency of the facility.**

### Compliance Inputs

— Copy of the Lending Agreement

### Checklist for Compliance with the terms and conditions set forth by the lending Institution at the time of availing the facility.

Check the following points to confirm that:

- (a) further funds have not been borrowed from bank(s)/financial institution(s) on hundis, other than from its bankers, without prior consent;
- (b) no donations/contributions have been made to the charitable and other funds, which are not directly related to the business of the borrower or to the welfare of its employees, in excess of the indenture (if any), without the consent of the bank; and
- (c) no merger/consolidation/re-organisation/arrangement/compromise with the creditors/shareholders has been undertaken/permitted without the approval of the bank.

### Checklist for Operations of the Company

Check whether the following have been ensured, about the operations of the company:

- (a) the company has not ceased to carry on business, even temporarily;
- (b) any material changes in the operations, including creation of a subsidiary, implementation of expansion programmes, and undertaking any general trading activities have been approved by the bank(s)/financial institution(s);
- (c) the selling/purchasing agency has been given on terms and conditions laid down in the indenture. Where required the existing arrangements have been suitably modified. Specific permission has been taken where agreement is being entered into with the associate concerns of the promoter(s)/director(s) of the company; and

- (d) any arrangements required to be entered into, as per the provisions of the indenture, have been duly made.

#### **Checklist for Security Offered on the Term Loan**

Verify the following as regards security offered on the term loan, and subsequent acquisition of assets:

- (a) Assets acquired pursuant to the loan agreement are in line with the terms of the sanction;
- (b) Assets purchased from the money advanced/to be advanced, if not brought upon/fixed to the factory premises, have been hypothecated with the bank(s)/financial institution(s)/commercial bank;
- (c) The company has not entered into any arrangement with the creditors, nor has any act or default been committed, as would render the company liable to be taken into liquidation;
- (d) Where guarantees have been furnished, in the event of death of a guarantor, his heirs have not given notice of revocation; and
- (e) In the opinion of the assessors/valuers appointed by the company the value of the security has not become insufficient or depreciated beyond norms prescribed in the indenture.

#### **Checklist for Default in Payment of Interest/Principal Instalments**

Confirm that in the event of default:

- (a) the consent of the bank(s)/financial institution(s) has been taken, where required, prior to distributing dividends and making interest payment on unsecured loans and deposits; and
- (b) sales tax refunds/sum received from incentive schemes, etc., have been applied towards payment of overdue amounts.

#### **Checklist for Information submitted to Bank(s)/Financial Institutions**

Verify that the periodical statements required to be submitted to the bank(s)/financial institution(s), are being furnished on time. The statements may be on the operations of the company/implementation of the project undertaken.

#### **Checklist for Utilisation of Moneys Advanced**

Ensure that consistency has been maintained in utilisation of moneys advanced to the mortgagor. The following aspects may be specifically examined:

- (a) funds have been utilised for the purposes laid down in the indenture. Where funds have not been so utilised, the requisite permission has been taken;
- (b) requisite conditions laid down to qualify for the outstanding balance of the loan have been fulfilled;
- (c) the draws from the loan are being kept in a separate Scheduled Bank Account, payments there from 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 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**

To

\_\_\_\_\_

\_\_\_\_\_

**Relevant Terms, Conditions & Covenants, etc. applicable to the  
Sanctioned facility(ies)**

	<i>Terms, Conditions and Covenants</i>	<i>Remarks</i>
1.	The Company/firm to execute necessary security documents/renewal documents for sanctioned/enhanced limit(s) duly supported by Board resolution and create and register stipulated charges with the authorities specified for the purpose within stipulated time limit before release of sanctioned/enhanced limits.	Self Explanatory
2.	Company/firm to have title deeds of the immovable assets released from Term Lenders and re-deposit the same at the Bank as an agent and custodian of First Charge and Second Charge holders.	Self Explanatory
3.	Where Company/firm agrees to give second charge favouring the Bank, it has to complete the process as mentioned in serial “___” above and	

create second charge on block of fixed assets within a period of \_\_\_\_ months (to be as per terms of sanction) to secure the last enhanced limits and the present enhanced limits along with loan of ₹\_\_\_\_\_ sanctioned by us outside the consortium.

Self Explanatory

4. Guarantor(s): All fund based and non fund based facilities to be guaranteed (Joint & Several guarantee) by Mr./M/s. \_\_\_\_\_. The firm/Company shall not pay any guarantee commission to the guarantors.

Self Explanatory

5. The release of credit facilities is also subject to vetting of security documents by the bank's approved advocate and bank's internal procedure of Credit Process Audit. The charges for vetting of the documents by the Bank's advocate are payable by firm/Company

Self Explanatory

6. Stock/book debt statements are to be submitted at a frequency stipulated by the Bank (monthly/quarterly) along with 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

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 quantity

7. The drawing power in the accounts would be arrived at after deducting the unpaid creditors, outstanding balance, if any, in the accepted DA L/C account. In the case of book debts no drawings would be allowed against book debts on sister concerns, unless specifically agreed to by the bank, and also those which are more than 90/180 days old. Drawings would be allowed based on the QIS returns subject to the availability of drawing powers as mentioned above.
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
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.

wise 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 ascertained 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

#### **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.

—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   |
|     |  | <ul style="list-style-type: none"> <li>— Delayed Payments/Return of bills acts as a warning signal to lender on problems likely to arise</li> <li>— Return of goods by drawee can indicate rejections due to product deficiencies or delays in dispatches i.e. inability to meet commitments – may be a reflection of management problems</li> </ul>   |
| 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 | <p>To verify end use of funds for financing only those assets as were originally approved</p> <p>That the pricing of equipments is as per the quotations that may have been obtained originally and that the expenditures are within the budgeted figures</p> <p>— To also verify that the promoter's have brought in their contributions as originally envisaged, in the form and time period stipulated i.e. Form as equity/quasi equity</p> |
| 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.   | — 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   |

**(Only illustrative)**

14. Inspection will be done on quarterly basis (in rotation by consortium member banks) or as and when required by the bank. The Bank has the right of deputing its officials/person(s) (like qualified auditors or management consultants or technical experts) duly authorised by the Bank to inspect the unit, assets, books of accounts/records etc. from time to time. Also the Bank may appoint, at its sole discretion, stock/concurrent auditors, valuers, consultants for specific jobs relating to company's/firm's activities, the cost of which will be borne by the company/firm.

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 installments 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 installments within one month of their falling due, reduction in drawing power/limit, excess borrowings due to over limit, devolvement

— 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 physical assets/amounts due from debtors

— 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

Self Explanatory

Self Explanatory

of L/C, invocation of Guarantee etc. If the account continues to be overdrawn for a period of 90 days, the bank may consider initiation of other action also as deemed fit by the bank.

Self Explanatory

18. Any default in complying with terms of sanction within the stipulated time will attract penal interest of 1% p.a. from the date of expiry of such time.

19. Lead Bank/processing charges of ₹\_\_\_\_\_ will be levied annually. Earmarking charges of ₹\_\_\_\_\_ p.a. per account for Earmark Limit of ₹\_\_\_\_\_ at \_\_\_\_\_ branch, Documentation charges of ₹\_\_\_\_\_ and inspection charges @ ₹\_\_\_\_\_ per inspection are payable. Working Capital Demand Loan (WC DL) conversion to FCL/FCL rollover charges as applicable maximum ₹ 25, 000/- per transaction. Out of pocket expenses incurred towards title verification and valuation of property/assets, inspections/techno-economic appraisal of the project/unit will be recovered separately.

Self Explanatory

20. Commitment charges: A minimum commitment charge of 1% p.a. will be levied on unutilised portion of working capital limits subject to tolerance level of 15% of such limits. Company/firm to intimate in advance about the level of utilisation of the limit through QIS returns. If overall utilisation of fund based limits during the year is less than 60% of the sanctioned limit, then commitment charges of 2% p.a. will be recovered and the limits will be pruned down at the time of review

Self Explanatory

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 repayment.

Self Explanatory

22. The firm/company is required to submit QIS I, II & III returns. QIS I (showing estimates) is required to be submitted in the week preceding the commencement of the quarter to which it relates, QIS II (showing performance) within six weeks from the close of the quarter to which the

— 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

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.

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 (along with comments/explanation) about all material and

— 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

#### 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 manage-

adverse changes in your project/business, ownership, management, liquidity, financial position etc.

ment personnel, winding up petitions filed etc.

Illustrative only

— that any liabilities or obligations under the facilities shall not, at any time, rank postponed in point and security to any other obligation or liabilities to other lending institutions or banks or creditors, unless expressly agreed or permitted by bank.

Self Explanatory

— 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.

Self Explanatory

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 :-

Acts as a Deterrent.

Undertaking to prevent utilisation of funds for unauthorised purposes

— 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;

Prevent diversion of short term funds to long term uses which can seriously impair day to day operations and create strain on cash flow.

— 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

Prevents diversion of funds to unauthorised purposes/ investments not approved/ endorsed by lenders etc.

business or advance to employees can, however be extended.

— undertake guarantee obligations on behalf of any other company/firm/person

Can be debilitating if amount large and default ensues

— declare dividend for any year except out of profits relating to that year after meeting all the financial commitments to the bank and making all due and necessary provisions.

To check disproportionate outgo of funds which can adversely impact repayment of lender's dues

— make any drastic change(s) in its management set-up.

Self Explanatory

— 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.

To check siphoning of funds

— repay monies brought in by the promoters, partners, directors, share holders, their relatives and friends in the business of the company/firm by way of deposits /loans/share application money etc.

To check siphoning of funds

28. Declare the relationship, if any, of the directors of the company with the directors of the bank and senior officers of the bank.

Self Explanatory

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.

Self Explanatory

30. The company/firm to take prior approval from bank for opening any account with any other bank/other branch of our bank.

To check diversion of funds/ utilization for unauthorized purposes/ investments

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.	Self Explanatory
32.	<p>The company/firm to submit a stamped declaration cum undertaking to the effect that :-</p> <p>—the company/firm or its directors/partners/promoters/guarantors/associate concerns of the company/firm are not on ECGC Caution list/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.</p> <p>—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.</p> <p>—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.</p>	<p>Self Explanatory</p> <p>Self Explanatory</p> <p>Self Explanatory</p>
33.	The credit facilities shall be utilised only for the purposes for which same are granted and said facilities shall not be 'diverted' or 'siphoned off' or used for any other purposes.	Self Explanatory
34.	In case of default in the repayment of loans/advances/above said facilities or in the repayment of interest thereon or any of the installment of Loan as per stipulated terms, or in the event of diversion or siphoning off or utilising the said facilities for any other purpose other than for which it is granted, the Bank and/or the Reserve Bank of India (RBI) will have an unqualified right to disclose or publish the name of the company/firm or its directors/partners as defaulters in such manner and through such medium as the Bank or RBI or such other agency authorised by them, in their absolute discretion may think fit.	Self Explanatory

35. Please note that the cheques drawn by firm/ Company will not be honoured by bank if in its view the payment is going towards a purpose for which the facilities are not sanctioned. Further, please note that Bank will not allow cash withdrawals beyond Rs.\_\_\_\_\_ per cheque/per day.

To prevent diversion to un- authorised purposes/investments/ siphoning off of funds

36. Bank assumes no obligation whatsoever to meet your further (fund based or non fund based) requirements on account of growth in business or otherwise without proper revision and sanction of credit limits decided at the sole discretion of the bank. Further, if sanction terms are not complied with by you or if your account is classified as Non-performing Asset (NPA), then bank may not allow further withdrawals in the account.

Self Explanatory

37 (a) Notwithstanding what is stated herein above, we shall at any time and from time to time, be entitled to notify you and charge interest/commission/charges at such notified rates and this letter shall be construed as if such revised rates were mentioned herein.

Self Explanatory

(b) You shall pay to or reimburse all costs, charges, expenses (including charges between the attorney or counsel and bank and those of our internal legal adviser/officer and other experts, consultants or professionals), disbursements, taxes, fees, stamp duties etc. whatsoever, incidental or to arising out of the facilities, their negotiation, the preparation, execution, registration and stamping of the documents relating thereto, the preservation or protection of our rights and interests of the enforcement or realisation of any security or any demand or any attempted recovery of the amounts due from you.

Self Explanatory

38. We shall be entitled to debit the amounts of all costs, charges and expenses to your account and such amounts shall stand secured by all securities given to or created in our favour in connection with the facilities. You indemnify and keep us fully and completely indemnified from time to time against the liabilities including all costs, charges and expenses stipulated herein whether debited to your account or not.

Self Explanatory



- |     |   |   |
|-----|---|---|
| 39. | Any failure to exercise or delay in exercising any of our rights hereunder or under any other documents will not act as a waiver of that or any other right nor shall any single or partial exercise preclude any future exercise of that right.  | Self Explanatory  |
| 40. | So long as any monies are due to us from you under any of the facilities, we shall have a lien/charge for such amounts on all your credit balances, deposits, securities or other assets with, any of the branches of the Bank or of its subsidiaries any where in the world and upon the happening of any of the events of default referred herein, we shall be entitled to exercise a right of set off between the amounts due and payable to us and the said credit balances, deposits, securities and other assets. | Self Explanatory  |
| 41. | You shall not, except after prior written permission from us, make any alterations in your constitution, controlling ownership or any documents relating to its constitution or any other material change in your management or in the nature of your business or operations during the period of the subsistence of facilities.  | Self Explanatory  |
| 42. | The bank reserves the right to discontinue any/all the credit facilities granted without giving you any prior notice in case of non-compliance and/or breach of any of the terms and conditions based on which the facilities have been sanctioned to you and/or if any information/particulars/documents furnished by you are found to be incorrect.   | Self Explanatory  |
| 43  | You shall not undertake derivative transactions without approval of the Bank. You should obtain NOC from the Bank before entering into any derivative agreement with any other Bank.  | Self Explanatory  |
| 44. | The Bank carries out the credit rating exercise every year when the facilities are reviewed. However, it reserves the right to carry out the credit rating exercise of the facilities at frequencies considered necessary and the rate of interest chargeable to the facilities would depend upon the rating obtained by the borrowing firm/Company.  | Self Explanatory. Due to implementation of Basel II, External rating is also being asked for. |

The Bank reserves the right to add, amend, alter,

cancel and modify any of the terms and conditions stipulated hereinabove with or without any prior reference to you. Further, the bank's general rules governing advances shall also apply. The company/firm to abide by such terms and conditions as the bank may stipulate from time to time.

Self Explanatory

#### PARA NO. 15 OF THE REPORT:

**The Company has insured fully all its assets.**

Particulars of Insurance cover obtained by the Company are as under:-

Sl. No.	Particulars of Asset Insured	Value of Asset (₹)	Sum Insured (₹)	Risk Covered	Amount of Policy	Insurance Company	Insurance Policy Number
1.						M/s ...	
2.						M/s ...	
3.						M/s ...	

**Note :** Insert a remark, whether all the assets have been insured and provide a list of assets that haven't been insured.

#### Compliance Inputs

- Original insurance policies
- Register of Assets
- Collateral Security offered to the lenders
- Stock Statement
- Premium payment receipts

#### Checklist for Insurance Policies

- (a) Verify the original insurance policies and check carefully the details of assets covered by the policy.
- (b) The Company should take a Policy from a General Insurance company registered with IRDA
- (c) Policies are issued for a period of one year. Sometimes, short period policies for less than one year are also issued. Hence Policy period should be checked.
  - Generally Fire Insurance policies cover immovable properties, stocks etc. Earthquake, Terrorism etc. are given as add on covers. Vehicles should have Valid Comprehensive

## Insurance Policies.

- Sum insured should represent the Market value/Replacement value as the case may be (not book value) or else, under insurance will be applicable. Name, address, situation (with Building No. etc.) of the Company should tally with the records.
- Name of the mortgagee should be verified.
- Any endorsement during the policy period, noting the changes in the sum insured, situation, risk etc. should be verified.

**Checklist for Terms of Insurance**

Check the following in regard to compliance of terms of insurance:

- (a) the company's assets have been insured comprehensively. Where a joint insurance on plant and buildings has been taken, the value thereof has been apportioned in the manner prescribed/ approved;
- (b) the insurance policy has been taken in the joint names of the company and the bank(s)/financial institution(s) ;
- (c) the policy has been kept alive for such full value, as has been determined by the bank(s)/financial institution(s) , all premia are being paid on time, and the company has not done any such act as would render the policy void or voidable;
- (d) the policy has been taken from an insurance office of repute, as determined by the bank(s)/financial institution(s) ; and
- (e) all moneys received under the insurance policies are held in trust for better securing to the bank(s)/ financial institution(s) , the payment of all moneys secured under the indenture agreement.

**PARA NO. 16 OF THE REPORT:**

**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 willful default**

A "willful 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 willful defaulters, a copy of the list of willful defaulters (non-suit filed accounts) and list of willful 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 Suit Filed Accounts and Willful Defaulters. These are available on the Reserve Bank of India website on a special URL: [defaulters.rbi.org.in](http://defaulters.rbi.org.in)

#### 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.

#### PARA NO. 17 OF THE REPORT:

**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](http://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;

#### PARA NO. 18 OF THE REPORT:

**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

**PARA NO. 19 OF THE REPORT:**

**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 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 there from 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 judgment of the lenders based on objective facts and circumstances of the case.

The identification of the willful 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 willful must be intentional, deliberate and calculated.

## Compliance Inputs

### *Term Loan*

#### Large term loans

- In most cases, more than one bank will be involved and a lender's engineer might have been appointed, who is expected to inspect and benchmark progress against milestones and expenditure incurred commensurate with the drawals. The PCS may rely on such certification.
- Wherever letters of credit (inland/foreign) have been opened for specific items of capital expenditure and the relative bill(s) debited to term loan account end use is automatically taken care of.
- It's quite likely that in some projects where civil construction takes place, architect certificate is asked for. The PCS may rely on such certification.
- Lenders in some specific cases, permit reimbursement of expenditure incurred. PCS are advised to verify that proper certification exists for such transactions.
- Wherever items of expenditure are clearly identified PCS may comment on compliance with monetary outgo in respect of such items.

#### *Mid Size and Small Projects*

- Wherever lenders engineer/architect certification is available these may be relied upon; similarly for inland foreign L/C for capital expenditure.
- In other cases PCS may verify mode of payment made to the supplier/intended beneficiary in respect of drawals from term loans.
- Wherever certification such as engineer/chartered engineer's valuation report exists, reliance can be placed on the same.

### *Working Capital*

#### Cash Credit Accounts

- Compliance inputs
  - Cash and Bank Book
  - Stocks/Book debts Statements submitted to the bank(s)
  - Monthly Select Operational Data (MSOD)/Quarterly Information System (QIS)/Financial Follow up Report (FFR) filings to banks

- Stock /Book Debt (Receivables) Audit Report commissioned by any of the member bank(s)
- Auditors Report under CARO to ensure compliance
- Quality of Inventory Management system

**Suggested alerts:**

- Disproportionately large cash payments in relation to normal requirements in a company of its size
- Frequent circular transactions between various bank accounts
- Inordinate delay in submission of stock statements/book debts/quarterly filings to the Bank(s)
- Large differences between MSOD/QIS2/FFR etc. with stock statements and inventory regularly and particularly as on date of balance sheet.
- Delay/default in meeting statutory payments
- Any apparent unrelated payment(s) that come to notice
- Disproportionate holding of Work-in-progress (WIP)
- Regular on account payments to creditors
- Regular on account payments from debtors
- Any differential pricing system to associates
- Any attachment of bank accounts from statutory authorities (input from bank)
- Borrowings from unconventional sources
- Dishonour of cheques
- Unduly large sales returns/return of bills
- Lack of tie ups in project finance resulting in diversion of short term funds
- Winding-up cases if any filed against the company
- Insolvency proceedings against any of the promoter(s)/director(s)

**PARA NO. 23 OF THE REPORT:**

**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 or under the Companies Act, 2013 and if so, assess the status at the time of issuing the Compliance Certificate;
- (e) Check whether any fines and penalties or any other punishment was imposed on the company;
- (f) Check whether any order has been issued under the Companies Act, 1956 or under Section 441 of Companies Act, 2013 (as and when the latter is notified) for compounding of the offences; if so check whether the company has complied with the orders passed by the concerned authorities.

**PARA NO. 25 OF THE REPORT:**

**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 of Companies Act, 1956 or invested in the securities mentioned or referred to in clause (a) to (e) of section 20 of the Indian Trust Act, 1882.

**Annexure - I**

**Minimum Information to be Declared by Borrowing Entities to  
Banks while Approaching for Finance under Multiple Banking Arrangement**

A. Details of borrowing arrangements from other banks  
(institution-wise and facility-wise)

I. Name and address of bank/institution

II. Facilities availed

A. Fund-based credit facilities

(Indicate the nature of facilities e.g. working



capital/demand loan/term loan/short term loan)/foreign currency loan, corporate loan/line of credit/Channel financing, bill discounting etc. amount and the purpose)

B. Non-fund-based facilities other than derivatives

(Indicate the nature of facilities e.g. L/C, BG, DPG (I & F) etc. amount and the purpose)

C. Derivatives contracts entered into with the bank

(Indicate the nature of the contract, maturity, amount and the purpose)

III. Date of sanction

IV. Present outstanding

(In the case of derivatives contracts, negative MTM i.e which is not due for settlement may be indicated)

V. Overdues position, if any

(In the case of derivatives contracts, the negative MTM i.e. amount payable to the bank under the contract but not yet paid may be indicated)

VI. Repayment terms

(for demand loans, term loans, corporate loans, project - wise finance)

VII. Security offered

(complete details of security both primary and collateral including specific cash flows assigned to project wise finance/loan raised & personal/corporate guarantee, to be furnished)

VIII. Requests for facilities which are under process

[The information to be given for domestic and overseas borrowings from commercial banks, Financial Institutions and NBFCs]

**B. Miscellaneous Details**

(Rs. in crore)

I. CPs raised during the year and current outstanding

II. Details of financing outside banking system e.g. L/C Bills discounting

III Amount of **un-hedged** foreign currency exposures( please give currency-wise position in the format given below)

- (i) *Short term exposures (less than one year)*
  - (a) Long positions
  - (b) Short positions
  - (c) Net Short term Exposure (a-b)
- (ii) *Long term exposures ( one year and beyond)*
  - (a) Long positions
  - (b) Short positions
  - (c) Net Long term exposure a-b)
- (iii) Overall Net Position (i-ii) for each currency
- (iv) Overall Net Position across all currencies
- III. Main and allied activities with locations
- IV. Territory of sales and market share
- V. Details of financial aspects incl. DSCR Projections wherever applicable as per requirement of bank - Imp. Financial covenants, if any, agreed to/accepted with other lenders.
- VI. CID A/Cs, within/outside financing Banks, being operated, if any
- VII. Demands by statutory authorities/current status thereof
- VIII. Pending litigations
- IX. A declaration authorizing the bank to share information with other financing banks

## Annexure - II

### **Revised Format under Multiple Banking Arrangement Credit Information Exchange**

#### **Part – I**

#### **Bio Data of the Company**

- I. Borrowing party's name and address
- II. Constitution
- III. Names of Directors/Partners
- IV. Business activity
  - \* Main
  - \* Allied

- V. Names of other financing Banks
- VI. Net worth of Directors/Partners
- VII. Group affiliation, if any
- VIII. Date on associate concerns, if banking with the same bank
- IX. Changes in shareholding and management from the previous report, if any

## Part - II

### Major credit quality indicators

- I. IRAC Classification
- II. Internal Credit rating with narration
- III. External Credit rating, if any
- IV. Latest available Annual Report of the borrower      As on -----

## Part – III

### Exposure Details other than Derivatives

*(Rs. in crore)*

- I. Type of credit facilities, e.g. working capital loan/demand loan/term loan/short term loan/foreign currency loan, corporate loan/line of credit/Channel financing, contingent facilities like LC, BG & DPG (I & F) etc. Also, state L/C bills discounting/project wise finance availed).
- II. Purpose of loan
- III. Date of loan facilities (including temporary facilities)
- IV. Amount sanctioned (facility wise)
- V. Balance outstanding (facility wise)
- VI. Repayment terms
- VII. Security offered
  - \* Primary
  - \* Collateral
  - \* Personal/Corporate Guarantees
  - \* Extent of control over cash flow

VIII. Defaults in term commitments/lease rentals/others

IX. Any other special information like court cases, statutory dues, major defaults, adverse internal/external audit observations

#### Part - IV

#### Exposure Details – Derivatives Transactions

(Rs. in crore)

Sr.No.	Nature of the derivatives Transactions	Notional Amount of contracts	Weighted - average maturity of contracts	Amount of positive MTM for the bank (Not due for settlement)	Amount of contracts classified as NPA	Notional Amount of outstanding contracts which have been restructured	Major reasons for restructuring (in brief)
A.	Plain Vanilla Contracts						
1.	Forex Forward contracts						
2.	Interest rate Swaps						
3.	Foreign Currency Options						
4.	Any other contracts (Please specify)						
B.	Complex derivatives including various types of option combinations designed as cost reduction/zero cost structures						
1.	Contracts involving <u>only</u> interest rate derivatives.						
2.	Other contracts including those involving						

- foreign  
currency  
derivatives
3. Any other  
contracts  
(Please  
specify)

### Part – V

#### Un-hedged foreign currency exposures of the borrower with currency-wise details

(Rs. in crore)

#### I Short term exposures (less than one year)

- (a) Long positions
- (b) Short positions
- (c) Net short- term exposure (a-b)

#### II Long term exposures ( one year and beyond)

- (a) Long positions
- (b) Short positions
- (c) Net long-term exposure (a-b)

#### III Overall Net Position (I –II) for each currency ( Please give Overall Net Position in this format for each currency)

#### IV Overall Net Position across all currencies

### Part – VI

#### Experience with the borrower

- I. Conduct of funded facilities (based on cash  
management/tendency to overdraw)
- II. Conduct of contingent facilities (based on  
payment history)
- III. Compliance with financial covenants
- IV. Company's internal systems & procedures
- V. Quality of management
- VI. Overall Assessment

(The above to be rated as good, satisfactory or below par only)

(\*) Broad guidelines for incorporating comments under this head is furnished in the next page

#### Broad Guidelines for Incorporating Comments under Part - VI (Experience) of the Credit Information Report

	Good	Satisfactory	Below Par
<b>I. Conduct of funded facilities</b>			
* Over-drawings (No. of times)	Upto 4 times	5 to 6 times	Above 6

					times	
	* Average period of adjustment	Within month	1	Within months	2	Beyond months 2
	* Extent of overdrawings (% of limit)	Upto 10%		10 to 20%		Above 20%
<b>II.</b>	<b>Conduct of contingent facilities (Other than Derivatives)</b>					
	* No. of Defaults	Upto 2 times		3 to 4 times		Above times 4
	* Average period of adjustment	Within 1 week		Within 2 weeks		Beyond weeks 2
<b>III</b>	<b>Conduct of Derivatives Transactions</b>					
	* No. of contracts where the positive MTM value due to the bank remained overdue for more than 30 days	<25% of total number of contracts		25-50% of total number of contracts		> 50% of total number of contracts
	* No. of contracts where the positive MTM value due to the bank remained overdue for more than 90 days and the account had to be classified as NPA ( but later on regularized and is not NPA as on the date of exchange of information) Note: All cases where any of the contracts has been classified as NPA and continues to be NPA as on the date of the exchange of information should be shown as Below Par)	<1% of total number of contracts		1-5% of total number of contracts		> 5% of total number of contracts
	* No. of contracts restructured during the relevant period	<25% of total number of contracts		25-50% of total number of contracts		> 50% of total number of contracts
<b>IV.</b>	<b>Compliance with financial covenants</b>					
	* Stock statement/Financial data	Timely		Delay upto 15 days		Delay over 15 days
	* Creation of charge	Prompt		Delay upto 2 months		Delay over 2 months
<b>V.</b>	<b>Company's internal systems and procedures</b>					
	* Inventory Management	Adequate systems are in place		Adequate systems are in place but not adhered		Adequate systems are not in place
	* Receivables Management	- do -		- do -		- do -
	* Resource Allocation	- do -		- do -		- do -
	* Control over Information	- do -		- do -		- do -
<b>VI.</b>	<b>Quality of management</b>					
	* Integrity	Reliable		Nothing adverse		Cannot be categorized in previous columns

*	Expertise Competence/Commitments	Professional & visionary	Have necessary experience	-do-
*	Tract Record	Timely	Executions /	-do-

#### V. Company's internal systems and procedures

*	Inventory Management	Adequate systems are in place	Adequate systems are in place but not adhered	Adequate systems are not in place
*	Receivables Management	- do -	- do -	- do -
*	Resource Allocation	- do -	- do -	- do -
*	Control over Information	- do -	- do -	- do -

#### VI. Quality of management

*	Integrity	Reliable	Nothing adverse	Cannot be categorized in previous columns
*	Expertise Competence/Commitments	Professional & visionary	Have necessary experience	-do-
*	Tract Record	Timely	Executions /	-do-

### 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 Notification 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 Notification dated January 21, 2009 also advised all Primary Urban Co-operative Banks to obtain Diligence Report. Subsequently the RBI vide its Notifications 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 Notification dated February 12, 2009.
- This report includes twenty five point compliance check list covering matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilisation/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc.

## SELF TEST QUESTIONS

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

1. What is the necessity for diligence report for banks?
2. What are the aspects covered in the diligence report for banks?
3. Describe the compliance with respect to listed companies in the context of diligence report for banks.

This image shows a blank sheet of white paper with horizontal black ruling lines. The lines are evenly spaced and run across the width of the page. There is no handwriting or other markings on the paper.





# Lesson 10

## Environmental Due Diligence

### LESSON OUTLINE

- Introduction
- Environmental failures may lead to financial, reputational damage and business discontinuity as well.
- Why Environmental due diligence?
- Process involved in environmental due diligence
- Regulatory framework relating to environment
- Checklist on various compliances
- Environment Impact Assessment
- Environment Management Plan
- Identification of potential issues, impact analysis and remedial measures etc.,

### LEARNING OBJECTIVES

Environmental failures not only result in financial loss, but reputation loss, public damage and at times total business failure. Compliance with environmental responsibilities from the letter and spirit is the primary requirement of organizations today for business sustainability.

Environmental due diligence has gained importance in the recent past while carrying out inorganic business transactions such as mergers, acquisitions, takeovers etc mainly due to increased awareness and consciousness of the public from potential negative environmental impact of the organization that may be caused by the company on them. Besides the regulatory framework also supports the environmental cleaning mechanism. Any potential non compliance of laws /negligence towards society would cause major environmental risk which will have an impact on the financial side too, in addition to reputational damage.

After reading this study you will be able to understand the impact of environmental failures on business, importance of due diligence on environmental obligations of business, various compliances of environmental laws, environment impact assessment, environment management plan etc.,

“Earth provides enough to satisfy every man's needs, but not every man's greed.”

— *Mahatma Gandhi*

Environmental Due Diligence has become an important feature of an increasing number of mergers & acquisitions (M&A) transactions.

— *Environmental Due Diligence: a survey of major UK companies by KPMG*

## INTRODUCTION

Environmental problems often threaten the viability of transactions. If a business transaction proceeds without environmental risks being correctly evaluated or addressed, they can significantly reduce the profitability of the acquisition.

Society is increasingly unwilling to tolerate harm to the environment, and those businesses that are perceived to be irresponsible towards environment and community can expect considerable criticisms from the media and public. Environmental risk can have serious negative effects on an organisation's financial well being and its ability to achieve its business objectives.

Considering the impact of business failures towards environment in terms of cost of non-compliance, in terms of economic and other reputational matters, businesses are to be assessed from the point of view of environment, wherever applicable.

**Environmental failures may lead to financial, reputational damage and business discontinuity as well.**

Environmental non-compliances may not only result in huge financial liability or reputation wreck, but also may result in business discontinuity or huge public damage. The following case studies would throw some light on the impact of environmental failures.

### **1. Sri Ram Food and Fertilizer Case (M.C. Mehta v. Union of India, AIR 1987 SC 1086)**

In that case, a major leakage of Oleum Gas affected a large number of persons, both amongst the workmen and public. The Supreme Court held that where an enterprise is engaged in a hazardous or inherently dangerous activity and harm results to any one on account of an accident in the operation of such hazardous and inherently dangerous activity resulting in the escape of toxic gas, the enterprise is strictly and absolutely liable to compensate all those who are affected by the accident and such a liability is not subject to any exception. Hon'ble Supreme Court also pointed out that the measure of compensation in such kind of cases must be co-related to the magnitude and capacity of the enterprise because such compensation must have a deterrent effect. The larger and more prosperous the enterprise, the greater must be the amount of compensation payable by it.

### **2. Dehradun Valley Case (Rural Litigation & Entitlement Kendra v. State of U.P., AIR 1985 SC 652; see also AIR 1988 SC 2187)**

In that case, carrying haphazard and dangerous limestone quarrying in the Mussoorie Hill range of the Himalaya, mines blasting out the hills with dynamite, extracting limestone from thousands of acres had upset the hydrological system of the valley. The Supreme Court ordered the closing of limestone quarrying in the hills and observed that this would undoubtedly cause hardship to them, but it is a price that has to be paid for protecting and safeguarding the right of the people to live in healthy environment with minimal disturbance of ecological balance. Thus, Hon'ble Supreme Court attended to the need to balance environmental and ecological integrity against industrial demands on forest resources.

### **3. Effluents by tanneries in river Ganga (M.C. Mehta v. Union of India, AIR 1115, 1988 SCR (2) 530)**

In M.C. Mehta v. Union of India the Court directed that the work of those tanneries be stopped, which were discharging effluents in River Ganga and which did not set up primary effluent treatment plants. It held that the financial incapacity of the tanners to set up primary effluent treatment plants was wholly irrelevant. The Court observed the need for (a) imparting lessons in natural environment in educational institutions, (b)

group of experts to aid and advise the Court to facilitate judicial decisions, (c) constituting permanent independent centres with professional public spirited experts to provide the necessary scientific and technological information to the Court, and (d) setting up environmental courts on regional basis with a right to appeal to the Supreme Court.

### Why Environmental Due diligence?

As discussed, environmental failure may result in ethical disaster and business continuity. For any type of strategic decision, be it a strategic alliance, starting up of a new venture, merger or acquisition, due diligence of environmental factors, both present and prospective, covering regulatory and social issues, are vital and essential.

#### Some of the reasons for performing environmental due diligence:

- To assess hazardous substances emission and the mitigation measures through examination of industrial sites
- Regulatory compliances and the cost of non-compliances if any
- Societal reaction to emission of effluents and its impact on the financial health of the company.
- To have an overall environmental impact assessment
- To suggest remedial course of actions and environmental management plan
- To assess the sustainability initiatives of the company and its potential impact on the business
- To allocate liabilities identified during the investigation, draft indemnities, or perhaps re-price the deal.

### Process involved in Environmental Due diligence

Environmental due diligence involves

#### 1. Company analysis

- Business assessment
- Sites assessments
- Products assessment
- Process assessment
- Safety standards
- Pollution control mitigation measures

#### 2. Media Report Analysis

#### 3. Stakeholders analysis

#### 4. Regulatory Analysis (Potential Compliance Risks)

- Regulatory compliance check lists
- Non compliance details from Regulatory authorities

#### 5. Risk analysis matrix

- Nature of business

- Area of operations
- Potential Issues
- Impact Assessment
- Mitigation measures
- Management plan

#### 6. Reporting and suggestions.

### Regulatory Framework relating to environment

#### Indian Constitution and Environment

Indian Parliament inserted two Articles, i.e., 48A and 51A in the Constitution of India in 1976. Article 48A of the Constitution which is a part of Directive Principles directs that the State shall endeavour to protect and improve the environment and safeguard forests and wildlife of the country. Similarly, clause (g) of Article 51A which is a part of Fundamental Duties imposes a duty on every citizen of India, to protect and improve the natural environment including forests, lakes, river, and wildlife and to have compassion for living creatures. The cumulative effect of Articles 48A and 51A (g) seems to be that the 'State' as well as the 'citizens' both are now under constitutional obligation to conserve, perceive, protect and improve the environment.

Besides, a number of Central/State Legislations/Regulations etc., govern environmental aspects India. It includes the following

#### Acts

- **The Water (Prevention and Control of Pollution) Act** was enacted in 1974 to provide for the prevention and control of water pollution, and for the maintaining or restoring of wholesomeness of water in the country.
- **The Water (Prevention and Control of Pollution) Cess Act** was enacted in 1977, to provide for the levy and collection of a cess on water consumed by persons operating and carrying on certain types of industrial activities and with a view to augment the resources of the Central Board and the State Boards for the prevention and control of water pollution constituted under the Water (Prevention and Control of Pollution) Act, 1974.
- **The Air (Prevention and Control of Pollution) Act** was enacted in 1981 and amended in 1987 to provide for the prevention, control and abatement of air pollution in India.
- **The Environment (Protection) Act** was enacted in 1986 with the objective of providing for the protection and improvement of the environment.
- **Public Liability Insurance Act, 1991** was enacted to provide for damages to victims of an accident which occurs as a result of any hazardous activity or due to handling any hazardous substance.
- **National Green Tribunal Act, 2010** was enacted for effective and expeditious disposal of cases relating to environmental protection and conservation of forests and other natural resources including enforcement of any legal right relating to environment and giving relief and compensation for damages to persons and property and for matters connected therewith or incidental thereto.

#### Rules

1. The Water (Prevention and Control of Pollution) Cess Rules, 1978

2. The Water (Prevention and Control of Pollution) Rules, 1975
3. The Air (Prevention and Control of Pollution) (Union Territories) Rules, 1983
4. The Air (Prevention and Control of Pollution) Rules, 1982
5. The Environment (Protection) Rules, 1986
6. The Public Liability Insurance Rules, 1991
7. Hazardous Wastes (Management, Handling and Transboundary Movement) Rules, 2008

All the above Rules are also amended from time to time.

From the above facts, we can derive that there is no dearth of legislations in India. What is needed is the effective and efficient enforcement of the constitutional mandate and the other environmental legislations. This can be achieved with the co-ordinated efforts of the states as well as citizens.

### CHECKLIST ON MAJOR COMPLIANCES

#### THE ENVIRONMENT (PROTECTION) ACT, 1986 (READ WITH THE ENVIRONMENT (PROTECTION) RULES, 1986)

<i>Sl. No.</i>	<i>Section/ Rule</i>	<i>Nature of Statutory Compliance</i>	<i>Due date</i>	<i>Penalty</i>
1.	Sec. 5 & Rule 4	<p>A company has to follow directions given by the Central Government. The direction shall specify the nature of action to be taken and the time within which it shall be complied with by the company.</p> <p>The Directions may include closure, prohibition or regulation of industry, process or operation, stoppage or regulation of electricity or water or any other service.</p>	As and when	<p>Imprisonment for a term which may extend to five years or with fine which may extend to 1 lakh or with both.</p> <p>In case the failure or contravention continues with additional fine which may extend to ₹5,000/- for every day during which such failure or contravention continues after convictions for the first such failure or contravention. (Section 15)</p> <p>Any person aggrieved by the direction may prefer an appeal to National Green Tribunal. [Section 16(G) of the National Green Tribunal Act, 2010]</p>
2.	Sec. 7	A company carrying on any industry, operation or process shall not discharge or emit or permit to be discharged or emitted any environmental pollutant in excess of such standards as may be	Always	Penalty as prescribed under Section 15, as mentioned in

		prescribed.		point no. 1.
3.	Sec.8	Company not to handle or cause to be handled any hazardous substance except in accordance with such procedure and after complying with such safeguard as may be prescribed.	Always	
4.	Sec. 9	A company shall be responsible for the discharge of any environmental pollutant in excess of the prescribed standard due to any accident or other unforeseen act or event and the person in charge of the place at which such discharge occurs or is apprehended to occur shall be bound to prevent or mitigate the environmental pollution caused as a result of such discharge and shall also forthwith – (i) intimate the fact of such occurrence or apprehension of such occurrence (ii) be bound, if called upon, to render all assistance, to such authorities or agencies as may be prescribed.	Always	Where any offence has been committed by a Company, every person who was directly in charge of and was responsible to the Company for the conduct of business of the Company as well as the Company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. (Section 16)
5.	Sec. 10	A company has to assist the person empowered by the Central Government to enter and inspect any place of the company for carrying out the functions required under the Act	As and when	Penalty as prescribed under Section 15, as mentioned in point no. 1.
6.	Sec. 11	A company has to give access to the Central Government or any offices empowered by it to collect, for the purpose of analysis, samples of air, water, soil or other substance from the factory, premises or	As and when	Penalty as prescribed under Section 15, as mentioned in point no. 1.

		other place in such manner as may be prescribed.		
7.	Rule 12 (under Sec. 9 mentioned above)	Where the discharge of environmental pollutant in excess of the prescribed standard occurs or is apprehended to occur due to any accident, the person in charge of the place at which such discharge occurs or is apprehended to occur shall forthwith intimate the fact of such occurrence to the authorities as specified in these provisions.	As and when	Penalty as prescribed under Section 15, as mentioned in point no. 1.
8	Rule 14	Every person carrying on an industry, operation or process requiring consent under Section 25 of the Water (Prevention and Control of Pollution) Act, 1974 or under section 21 of the Air (Prevention and Control of Pollution) Act, 1981 or both or authorization under the Hazardous Wastes (Management and Handling) Rules, 1989 issued under the Environment (Protection) Act, 1986 shall submit an environmental audit report for the financial year ending the 31st March in prescribed form (Form V) to the concerned State Pollution Control Board.	On or before the thirtieth day of September every year	Penalty as prescribed under Section 15, as mentioned in point no. 1.

**THE WATER (PREVENTION & CONTROL OF POLLUTION) ACT, 1974**  
**[READ WITH WATER (PREVENTION & CONTROL OF POLLUTION) RULES, 1975]**

Sl. No.	Section/ Rule	Nature of Statutory Compliance	Due Date	Penalty
1	Section 20	Directions from state government regarding abstracting water from any stream or well as also discharge of sewage and	As and when	Imprisonment for a term which may extend to three months or with fine which may extend to ten thousand rupees or with both and in case the failure continues, with an additional



		effluents.		fine which may extend to five thousand rupees for every day during which such failure continues after the conviction for the first such failure.(Section 41)
2	Section 24	A company shall not knowingly cause or permit any poisonous, noxious or polluting matter determined in accordance with such standards as may be laid down by the State Board to enter (whether directly or indirectly) into any stream or well or sewer or on land to enter into any stream any other matter which may tend, either directly or in combination with similar matters, to impede the proper flow of the water of the stream in a manner leading or likely to lend to a substantial aggravation of pollution due to other causes or of its consequences. (this is subject to certain exemptions provided under Section 24 (2)	Always	Imprisonment which shall not be less than one year and six months but which may extend to six years and with fine. (Section 43)
3.	Sec. 25	A company to take previous consent of the State Board by making Application in prescribed form (FORM XIII) : (i) to establish or take any steps to establish any industry, operation or process, or any treatment and disposal system or any extension or addition thereto, which is likely to discharge sewage or trade effluent into a stream or well or sewer or on land or (ii) to bring into use any new or altered outlet for the discharge of sewage or (iii) to begin to make any new	Always	Imprisonment which shall not be less than one year and six months but which may extend to six years and with fine. (Section 44)

		discharge of sewage.		
4.	Sec. 31	If at any place where any industry, operation or process, or any treatment and disposal system or any extension or addition thereto is being carried on, due to accident or other unforeseen act or event, any poisonous, noxious or polluting matter is being discharged, or is likely to be discharged into a stream or well or sewer or on land and, as a result of such discharge, the water in any stream or well is being polluted, or is likely to be polluted, then the person in charge of such place shall forthwith intimate the occurrence of such accident act or event to the State Board.	Always	Imprisonment which may extend to three months or with fine which may extend to ten thousand rupees or with both and in the case of a continuing contravention or failure, with an additional fine which may extend to five thousand rupees for every day during which such contravention or failure continues after conviction for the first such contravention or failure.(Section 45A)

**THE AIR (PREVENTION & CONTROL OF POLLUTION) ACT, 1981**  
**[READ WITH THE AIR (PREVENTION & CONTROL OF POLLUTION) RULES, 1982]**

<b>Sl. No.</b>	<b>Section/ Rule</b>	<b>Nature of Statutory Compliance</b>	<b>Due Date</b>	<b>Penalty</b>
1	Section 19	Adhering to the directions of State Government regarding use of approved fuel.	As and when	Imprisonment for a term which may extend to three months or with fine which may extend to ten thousand rupees or with both, and in the case of continuing contravention, with an additional fine which may extend to five thousand, rupees for every day during which such contravention continues after conviction for the first such contravention.(Section 39)
2.	Sec. 21	A company shall have to obtain prior consent of the State Board, to establish or operate any industrial plant in an Air Pollution Control Area. Upon consent being granted by the State Board to the Company, the Company shall	As and when	Imprisonment for a term which shall not be less than one year and six months but which may extend to six years and with fine and in case the failure continues, with an additional fine which may extend to five thousand rupees for every day during which such failure continues after the

		comply with the conditions as may be imposed by the State Board within the stipulated period.		conviction for the first such failure. If the failure referred above continues beyond a period of one year after the date of conviction, the offender shall be punishable with imprisonment for a term which shall not be less than two years but which may extend to seven years and with fine. (Section 37)
2.	Sec. 21(5)	<p>After consent has been granted by the State Board it, shall have to comply with the following :-</p> <p>the control equipment of such specification as the State Board may approve in this behalf shall be installed and operated in the premises where the industry is carried on/ proposed to be carried on;</p> <p>the existing control equipment, if any, shall be altered or replaced in accordance with the directions of the State Board;</p> <p>the control equipment referred to in clause (i) or clause (ii) shall be kept at all times in good running condition;</p> <p>chimney, wherever necessary, of such specifications as the State Board may approve in this behalf shall be erected or re-erected in such premises;</p> <p>such other conditions as the State Board may specify in this behalf and</p> <p>the conditions referred to in clause (i) (ii) and (iv) shall be complied with within such period as the State Board may specify in this behalf.</p>	Always	Penalty under Section 37 as mentioned above.
3.	Sec. 22	Company not to operate any industrial plant, in any air pollution control area, which shall discharge or cause or permit to be discharged the emission of any air pollutant in	Always	Penalty under Section 37 as mentioned above.

		excess of the standards laid down by the State Board.		
4.	Sec. 23	Where in any area the emission of any air pollutant into the atmosphere in excess of the standards laid down by the State Board occurs or is apprehended to occur due to accident or other unforeseen act or event, the person in charge of the premises from where such emission occurs or is apprehended to occur shall forthwith intimate the fact of such occurrence or the apprehension of such occurrence to the State Board and to the prescribed authorities or agencies.	Always	Three months or fine up to ten thousand rupees or both (Section 38(e).)
5.	Sec. 24(2)	The Company operating any control equipment or any industrial plant, in an air pollution control area shall be bound to render all assistance to the person empowered by the State Board for carrying out the functions and if he fails to do so without any reasonable cause or excuse, he shall be guilty of an offence under this Act.	Always	Penalty under Section 39 as mentioned in point 1.
6.	Sec. 24(3)	If any person willfully delays or obstructs any person empowered by the State Board in the discharge of his duties, he shall be guilty of an offence under this Act.	As and when	Penalty under Section 38(b) as mentioned in point no. 4
7.	Sec. 31A	If any direction is given by the State Board, the Company is to comply with such direction.	Always	Penalty under Section 37 as mentioned in point 1.

### Environmental Guidelines for Industries by Ministry of Environment<sup>1</sup>

#### Location of industry

<sup>1</sup> www.moef.gov.in

In order to help the concerned authorities and the entrepreneurs, it is necessary to frame certain broad guidelines for setting up an industry. It is also necessary to identify the parameters that should be taken into account while setting up an industry. With this in view, the following environmental guidelines are recommended for setting up of Industries to ensure optimum use of natural and man-made resources in sustainable manner with minimal depletion, degradation and/or destruction of environment. Those are in addition to those directives that are already in existence under the Industries (Development and Regulation) Act, 1951

### Areas to be avoided

In setting up industries, care should be taken to minimise the adverse impact of the industries on the immediate neighbourhood as well as distant places. Some of the natural life sustaining systems and some specific land uses are sensitive to industrial impacts because of the nature and extent of fragility. For this purpose, such industrial sites shall maintain the following distances from the areas listed:

- Ecologically and/or otherwise sensitive areas: At least 25 km; depending on the geo-climatic conditions, the requisite distance shall have to be increased by the appropriate agency.
- Ecological and/or otherwise sensitive areas include: (i) Religious and Historic Places; (ii) Archaeological Monuments (e.g. identified zone around Taj Mahal); (iii) Scenic Areas; (iv) Hill Resorts; (v) Beach Resorts; (vi) Health Resorts; (vii) Coastal Areas rich in Coral, Mangroves, Breeding Grounds of Specific Species; (viii) Estuaries rich in Mangroves, Breeding Ground of Specific Species; (ix) Gulf Areas; (x) Biosphere Reserves; (xi) National Parks and Sanctuaries; (xii) Natural Lakes, Swamps; (xiii) Seismic Zones; (xiv) Tribal Settlements; (xv) Areas of Scientific and Geological interest; (xvi) Defence Installations, especially those of security importance and sensitive to pollution; (xvii) Border Areas (International) and (xviii) Airports.
- Coastal areas: at least 1/2 km from High Tide Line.
- Flood Plain of the Riverine Systems: at least 1/2 km from flood plain or modified flood plain affected by dam in the upstream or by flood control systems.
- Transport/Communication System: at least 1/2 km from highway and railway.
- Major settlements (3,00,000 population): distance from settlements is difficult to maintain because of urban sprawl. At the time of setting up of the industry if any major settlement's notified limit is within 50 km, the spatial direction of growth of the settlement for at least a decade must be assessed and the industry shall be sited at least 25 km from the projected growth boundary of the settlement.

**Pre-requisite:** State and Central Governments are required to identify such areas on a priority basis.

Economic and social factors are recognized and assessed while setting up an industry. Environmental factors must be taken into consideration in industrial setting up.. Proximity of water sources, highway, major settlements, markets for products and raw material resources is desired for economy of production, but all the above listed systems must be away for environmental protection. Industries are, therefore, required to be sited, striking a balance between economic and environmental considerations. In such a selected site, the following factors must be recognized:

- No forest land shall be converted into non-forest activity for the sustenance of the industry (Ref: Forest Conservation Act, 1980).
- No prime agricultural land shall be converted into industrial site.

- Within the acquired site the industry must locate itself at the lowest location to remain obscured from general sight.
- Land acquired shall be sufficiently large to provide space for appropriate treatment of waste water still left for treatment after maximum possible reuse and recycle. Reclaimed (treated) waste water shall be used to raise green belt and to create water body for aesthetics, recreation and if possible, for aquaculture. The green belt shall be 1/2 km wide around the battery limit of the industry. For industry having odour problem it shall be a kilometer wide.
- The green belt between two adjoining large scale industries shall be one kilometer.
- Enough space should be provided for storage of solid wastes so that these could be available for possible reuse.
- Lay out and form of the industry that may come up in the area must conform to the landscape of the area without affecting the scenic features of that place.
- Associated township of the industry must be created at a space having physiographic barrier between the industry and the township.
- Each industry is required to maintain three ambient air quality measuring stations within 120 degree angle between stations.

### **Environmental Impact Assessment (EIA)**

1. The purpose of Environmental Impact Assessment (EIA) is to identify and evaluate the potential impacts (beneficial and adverse) of development and projects on the environmental system. It is a useful aid for decision making based on understanding of the environment implications including social, cultural and aesthetic concerns which could be integrated with the analysis of the project costs and benefits. This exercise should be undertaken early enough in the planning stage of projects for selection of environmentally compatible sites, process technologies and such other environmental safeguards.
2. While all industrial projects may have some environmental impacts all of them may not be significant enough to warrant elaborate assessment procedures. The need for such exercises will have to be decided after initial evaluation of the possible implications of a particular project and its location. The projects which could be the candidates for detailed Environment Impact Assessment include the following:-
  - Those which can significantly alter the landscape, land use pattern and lead to concentration of working and service population;
  - Those which need upstream development activities like assured mineral and forest products supply or downstream industrial process development;
  - Those involving manufacture, handling and use of hazardous materials;
  - Those which are sited near ecologically sensitive areas, urban centers, hill resorts, places of scientific and religious importance.
  - Industrial Estates with constituent units of various types which could cumulatively cause significant environmental damage.
3. The Environmental Impact Assessment (EIA) should be prepared on the basis of the existing background pollution levels *vis-a-vis* contributions of pollutants from the proposed plant. The EIA should address some of the basic factors listed below:

- Meteorology and air quality Ambient levels of pollutants such as Sulphur Dioxide, oxides of nitrogen, carbon monoxide, suspended particulate matters, should be determined at the center and at 3 other locations on a radius of 10 km with 120 degrees angle between stations. Additional contribution of pollutants at the locations are required to be predicted after taking into account the emission rates of the pollutants from the stacks of the proposed plant, under different meteorological conditions prevailing in the area.
  - Hydrology and water quality
  - Site and its surroundings
  - Occupational safety and health
  - Details of the treatment and disposal of effluents(liquid, air and solid) and the methods of alternative uses
  - Transportation of raw material and details of material handling
  - Control equipment and measures proposed to be adopted.
4. Preparation of Environmental Management Plan is required for formulation, implementation and monitoring of environmental protection measures during and after commissioning of projects.

### **ISO standards for Environment.**

The ISO 14000 family addresses various aspects of environmental management. It provides practical tools for companies and organizations looking to identify and control their environmental impact and constantly improve their environmental performance. It helps organizations improve their environmental performance through more efficient use of resources and reduction of waste, gaining a competitive advantage and the trust of stakeholders. ISO 14001:2015 and ISO 14004:2016 focus on environmental management systems.

ISO 14001:2015 helps an organization achieve the intended outcomes of its environmental management system, which provide value for the environment, the organization itself and interested parties. Consistent with the organization's environmental policy, the intended outcomes of an environmental management system include:

- enhancement of environmental performance;
- fulfilment of compliance obligations;
- achievement of environmental objectives.

ISO 14004:2016 provides guidance for an organization on the establishment, implementation, maintenance and improvement of a robust, credible and reliable environmental management system. The guidance provided is intended for an organization seeking to manage its environmental responsibilities in a systematic manner that contributes to the environmental pillar of sustainability. The other standards in the family focus on specific environmental aspects such as life cycle analysis, communication and auditing.

### **Elements of the ISO 14001 standard**

ISO 14001 contains the core elements for an effective environmental management system. It can be applied to both service and manufacturing sectors. The main elements of the standard are:

- Environmental policy
- Planning
- Implementation and operation

- Checking and corrective action
- Management review
- Continuous improvement

### **Environmental Management Plan (EMP) for commissioning of projects.**

Preparation of environmental management plan is required for formulation, implementation and monitoring of environmental protection measures during and after commissioning of projects. The plans should indicate the details as to how various measures have been or are proposed to be taken including cost components as may be required. Cost of measures for environmental safeguards should be treated as an integral component of the project cost and environmental aspects should be taken into account at various stages of the projects:

- Conceptualization :preliminary environmental assessment
- Planning :detailed studies of environmental impacts and design of safeguards
- Execution :implementation of environmental safety measures
- Operation :monitoring of effectiveness of built-in safeguards

The management plans should be necessarily based on considerations of resource conservation and pollution abatement, some of which are:

- Liquid Effluents
- Air Pollution
- Solid Wastes
- Noise and Vibration
- Occupational Safety and Health
- Prevention, maintenance and operation of Environment Control Systems
- House-Keeping
- Human Settlements
- Transport Systems
- Recovery – reuse of waste products
- Vegetal Cover
- Disaster Planning
- Environment Management Cell

#### **1. Liquid Effluents**

- Effluents from the industrial plants should be treated well to the standards as prescribed by the Central/State Water Pollution Control Boards.
- Soil permeability studies should be made prior to effluents being discharged into holding tanks or impoundments and steps taken to prevent percolation and ground water contamination.
- Special precautions should be taken regarding flight patterns of birds in the area. Effluents



containing toxic compounds, oil and grease have been known to cause extensive death of migratory birds. Location of plants should be prohibited in such type of sensitive areas.

- Deep well burial of toxic effluents should not be resorted to as it can result in re-surfacing and ground water contamination. Re-surfacing has been known to cause extensive damage to crop and livestock.
- In all cases, efforts should be made for re-use of water and its conservation.

## 2. Air Pollution

- The emission levels of pollutants from the different stacks, should conform to the pollution control standards prescribed by Central or State Boards.
- Adequate control equipment should be installed for minimising the emission of pollutants from the various stacks.
- In-plant control measures should be taken to contain the fugitive emissions.
- Infrastructural facilities should be provided for monitoring the stack emissions and measuring the ambient air quality including micro-meteorological data (wherever required) in the area.
- Proper stack height as prescribed by the Central/State Pollution Control Boards should be provided for better dispersion of pollutants over a wider area to minimise the effect of pollution.
- Community buildings and townships should be built up-wind of plant with one-half to one kilometer greenbelt in addition to physiographical barrier.

## 3. Solid Wastes

- The site for waste disposal should be checked to verify permeability so that no contaminants percolate into the ground water or river/lake.
- Waste disposal areas should be planned down-wind of villages and townships.
- Reactive materials should be disposed of by immobilising the reactive materials with suitable additives.
- The pattern of filling disposal site should be planned to create better landscape and be approved by appropriate agency and the appropriately pretreated solid wastes should be disposed according to the approved plan.
- Intensive programs of tree plantation on disposal areas should be undertaken.

## 4. Noise and Vibration: Adequate measures should be taken for control of noise and vibrations in the industry.

## 5. Occupational Safety and Health: Proper precautionary measures for adopting occupational safety and health standards should be taken.

## 6. Prevention, maintenance and operation of Environment Control Systems:

- Adequate safety precautions should be taken during preventive maintenance and shut down of the control systems.
- A system of inter-locking with the production equipment should be implemented where highly toxic compounds are involved.

**7. House-Keeping:** Proper house-keeping and cleanliness should be maintained both inside and outside of the industry.

**8. Human Settlements**

- Residential colonies should be located away from the solid and liquid waste dumping areas. Meteorological and environmental conditions should be studied properly before selecting the site for residential areas in order to avoid air pollution problems.
- Persons who are displaced or have lost agricultural lands as a result of locating the industries in the area, should be properly rehabilitated.

**9. Transport Systems**

- Proper parking places should be provided for the trucks and other vehicles by the industries to avoid any congestion or blocking of roads.
- Setting up of industries on the highways should be avoided as it may add to more road accidents because of substantial increase in the movements of heavy vehicles and unauthorised shops and settlements coming up around the industrial complex.
- Spillage of chemicals/substances on roads inside the plant may lead to accidents. Proper road safety signs both inside and outside the plant should be displayed for avoiding road accidents.

**10. Recovery - reuse of waste products:** Efforts should be made to recycle or recover the waste materials to the extent possible. The treated liquid effluents can be conveniently and safely used for irrigation of lands, plants and fields for growing non-edible crops.

**11. Vegetal Cover**

Industries should plant trees and ensure vegetal cover in their premises. This is particularly advisable for those industries having more than 10 acres of land.

**12. Disaster Planning:** Proper disaster planning should be done to meet any emergency situation arising due to fire, explosion, sudden leakage of gas etc. Fire fighting equipment and other safety appliances should be kept ready for use during disaster/emergency situation including natural calamities like earthquake/flood.

**13. Environment Management Cell:** Each industry should identify within its setup a Department/Section/Cell with trained personnel to take up the model responsibility of environmental management as required for planning and implementation of the projects.

## PREPARING A RISK ANALYSIS MATRIX

### Preparation of Risk Analysis matrix includes the following aspects

#### Nature of Business

It covers the nature of industry, amount of air/water/noise pollution in the process, period of its existence, background of promoters, number of subsidiaries, stakeholders involved, turnover, profit from operations, contribution to CSR activities, business acquisition history etc.

#### Area of Operations

It covers location of site operations, Degree of diversification of products, location of sites of subsidiaries etc.

### Identification of potential issues

It covers with interaction with internal stakeholders such as employees, contractual labourers and with external stakeholders such as local community, shareholders, regulators, NGOs etc. A questionnaire may be evolved for each stakeholder for identifying the potential hidden issues.

### Potential issues may be

1. Regulatory non-compliance
2. Health hazard due to the operations to local community
3. Location of industry near agricultural land
4. Amount of noise
5. Impact of effluents on the rivers etc.
6. Lack of disaster planning
7. Inadequate safety systems.
8. Lack of sustainability initiatives
9. Lack of occupational or safety measures
10. Improper water disposal systems.

### Impact analysis

It covers cost of regulatory non-compliance, low level of employee morale, degree of reputation risk, agitation of local community, degree of threat to long term sustainability, impact of potential issues on the financial health of the company.

### Suggestions and mitigation measures

It covers compliance management system, proper disposal of wastes including e-waste, strong safety management systems, updated technology for manufacturing process, conservation in usage of water, energy, educating and training employees of environmental issues, frequent interaction with local community, sustainability initiatives and its reporting in the Annual Report.

## ENVIRONMENTAL MANAGEMENT AS A TOOL- FOR VALUE CREATION

Proper compliance of laws relating to Environment will increase the credibility and would also create value for a business organisation. Companies do earmark separate budget to meet the business expenditure relating to investments for meeting environmental compliances. There is a strong evidence and proof that improved environmental performance is positively correlated with increased competitiveness. Further, the effective environmental systems based on fundamentally sound regulatory structures can play an important role in encouraging business organisations to improve environmental performance, which can strengthen broader competitiveness related goals. Now-a-days, people are willing to pay more for a product which is environment friendly for e.g. lead free paint, jute bags instead of plastic, green homes etc and business houses are also being attracted to the liberalised policies of Indian Government which has encouraged the same. Companies should not view the total amount to be spent on protection of environment as expenditure. They should consider that it is an investment for creating value, for building goodwill and for making the presence felt. Reputation of an organisation often correlated with the way they function i.e. compliance of rules and regulations, adherence to environment safety, health policy, creating awareness to the

workers/employees and also to the outsiders regarding various safety techniques and policies to be observed while entering into a factory, hazardous industry, mines etc. and last but not least is accomplishing the task of corporate social responsibility etc.

Because of the various advantages and value creation, almost all businesses across the world come forward to introduce and implement proper implementation of Environmental Management. The advantages of proper environmental management are as follows:-

- (a) It avoids punishment which includes prosecution including fines.
- (b) Eliminates increased liability to environmental taxes.
- (c) Avoids loss in value of land.
- (d) Avoids destruction of brand values, loss of sales, consumer boycotts and inability to secure finances.
- (e) Avoids loss of insurance cover and contingent liabilities.
- (f) Fixes and ensures more accurate and comprehensive information about responsibility of business houses towards environment for improving corporate image with stakeholders, customers, local communities, employees, government and bankers.
- (g) Helps to attain competitive advantage in respect of identification of costs and benefits associated with it.
- (h) It will boost employee morale and organisation attains a good reputation in the market.
- (i) Ultimately add value to the economy as a whole.

### LESSON ROUND UP

- Environmental due diligence has gained importance in the recent past while carrying out inorganic business transactions such as mergers, acquisitions, takeovers etc mainly due to increased awareness and consciousness of the public from potential negative environmental impact of the organization that may be caused by the company on them.
- Environmental Due diligence involves company analysis, regulatory analysis, stakeholder analysis, impact assessment, risk analysis etc.
- The Indian regulatory framework for environmental protection is enforced through legislations like Environmental Protection Act, 1986, National Green Tribunal Act, 2010, Air/Water Pollution Prevention Acts etc.
- The compliances under various environmental legislations are essential not only during strategic business decisions, but for business sustainability as well.

### SELF TEST QUESTIONS

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

1. What necessitates environmental due diligence?
2. Write brief note on regulatory framework in India to protect environment.
3. Write short notes on
  - (a) Environmental Impact Assessment.

- (b) Environment Management Plan.
- (c) ISO standards on environment

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# Lesson 11

## Search/Status Reports

### LESSON OUTLINE

- Scope and importance of Search/Report
- Legal provisions relating to charges
- E- Filling of Form No. CHG-1, CHG-9, CHG- 4
- Requirement of Financial Institutions and corporate lenders

### 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.

## 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.

## SEARCH/STATUS REPORT

A Search and Status Report as is apparent from, its name contains two aspects. The first being 'search' which involves physical inspection of documents and the second activity 'status' which comprises of reporting of the information as made available by the search.

Thus a search and status report *de facto* acts as a 'Progress Report' on the legal aspects and also a ready reckoner of the exact position.

### (a) Particulars of Charges

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 CHG-1** (for other than debentures) or **Form 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 CHG-1** 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 CHG-2** and for registration of modification of Charge in **Form 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 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 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, if any, 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:

Item		Records to be verified
1		2
(a)	Name of the Company	Memorandum of Association Certificate of Incorporation or Fresh Certificate of Incorporation/Change of Name.
(b)	Date of Incorporation	Certificate of Incorporation.
(c)	Company Number/Corporate Identity Number	Certificate of Incorporation/Fresh Certificate

		upon change of name/ Certificate of registration of *CLB Order for shifting registered office to another State.
(d)	Address of Registered Office	INC-22, MGT-14 Resolution(s) of Board/General Body, INC-28 with copy of CLB/NCLT 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	Memorandum of Association, SH-7, MGT-14
(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 of Schedule-I of Companies Act, 2013 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).

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 Form 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 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**  
**Charges Requiring Registration**

<i>Sl. No.</i>	<i>Relevant Provisions</i>	<i>Charges under Reference</i>	<i>Illustrative Instruments</i>	<i>To Verify Whether Or Not</i>
(1)	(2)	(3)	(4)	(5)
I.	Section 77 of the Companies Act, 2013	(a) a charge for the purpose of securing any issue of debentures	(a) Hypothecation or mortgage including floating charge	*The instrument is executed and is dated.
		(b) a charge on uncalled share capital of the company	(b) Deed of assignment	*The common seal is affixed and if yes, the authority thereof is mentioned.

		(c) a charge on any immovable property, where-ever situate, or any interest therein	(c) Mortgage	*The instrument bears adequate stamps in accordance with the applicable Stamp Act
		(d) a charge on any book debts of the company	(d) Hypothecation	*The instrument creates the charge specifying the amount of charge and the assets charged.
		(e) a charge, not being a pledge, on any movable property of the company	(e) Hypothecation	*The instrument modifying a charge refers to the original charge under modification and spells the extent of modification.
		(f) a floating charge on the undertaking or any property of the company including stock-in-trade	(f) Hypothecation	*The instrument bears names of the persons in whose favour the charge is created or modified.
		(g) a charge on calls made but not paid	(g) Deed of assignment	*The instrument contains the terms relating to (a) mode of repayment, (b) applicable rate/s of interest, (c) margin and (d) priority or precedence of charge/s.
		(h) a charge on a ship or any share in ship	(h) Hypothecation	
		(i) a charge on goodwill, or on a patent or a license under a patent, or on a trade-mark, or on a copyright, or a license under a copyright	(i) Deed of assignment	
II.	Section 79 of the Companies Act, 2013	Charges on properties acquired subject to any charge thereon	Relevant instrument and also the instrument, evidencing the acquisition of the property which is subject to charge.	

\*The instrument bears adequate stamps in accordance with the applicable Stamp Act.

**TABLE B**  
**Time for Filing Forms**

<i>Event</i>	<i>Time Limit</i>	<i>Effect</i>	<i>Relevant provisions</i>
(1)	(2)	(3)	(4)
Creation of charge or modification of charge or acquisition of property which is subject to charge	Within thirty days from the date of creation, modification or acquisition	The date when the event takes place is also included while calculating the limit	Sections 77 and 79 of the Act.
Satisfaction of the charge.	Within a period of thirty days from the date of satisfaction	The date when the event takes place is to be excluded while calculating thirty days	Section 82 of the Act.

### REQUIREMENTS OF VARIOUS FINANCIAL INSTITUTIONS AND OTHER CORPORATE LENDERS

The All-India Financial Institutions while granting term loans to companies insist on certain formalities to be completed by a company availing such loan. These include furnishing of certificates by Company Secretaries in Practice in regard to the following:

- (a) Necessary power of a company and its directors to enter into an agreement.
- (b) Borrowing limits of a company under Section 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.

### 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. However, Section 8 Companies may exercise the power to borrow money by way of circulation. (Exemption to Section 8 Companies dated 05<sup>th</sup> June, 2015)

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.

However, Section 180 of Companies Act, 2013 shall not be applicable on Private Companies. (Exemption to Private Companies dated 05<sup>th</sup> June, 2015)

## **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.



## SELF TEST QUESTIONS

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

1. What is a status/search report? Discuss the format normally followed for 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.

This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and extend across the width of the page. There is a solid black rectangular bar at the top edge of the page.

# Lesson 12

## Compliance Management

### LESSON OUTLINE

- The concept, scope, significance and need for compliance management
- Establishment of Compliance Management Framework
- Role of Information Technology in Compliance Management System
- Systems approach to compliance management
- Apparent, Adequate and absolute compliance
- Secretarial Audit and Compliance Management System
- Role of Company Secretary in compliance management
- Compliance Programme

### 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 to acquire the skill-sets and systems to ensure continued adherence of law.

There has emerged a clear need to create proper systems, processes, tools and dynamic corporate compliance management systems. To promote a good compliance management, it is important that functions like tax/legal/finance have constant dialogue amongst themselves of the compliance obligations, discussing grey areas, if any, and seek constant best guidance for promoting compliance. These functions should stay in constant touch with business and identify any new business situations, which may warrant evaluation of newer compliances, and arrangements to be put in place to manage compliances.

After reading this lesson you will be able to understand the importance, need of compliance management, process involved, and systems approach to compliance management. Further the lesson also deals with apparent, adequate and absolute compliances.

## INTRODUCTION

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

The compliance program consists of the policies and procedures which guide in adherence of laws and regulations. The compliance audit is independent testing of level of compliance with various laws and regulations applicable.

Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management must recognize the scope and implications of laws and regulations that apply to the company. They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. To ensure an effective approach to compliance, the participation of senior management in the development and maintenance of a compliance program is necessary. They should review the effectiveness of its compliance management system at periodic intervals, so as to ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management

## NEED FOR COMPLIANCE

Corporate accountability is on everyone's mind today. Business executive face significant pressure to comply with multiple regulations. Many companies are adopting comprehensive compliance plans to address emerging regulatory paradigm and those that fail to address the new regulations, pay hefty fines or incurring punitive restrictions on their operations.

The organizations face mounting pressures that are driving them towards a structured approach to enterprise-wide compliance management. Increased liability and regulatory oversight has amplified risk to a point where it demands continuous evaluation of compliance management systems. Furthermore, the multiplication of compliance requirements that organizations face increases the risk of non-compliance, which may have potential civil and criminal penalties.

This focused attention on compliances with spirit and details of laws casts upon Company Secretaries an onerous responsibility to guide the corporates in this direction. They have to advise companies in totality to provide full, timely and intelligible information. To enable companies to put in place an effective Compliance Management System, company secretaries should ensure that companies:

- adhere to necessary industry and government regulations,
- Change business processes according to legislative change,
- Realign resources to meet compliance deadlines,
- React quickly and cost-effectively if regulations change.

## **Risk of Non-compliance**

The risks of non-compliance of the law are many:

1. Cessation of business activities
2. Civil action by the authorities
3. Punitive action resulting in fines against the company/officials
4. Imprisonment of the errant officials
5. Public embarrassment
6. Damage to the reputation of the company and its employees
7. Attachment of bank accounts.

## **SIGNIFICANCE OF CORPORATE COMPLIANCE MANAGEMENT**

1. Better compliance of the law
2. Real time status of legal/statutory compliances
3. Safety valve against unintended non compliances/ prosecutions, etc.
4. Real time status on the progress of pending litigation before the judicial/quasi-judicial fora
5. Cost savings by avoiding penalties/fines and minimizing litigation
6. Better brand image and positioning of the company in the market
7. Enhanced credibility/creditworthiness that only a law abiding company can command
8. Goodwill among the shareholders, investors, and stakeholders.
9. Recognition as Good corporate citizen.

Compliance with the requirements of law through a compliance management programme can produce positive results at several levels:

- Companies that go the extra mile with their compliance programs lay the foundation for the control environment.
- Companies with effective compliance management programme are more likely to avoid stiff personal penalties, both monetary and imprisonment.
- Companies that embed positive ethics and effective compliance management programme deep within their culture often enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns.

Clearly, the benefits of implementing and maintaining an effective ethics and compliance program far outweigh its costs. Not only does the compliance management protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

## **SCOPE OF CORPORATE COMPLIANCE MANAGEMENT**

Corporate compliance management should broadly include compliance of :

- Corporate Laws
- Securities Laws

- Commercial Laws including Intellectual Property Rights Laws
- Labour Laws
- Tax Laws
- Pollution Control Laws
- Industry Specified laws
- All other Laws affecting the company concerned depending upon the type of industry/activity.

The details of the above mentioned legislations are given below.

#### **(a) Corporate & Economic Laws**

Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws. Some of the important corporate laws are given below in brief:

- Companies Act, 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.
- Emblems and Names (Prevention of Improper Use) Act, 1947.
- Foreign Exchange Management Act, 1999 and the various Notifications, Rules and Regulations framed there under.
- Foreign Contribution (Regulation) Act, 2010.
- Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.
- Competition Act, 2002.
- Special Economic Zones Act, 2005.
- Prevention of Money Laundering Act, 2002.
- Micro, Small and Medium Enterprises Development Act, 2006.
- Essential Commodities Act, 1955.
- Intellectual Property Rights Laws.

#### **(b) Securities Laws**

- SEBI Act, 1992
- Securities (Contracts) Regulation Act, 1956 and rules made thereunder
- Various rules, regulations guidelines and circulars issued by SEBI
- SEBI (LODR) Regulations, 2015
- Depositories Act, 1996

#### **(c) Commercial Laws**

- Indian Contract Act, 1872
- Transfer of Property Act, 1882
- Arbitration and Conciliation Act, 1996

- Negotiable Instruments Act, 1881
- Sale of Goods Act, 1930

#### **(d) Fiscal Laws**

- Income Tax Act, 1961
- Central Excise Act, 1944
- Customs Act, 1962
- Wealth Tax Act, 1957
- Central Sales Tax/State Sales Tax/VAT
- Service Tax.

#### **(e) Labour Laws**

- Minimum Wages Act, 1948
- Payment of Bonus Act, 1965
- Payment of Gratuity Act, 1972
- Employees' Provident Funds and (Misc. Provisions) Act, 1952;
- Employees' State Insurance Act, 1948;
- Factories Act, 1948;
- Employees' Compensation Act, 1923;
- Maternity Benefit Act, 1961;
- Industrial Dispute Act, 1947; and
- Contract Labour (Regulation and Abolition) Act, 1970.

#### **(f) Pollution/Environment related Laws**

- Air (Prevention and Control of Pollution) Act, 1981
- Water (Prevention and Control of Pollution) Act, 1974
- Water (Prevention and Control of Pollution) Cess Act, 1974
- Environment Protection Act, 1986
- Public Liability Insurance Act, 1991
- National Green Tribunal Act, 2010.

#### **(g) Industry Specific Laws**

Legislations applicable to specific categories of industries – electricity, power generation and transmission, insurance, banking, chit funds, etc.

#### **(h) Local Laws**

These would include Stamp Act, Registration Act, municipal and civic administration laws, shops and establishments, etc.

Individual companies may suitably add or delete to/from the above list as required.

## **Establishment of compliance management framework**

The Compliance Management encompasses (1) Compliance Identification (2) Compliance Ownership (3) Compliance Awareness (4) Compliance Reporting and (5) Periodical Compliance MIS.

### *Compliance Identification*

This process involves the identification of compliances under various legislations applicable to the company, in consultation with the functional heads. The legal team has to identify the legislations applicable to the company and identify the compliances that are required under each legislation or rules and regulations made there under.

### *Compliance Ownership*

The next important aspect of compliance management is ownership. The ownership of the various compliances has to be described function wise and individual wise. Clear description of primary and secondary ownership is also very important. While the primary owner is mainly responsible for the compliance the secondary owner (usually the supervisor of the primary owner) has to supervise the compliance. Ex: Secretarial Officer /Asst Company Secretary may be primarily responsible and Group Company Secretary's responsibility is secondary.

### *Compliance Awareness*

The next important step in establishing a legal compliance Management is creation of awareness of the various Legal Compliances amongst those responsible. Many a times compliances are handled by persons who are not fully aware of the requirements of the legislations and hence creating appropriate awareness amongst the owners is very important. This could be done in the form of meetings/trainings explaining the various compliances or some manual containing the details of compliances.

### *Compliance Reporting*

Compliances or non-compliances should be communicated to the Concerned. Reporting of non-compliances ensures that appropriate corrective action is taken by the responsible person, Ex. Automated escalation emails in case of non compliance

### *Process of Corporate Compliance Reporting (CCR)*

Although the actual process of compiling the information under the various laws may vary from company to company and is dependent on various factors such as the number of units and scale of operations, a brief process of the CCR mechanism is as follows:

- (A) Functional heads for the reporting of various laws have to be identified. For instance, the Company Secretary would be the functional head for reporting of company law, Listing Regulations 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. SEBI (LODR) Regulations, 2015 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 does one know in one year or five that both the intent and letter of the law are still being observed throughout organization? How does the program and the organization adapt to changing legislation and business conditions? As the organization evolves for example, through mergers and acquisitions will the program remain relevant? The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organisations achieve sustained success.

## APPARENT, ADEQUATE AND ABSOLUTE COMPLIANCES

Corporates are expected to comply with the regulatory prescriptions in their true letter and spirit and should be seen as an opportunity to make their systems and processes more robust and bring them in line with global practice, resulting in the enhanced trust level of stakeholders. As regards corporate disclosure, there has been a paradigm shift from letter to spirit because of factors like demand from stakeholders, regulatory shift from control to self regulation, market competition etc.

Good Corporate Governance demands compliances level that match the intentions of legislature, expectations of stakeholders and requirements of regulators. The compliances, however, generally found to fall in three categories, i.e. Apparent Compliances, Adequate Compliances and Absolute Compliances.

Apparent compliance is a disguise form of non-compliance, which is worse than a non compliance. The classic example for Apparent Compliances are generating documents such as notice, agenda, minutes on papers for board and general meeting which are not actually held.

Adequate compliance is compliance in letters. The aspects specified in law are complied in letters, without getting into the spirit of the law, e.g. box ticking practices.

Absolute compliances are those which are in line with the spirit and intent of the law. A typical example in this regard is demonstrating shareholder democracy as prescribed by law. When a company complies with law in spirit it gains public confidence as well. For example, Infosys has set new and effective standards in communicating with shareholders, stock exchanges and general public at large. Its Annual Report is said to be a trend setter and has been commended as an ideal report by SEC. This company has demonstrated through its practices and procedures its commitment to enhance investor-relations and has amply rewarded its shareholders through its impressive performance and its value based management philosophy helps increase its brand value. The company has achieved trust of stakeholders by having a strategic balance between wealth and welfare.

Experts view Annual report as self appraisal report of the company. The shift from shareholder concept to stakeholder concept has necessitated the corporates to provide a transparent report which is viewed by all

stakeholders such as shareholders, creditors, lenders, strategic investors etc as a potential source of information. In order to attain corporate sustainability and to ensure a level playing field with international market, corporates has to necessarily increase their level of compliance from apparent to adequate leading to level of absolute, compliances.

### **SECRETARIAL AUDIT AND COMPLIANCE MANAGEMENT SYSTEM**

The compliance system and processes in a company are dependent mainly on the following factors:

- (a) Nature of business(es).
- (b) Geographical domain of its area of operation(s).
- (c) Size of the company both in terms of operations as well as investments, technology, multiplicity of business activities and manpower employed.
- (d) Jurisdictions in which it operates.
- (e) Whether the company is a listed company or not.
- (f) Regulatory authority(ies) in respect of its business operations.
- (g) Nature of the company viz., private, public, government company, etc.

Based on the above the Secretarial Auditor can constitute a broad idea about the desired system and process to be adopted by a company. For example, a multi product / multi operation company is supposed to comply all the applicable corporate laws in addition to regulatory framework applicable at products/ operations.

At corporate level, monitoring of such complex web of compliances are generally made on a back-to-back mechanism. In such cases Boards' reporting on compliances are made on the basis of reports/certification provided by field level management. As a better compliance structure in such cases it is desired to have a internal checking mechanism about the quality of such report either on regular basis or sample basis.

Now-a-days most of the large companies have adopted Enterprise Resource Planning (ERP) Systems to cater to their complex operations. In many a cases, compliance system becomes a part of these modules. Auditing in such systems requires the Auditor to enter and to have access within the system. While taking up the audit assignment, the Auditor needs to ensure that access would be given so that assessment of proper system and process of compliance is made.

Auditing of compliance system and process is not a fault finding exercise, rather a device to scale up compliance mechanism of a company commensurate to its size and operations. It is desired that the Secretarial Auditor as an expert in corporate compliance would advice the companies to build up strong corporate compliance system in case the system appears to be insufficient during the audit process.

### **Role of Company Secretaries in Compliance Management**

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the 'Compliance Manager' of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary. These disclosures can be classified into statutory disclosures, non-statutory disclosures, specifies disclosures and continuous disclosures. SEBI (Listing Obligations and Disclosure Requirements) Regulation, 2015 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-recurrence of such non-compliance etc.

Through an effective Compliance Programme, the business and its stakeholders learn 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)

### 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
- .....
- .....

2. Adherence with Vision and Mission statement of the Company.
3. To devise code of conduct for Board, senior management and employees
4. Conducting training on compliance, ethics, code of conduct.
5. Establishment of Corporate Compliance Committee.
6. Appointment of Chief Compliance officer.
7. Quarterly compliance Report to be presented to the Board.
8. Identification and classification of various compliance risks.
9. Organisation of compliance Audit, feed back, remedies.
10. ....
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, and 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***

Sl. No.	Question	Yes/No	Intent
<b>Board Oversight</b>			
1	Does the Board approve quarterly Compliance Report?		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.
2	Does the Board review Compliance Management programme at regular intervals?		Compliance Management programme has to be revisited at regular intervals in tune with the business environment, regulatory changes etc.
3	Do the members make use of Compliance Dash Board effectively and act upon it when required ?		The Board Members are expected to visit Compliance Dashboard every day in over-seeing the compliance level in the organisation
4	Is the board updated with the applicable laws ?		The Board should be updated with the applicable laws at regular intervals that helps the board in reviewing compliance plan, overseeing compliances, reading compliance dash board etc.,
<b>Chief Compliance Officer</b>			
1	Has the Company appointed Chief Compliance officer?		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.

2	Has the role of Chief Compliance officer been specifically defined?	As part of Compliance programme, the specific duties of Chief compliance officer be defined. This helps in casting the responsibility as well.
3	Is the Chief Compliance officer an independent person?	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.
4	Is the Chief Compliance officer reporting to CEO?	Chief Compliance Officer reporting directly to CEO helps in direct and effective communication of compliance aspects with the top management.
5	Does the compliance officer participate in major decisions?	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.

### Systems and Processes

1	Has the company in place, a centralised mechanism for tracking and monitoring compliance?	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.
2	Has the company in place the process for development and approval of table of applicable laws, function wise and criticality wise?	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
3	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?	The process should provide for alerts whenever there is any change in the regulatory ambit applicable to the Company.
4	Has the company paid any penalty for any compliance failure? If	The Compliance mechanism should provide for no-tolerance to non-compliances. Non- compliances are to be addressed through establishing necessary controls for the same.



so, has the company gap analysis and has taken remedial measures?

5	Has the company appointed designated compliance official (Compliance owners) at unit level ?	Compliance Owners at unit level helps in ensuring compliance in the respective business units.
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6	Has the company co-ordinated the activities of designated compliance official, functional heads, Chief Compliance officer and the Board of Directors?	Co-ordination of unit level compliances are essential for ensuring overall compliance.
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7	Is the Compliance Management subject to periodic Audit?	The existing Compliance management should be subject to periodic audit that helps in brining effective control
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### Corporate Compliance Committee

1	Has the company constituted corporate compliance committee?	Constituting the Board level Corporate Compliance Committee helps in the effective involvement of the Board in compliance management.
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2	Is functional directors and chief compliance officer participating in the meetings of Corporate Compliance Committee ?	Participation of Functional Heads and the Chief Compliance Officer in the meeting of Corporate Compliance Committee enhances the quality of discussions and decisions.
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3	Does the committee meet atleast in every quarter?	The Committee should meet atleast once in a quarter. This may be in line with assessment of quarterly compliance report.
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### Compliance Risk Management

1	Is Compliance risk a part of ERM ?	Compliance risk should be classified as one of the major risks under ERM.
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2	Has the company classified the compliance risk based on criticality (Legislation-wise)?	Some non-compliance results in huge fine and may be non-compoundable too. The company should identify the compliances based on criticality. Compliance risks are to be assessed by Chief Compliance Officer in consultation with functional heads.
3	Do the Compliance owners aware of financial implications of critical non-compliances?	The Compliance Owners should be aware of implications of non-compliances.
4	Does the Company undertake Compliance Risk Analysis ?	Compliance risk analysis helps establishing effective compliance controls.

### Training and Communication

1	Has the company imparted training to senior management & employees on compliance programme covering regulatory aspects and the internal policies?	Regular training helps in understanding the intent, process and consequences of compliances in better manner.
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.

[illegible]

PROFESSIONAL PROGRAMME  
SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

# PP-SACM&DD

## TEST PAPER

### A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet 'A Guide to CS Students' providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download from <http://www.icsi.edu/Portals/0/AGUIDETOCSSSTUDENTS.pdf>

### WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

"27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

PROFESSIONAL PROGRAMME  
**SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE**

**TEST PAPER**

*(This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/answers to this test paper to the Institute.)*

Time Allowed: 3 hours

Maximum Marks: 100

**PART A (25 Marks)**  
**(Secretarial Audit)**

**Question 1**

- (a) Explain the scope of Secretarial Audit. (10 marks)
- (b) What is meant by Secretarial Standards? Enumerate the Secretarial Standards issued by ICSI. (5 marks)
- (c) What are provisions to be considered by a Practising Company Secretary regarding Bonus issue while conducting Secretarial Audit? (5 marks)
- (d) Explain in brief the major beneficiaries of Secretarial Audit. (5 marks)

**OR**

**Question 1A**

- (a) Prepare a checklist of compliances with the following aspects, for the purpose of Secretarial audit
  - (i) Alteration of Memorandum of Association
  - (ii) Filing of Annual return
  - (iii) Registration of creation of charge
  - (iv) Foreign direct investment under Approval Route (10 marks)
- (b) Explain the provisions related to Corporate Social Responsibility. (5 marks)
- (c) Elaborate the relation between secretarial standards and good governance. (5 marks)
- (d) Madura Ltd. wants to file the return of Allotment in respect of shares allotted by them, but they don't have much knowledge about the provisions and procedures regarding that. As a Secretarial Auditor how would you advise Madura Ltd. in this situation? (5 marks)

**PART B (75 marks)**  
**(Due Diligence and Compliance Management)**

**Question 2**

- (a) State with reasons in brief whether the following statements are true or False:
  - (i) In private placement an issuer can issue shares to a select person or group of persons not exceeding 500 in a financial year.
  - (ii) The limit regarding money proposed to be spent on General Corporate Purposes is twenty five per cent of the amount raised by the issuer by issuance of specified securities.

- (iii) A monitoring agency shall be appointed for the issue size of more than 200 crores.
- (iv) Filing of offer document is mandatory for rights issue in excess of Rs 50 lakhs or more.
- (v) A member of the Institute of Company Secretaries of India, who is in full-time employment, can become a Secretary in whole-time practice. *(3 marks each)*

**OR**

**Question 2A**

- (i) Explain the need for Compliance management.
- (ii) "Legal Due Diligence is an art of managing a risk of undertaking a major business transaction". In the light of above statement explain the possible hurdles in carrying out a legal due diligence.
- (iii) Explain the parties involved in the issue of GDR. *(5 marks each)*

**Question 3**

- (a) "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' ". In the light of above statement explain in brief Approaches to Compliance Solutions those are adopted by Compliance solution providers
- (b) As it is said that "Environmental risk can have serious negative effects on an organisation's financial well being and its ability to achieve its business objectives. Taking into account the above statement explain the need for performing Environmental Due Diligence.
- (c) Describe the role of a Company Secretary in Compliance Management. *(5 marks each)*

**Question 4**

- (a) Describe the SME exchanges in India and the exemptions available for securities listed at SME Exchange.
- (b) As a statutory Auditor of ABC Ltd. prepare a checklist for Rights Issue.
- (c) A company named as Bright Ltd. Wants to issue GDRs in India, but the difficulty is that the company is not aware of the regulatory framework in India for issuing the GDRs; therefore Bright Ltd. approaches you to guide them on rules/regulations for Issue of GDRs in India.

As a Company Secretary, guide Bright Ltd. And explain the provisions related to Indian Regulatory framework in respect of Issue of GDR.

**Question 5**

- (a) What is meant by Cultural Due Diligence? What are the questions those are analysed to determine the different corporate culture?
- (b) XYZ Ltd. Is planning to acquire the shares of ABC Ltd. What information according to SEBI (SAST) Regulations, 2011 XYZ Ltd. shall have to provide in the respective public announcement?
- (c) You are a Practising Company Secretary and you have to perform a Secretarial Audit for Bharti enterprises what factors you will keep in mind while conducting Due Diligence?

**Question 6**

Briefly explain any three of the following:

- (a) Diversion and siphoning of funds
- (b) ISO standards for Environment
- (c) Wilful default
- (d) Legal Due Diligence process

*(5 marks each)*

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