

# **SUGGESTED ANSWERS**

## **PROFESSIONAL PROGRAMME**

### **SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE (PP- SACM&DD /2013)**



**THE INSTITUTE OF  
Company Secretaries of India**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**  
Statutory body under an Act of Parliament

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**PP-SACM&DD/2013**

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### CONTENTS

<i>Sl.No.</i>		<i>Page</i>
	<b>TEST PAPER 1/2013</b>	
1.	Answer to Question No. 1	... 1
2.	Answer to Question No. 2	... 3
3.	Answer to Question No. 3	... 6
4.	Answer to Question No. 4	... 6
5.	Answer to Question No. 5	... 7
6.	Answer to Question No. 6	... 9
7.	Answer to Question No. 7	... 10
8.	Answer to Question No. 8	... 11
9.	Answer to Question No. 9	... 13
10.	Answer to Question No. 10	... 15
	<b>TEST PAPER 2/2013</b>	
11.	Answer to Question No. 1	... 17
12.	Answer to Question No. 2	... 18

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(ii)

13. Answer to Question No. 3	...	20
14. Answer to Question No. 4	...	21
15. Answer to Question No. 5	...	23
16. Answer to Question No. 6	...	24
17. Answer to Question No. 7	...	26
18. Answer to Question No. 8	...	28
19. Answer to Question No. 9	...	29
20. Answer to Question No. 10	...	32

**TEST PAPER 3/2013**

21. Answer to Question No. 1	...	33
22. Answer to Question No. 2	...	34
23. Answer to Question No. 3	...	35
24. Answer to Question No. 4	...	35
25. Answer to Question No. 5	...	36
26. Answer to Question No. 6	...	37
27. Answer to Question No. 7	...	38
28. Answer to Question No. 8	...	40
29. Answer to Question No. 9	...	42
30. Answer to Question No. 10	...	43

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PROFESSIONAL PROGRAMME  
**SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT  
AND DUE DILIGENCE**

**TEST PAPER 1/2013**

*Time allowed : 3 hours*

*Max. Marks : 100*

**Part A (25 Marks)**

*[Answer Question No.1 which is COMPULSORY  
and ANY THREE of the rest from this part]*

**Question No. 1**

*Write short note on:*

*(a) Secretarial Standard*

*(b) Secretarial Audit.*

*(5 marks each)*

**Answer to Question No. 1(a)**

Secretarial Standards are the policy documents relating to various aspects of secretarial practices in the corporate sector. These Standards lay down a set of principles which companies are expected to adopt and adhere to, in discharging their responsibilities. The Secretarial Standards do not seek to substitute or supplant any existing laws or the rules and regulations framed thereunder but, in fact, seek to supplement such laws, rules and regulations. Secretarial Standards that are issued will be in conformity with the provisions of the applicable laws. However, if, due to subsequent changes in the law, a particular Standard or any part thereof becomes inconsistent with such law, the provisions of the said law shall prevail.

The ultimate goal of the Secretarial Standards is to promote good corporate practices leading to better corporate governance. The Standards are for good secretarial practices and desirable corporate governance with a view to ensuring shareholders democracy and utmost transparency, integrity and fair play, going beyond the minimum requirements of law. The adoption of the Secretarial Standards by the corporate sector will, over the years have a substantial impact on the improvement of quality of secretarial practices being followed by companies, making them comparable with the best practices in the world.

Many companies today are voluntarily adopting the Secretarial Standards in their functioning. The annual reports of several companies released during the last few years include a disclosure with regard to the compliance of the Secretarial Standards. By following the Secretarial Standards in true letter and spirit, companies will be able to ensure adoption of uniform, consistent and best secretarial practices in the corporate sector. Such uniformity of best practices, consistently applied, will result in furthering

the shareholders democracy by laying down principles for better corporate disclosures thus adding value to the general endeavour to strive for good governance.

### **Secretarial Standards under Companies Act, 2013**

Section 118 of the Companies Act, 2013 makes it mandatory for every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government. Section 205 of the Companies Act, 2013 casts duty on the Company Secretary to ensure that the company complies with the applicable Secretarial Standards. It is the beginning of a new era where non financial standards have been given importance and statutory recognition besides Financial Standards.

#### **Answer to Question No. 1(b)**

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

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

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

Coverage of the Secretarial Audit is as under:

- The Companies Act, 1956 and the rules made there under;
- The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder;
- The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder;

- Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder;
- The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992;
- The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
- The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
- The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
- The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
- The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
- The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;

**Question No. 2**

*Prepare a check list for Buy-back of shares by your Company, where you are the Company Secretary. (5 marks)*

**Answer to Question No. 2****Check List for Buyback of Securities**

The requirements to be complied with by listed companies under section 77A, 77AA and 77B read with relevant regulations of SEBI which covers all matters that apply to listed companies/companies purporting to be listed.

Even in respect of unlisted companies, it is necessary to note that under Section 77A read with Section 77AA and Section 77B, there are certain specific compliance requirements, restrictions and prohibitions. Besides these substantive provisions of law contained in the above sections, the company that intends to make a buyback should comply with the Private Limited Company and Unlisted Public Limited Company (Buyback of Securities) Rules, 1999.

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

- The buyback should be from out of specified sources of funds such as the free reserves, the securities premium account or the proceeds of issue of shares or other specified securities.
- The buyback requires an enabling clause in the articles of association.

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

to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting.

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

Most of the requirements such as the following pertain to accounts and financial statements of the company:

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

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

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

### **Question No. 3**

*Prepare a check list for Company's Inter-corporate loan and investments under Companies Act, 1956. (5 marks)*

**Answer to Question No. 3****Check list for Inter-Corporate Loans and Investments under Section 372 A of the Companies Act, 1956**

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

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

**Question No. 4**

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

*(5 marks)*

**Answer to Question No. 4****Reporting of issue of shares under Foreign Direct Investment**

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

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

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

#### *Annual Return for FDI*

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

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

The Annual Return has three sections covering identification particulars, foreign assets and foreign liabilities. The methods of valuation of foreign liabilities and assets are also prescribed. The information required to be given in the Annual Return should be based on audited Balance Sheet of the previous year. If the information is provided based on unaudited Balance Sheet and there are major difference in the information earlier provided, revised return along with audited Balance Sheet needs to be filed.

#### **Question No. 5**

*Briefly analysis the Secretarial Standard two (2) issued by the ICSI. (5 marks)*

#### **Answer to Question No. 5**

The Secretarial Standard on General Meetings prescribes a set of principles which companies are expected to observe in the convening and conducting of General Meetings and matters related thereto. Principles have been laid down with respect to requirements of quorum, voting, proxies, conduct of poll, withdrawal/ rescinding/modification of resolutions, adjournment of meetings, recording in and preservation of minutes as well

as the duties of the Chairman and the disclosures to be made in the Annual Reports of companies.

Further, explicit principles have been laid down on the related critical aspects such as distribution of gifts, presence and duties of Company Secretary/Auditors in the meetings, preservation of minutes. Besides, it intends to integrate and standardize the diverse secretarial practices prevalent in the corporate sector for conducting General meetings.

The salient features of Secretarial Standard two are as under:

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

- Best practices for entering, recording and signing as well as preservation of the Minutes have been laid down.

**Part B (75 Marks)**

*[Answer ALL Questions from this part]*

**Question No. 6**

- (a) *“All preferential issues by the listed companies should be approved by the shareholders’ resolution in the meeting of shareholders”. Critically examine and comment.* (8 marks)
- (b) *Write a note on ‘intellectual property due diligence’.* (7 marks)

**Answer to Question No. 6(a)**

Preferential issues are governed under Section 81(1A) of the Companies Act, 1956 and Section 81(1A) requires the company to obtain shareholders approval through special resolution in the meeting of the shareholder.

As per Chapter VII of SEBI(ICDR) Regulations 2009, Preferential issue of listed Companies a special resolution has been passed by its shareholder 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.

The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:

- the objects of the preferential issue;
- the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;
- the shareholding pattern of the issuer before and after the preferential issue;
- the time within which the preferential issue shall be completed;
- the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;
- 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;
- 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.

**Answer to Question No. 6(b)**

**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. 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 are no infringement claims.

**Question No. 7**

*Distinguish between the following:*

(i) 'Due diligence' and 'Audit'. (8 marks)

(ii) 'Dematerialisation' and 'Rematerialisation'. (7 marks)

**Answer to Question No. 7(i)**

<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 i.e. assurance 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

**Answer to Question No. 7(ii)**

**Dematerialisation**

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

- An investor must open an Account with a DP.
- The securities must be in the name of the account holder and owned by him.
- A separate demat requisition form (DRF) is required for each issuer.

- The DRF form must be signed by all the joint holders.

### **Rematerialisation**

Rematerialisation means the conversion of dematerialised holdings back into the physical certificates. In a simplified form the process of Rematerialisation could be explained hereunder:

- Investor to submit the Rematerialisation Request Form (RRF) to the DP.
- DP to electronically intimate the Depository.
- DP to submit RRF to the Registrar/Issuer Company.
- Depository confirms rematerialisation request to the Registrar/Issuer Company.
- Registrar/Issuer Company verifies particulars, prints certificates and intimates the Depository.
- Depository updates Accounts and downloads details to DP.
- Registrar/issuer dispatches certificates to the investors.

### **Question No. 8**

- (a) *Explain briefly the possible hurdles that may occur while carrying out the due diligence and the steps needed to overcome such hurdles. (8 marks)*
- (b) *As a Company Secretary of the company, advise the company on the constitution, composition, quorum and the role of audit committee. (7 marks)*

### **Answer to Question No. 8(a)**

#### **Possible Hurdles in Carrying out a 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 sufficient to drive a complete picture.
2. *Unwillingness of Target Company's personal in providing the complete information*  
Non- co-operation of Target Company's personal may also prove to be a major hurdle during due diligence process. Sometimes, the available information would be pretended as not available.
3. *Providing of incorrect information*  
Providing of incorrect information by the target personal also acts as a major hurdle in the due diligence process.
4. *Complex tax policies and hidden liabilities*  
Complex tax policies & structure 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, may 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**

- Follow up questions/actions
- Ask several people the same questions
- Polite persistence
- Independent check with regulatory authorities
- Developing an MIS.

Considering this hurdles, it is advisable to insert the necessary disclaimer clause in the due diligence report.

**Answer to Question No. 8(b)**

**Constitution/Composition of Audit Committee**

1. All listed companies shall have qualified and independent audit committee.
2. The audit committee shall have minimum three directors as members.
3. Two-thirds of the members of audit committee shall be independent directors.
4. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
5. The Chairman of the Audit Committee shall be an independent director.
6. The Company Secretary shall act as the secretary to the committee.

**Quorum of the meeting of Audit Committee**

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings and the quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

**Role of Audit Committee**

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.

4. Reviewing, with the management, the Quarterly/annual financial statements before submission to the board for approval.
5. Reviewing, with the management, the statement of uses / application of funds raised through an issue, the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower Mechanism, in case the same is existing.
13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

**Question No. 9**

- (a) *Discuss the need for Due Diligence for banks.* (8 marks)
- (b) *Enumerate the points to be checked by a Secretarial Auditor in respect of the Air (Prevention and Control of Pollution) Act, 1981.* (8 marks)

**Answer to Question No. 9(a)**

In order to streamline consortium/multiple banking arrangements, Reserve Bank of India has been making regulatory prescriptions from time to time regarding conduct of consortium/multiple banking. Banks have also been advised to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks by following specified criteria.

Way back in October 1996, Reserve Bank of India withdrew various regulatory prescriptions regarding conduct of consortium/multiple banking/syndicate arrangements so as to bring flexibility in the credit delivery system. With the passage of time, however, it was observed that the relaxations meant for providing flexibility to the borrowing community, may also have contributed to various types of frauds, prompting the Central

Vigilance Commission to attribute the incidence of frauds mainly to the lack of effective sharing of information about the credit history and the conduct of account of the borrowers among various banks.

Accordingly, Reserve Bank of India in consultation with the Indian Banks' Association, specified the framework to be observed by banks for improving the sharing/dissemination of information amongst the banks about the status of the borrowers enjoying credit facilities from more than one bank. Further, the banks are required to obtain regular certification of Diligence Report from a professional, preferably a Company Secretary about conformity to statutory prescriptions in vogue. Thus, the banking community in general and the Regulatory in particular have reposed enormous trust on professionals.

The Diligence Report covers many critical and relevant matters such as details of the Board of Directors, shareholding pattern, details of the forex exposure and overseas borrowings, risk mitigation through insurance cover in respect of all assets, payment of all statutory dues and other compliances, proper utilization/end-use of the loan funds, compliance with mandatory Accounting Standards, compliance with various clauses of Listing Agreement in case of a listed company etc. The compact structure of the Diligence Report under its twenty-five paragraphs makes it obligatory for a Practicing Company Secretary to prepare the Report after critical examination of all relevant records and documents of the borrowing companies which demands a high degree of care, skill and knowledge.

The introduction of diligence reporting by Company Secretary in Practice is expected to lay down a strong foundation for good governance culture among borrowing corporates and correspondingly enhance the comfort level of the banks by reducing the information asymmetry prevailing currently.

#### **Answer to Question No. 9(b)**

#### **Checklist : Air (Prevention and control of Pollution) Act, 1981**

The Secretarial auditor has to check the following points in respect of Air (Prevention and Control of Pollution) Act, 1981:-

1. *Prohibition on use of certain appliances in declared areas (Section 19)*
  - (i) Whether any notification has been issued under Section 19 declaring the area in which the premises of the factory of the company is situated, as air pollution control area.
  - (ii) If so, whether directions, if any, of the state Government concerned regarding use of approved appliances have been complied with
2. *Previous consent of the State Board for operating industrial plants (Section 21)*
  - (i) Whether previous consent of the State Board has been obtained for establishing or operating any new industrial plant set up by the Company.
  - (ii) Whether the conditions of consent have been complied with.
  - (iii) Whether consent given has been cancelled. If yes, what action has been taken by the company in the matter.

3. *Whether the air pollutants conform to the standards (section 22) prescribed by the State Government*
4. *Restraints on causing air pollution (Section 22A)*
  - (i) Whether any court has been made orders restraining the company in regard to emission of any air pollutant.
  - (ii) Whether the state board has been authorized to implement the court's direction in a specified manner.
5. *Information to be furnished to the State Board etc. (Section 23, 24,25 & 26)*
  - (i) Whether information, if any, has been given to the State Board regarding emission or apprehended emission of any air pollutant in excess of the standard laid down.
  - (ii) Whether any inspection has been carried/information called or samples have been taken by the state board or any officer empowered by it.
6. *Whether any appeal has been preferred by an aggrieved person against the orders of State Board. (Section 31)*
7. *Compliance with directions issued by the Central/State Board(s) – (Section 31-A)*
  - (i) Whether any directions have been issued by the central/state board(s) particularly in regard to — Closure, prohibition or regulation of any industry operation of process; or  
— The stoppage or regulation of supply of electricity, water or any other service.
  - (ii) If so, whether such directions have been complied with.
8. *Prosecution of company and its directors (Chapter VI)*
  - (i) Whether prosecution proceedings have been initiated against the company and its directors for violation of any provisions of the Act.
  - (ii) If yes, what is the State/result of such proceedings?

**Question No. 10**

- (a) *A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction. (7 marks)*
- (b) *Under the Employee Stock Option Scheme, the companies have freedom to determine the exercise price. (8 marks)*

**Answer to Question No. 10(a)**

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction as the nature of due diligence varies from the type of transaction, its volume, the motive and objective of parties to a transaction. The nature and the extent of due diligence depends upon the risk perceived by parties to a transaction.

The 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. The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision 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.

**Answer to Question No. 10(b)**

The companies granting option to it is employees pursuant to the Employees Stock Option Scheme is having the freedom to determine the exercise price subject to adherence to the accounting policies, specified in Schedule I of SEBI (ESOP &ESPS) Guidelines, 1999.

**Accounting Policies for ESOS**

- (a) In respect of options granted during any accounting period, the accounting value of the options shall be treated as another form of employee compensation in the financial statements of the company.
  - (b) The accounting value of options shall be equal to the aggregate, over all employee stock options granted during the accounting period, of the intrinsic value of the option or, if the company so chooses, the fair value of the option.
  - (c) Where the accounting value is accounted for as employee compensation in accordance with clause (b), the amount shall be amortised as specified under the schedule.
  - (d) When an unvested option lapses by virtue of the employee not conforming to the vesting conditions after the accounting value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expense equal to the amortized portion of the accounting value of the lapsed options and a credit to deferred employee compensation expense equal to the unamortized portion. When a vested option lapses on expiry of the exercise period, after the fair value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expenses.
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## TEST PAPER 2/2013

Time allowed : 3 hours

Max. Marks : 100

### Part A (25 Marks)

*[Answer Question No.1 which is COMPULSORY  
and ANY THREE of the rest from this part]*

#### Question No. 1

*Write short note on:*

*(a) Advantages of Secretarial Standard*

*(b) Benefits of Secretarial Audit*

*(5 marks each)*

#### Answer to Question No. 1(a)

Advantages of Secretarial Standards are as under:

- To promote good corporate practices leading to better corporate governance
- To ensuring shareholders democracy
- Utmost transparency, integrity, fair play and going beyond the minimum requirements of law
- Better corporate disclosures, adding value to the general endeavour to strive for good governance
- Substantial impact on the improvement of quality of secretarial practices being followed by companies, making them comparable with the best practices in the world
- Secretarial Standards under Companies Act, 2013
- It is the beginning of a new era where non financial standards have been given importance and statutory recognition besides Financial Standards.

#### Answer to Question No. 1(b)

The benefits of secretarial audit are as under:

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

- 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 noncompliance by the company.
- 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.
- Instilling professional discipline and self-regulations.
- Reduces the work load of the regulators due to better and timely compliances.

**Question No. 2**

*Prepare a procedural checklist for Indian party, desired to invest outside India through Automatic Route. (5 marks)*

**Answer to Question No. 2****Procedural Checklist**

1. Board Resolution is required to be passed under Section 292 of the Companies Act, 1956, specifying the limits for investment by Directors, in respect of out bound investment by the company.
2. Special Resolution has to be passed under Section 372 A of the Companies Act, 1956 for investments in excess of 60% of the paid-up Capital and free reserves or 100% of free reserves whichever is higher and necessary e-form 23 has to be filed with ROC, in case of out bound investment by company.
3. It has to be ensured that direct investment outside India does not exceed 400% of the net worth of the company.
4. Statutory Auditors certificate has to be obtained in the specified format.
5. Valuation report has to be obtained from a Chartered Accountant or certified public accountant. In case the investment is more than USD 5 Million, then valuation has to be done by a category I Merchant Banker registered with SEBI or appropriate authority of the host country.
6. Certificate from Chartered accountant has to be obtained for the reasonableness of the acquisition price.
7. Authorised dealer has to be approached with form A-2, Board Resolution, Statutory Auditors' certificate etc for effecting the investment.
8. It has to be ensured that Reporting of ODI has to be made in form ODI (both Part I and Part II) with through authorized dealer to The Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Amar Bldg. 5th floor, Sir P. M. Road, Fort, Mumbai 400 001 along with the following documents:
  - (a) A report from the bankers of the Indian party in a sealed/closed cover.
  - (b) The latest Annual Accounts, i.e. Balance Sheet and Profit and Loss Account of the Indian party along with the Directors' Report

- (c) Additional documents as under, if the application is made for partial/full take over of an existing foreign concern:
    - (i) A copy of the certificate of incorporation of the foreign concern;
    - (ii) Latest Annual Accounts, i.e. the Balance Sheet and Profit and Loss Account of the foreign concern along with Directors' Report; and
    - (iii) A copy of the share valuation certificate from:
      - a Category I Merchant Banker registered with SEBI, or, an Investment Banker/Merchant Banker registered with the appropriate regulatory authority in the host country, where the investment is more than USD 5 million, and
      - in all other cases, by a Chartered Accountant or a Certified Public Accountant.
  - (d) A certified copy of the Resolution of the Board of Directors of the Indian party/ies approving the proposed investment.
  - (e) Where investment is in the financial services sector, a certificate from a Statutory Auditor/Chartered Accountant to the effect that the Indian Party:
    - (i) has earned net profits during the preceding three financial years from the financial service activity;
    - (ii) is registered with the appropriate regulatory authority in India for conducting the financial services activity;
    - (iii) has obtained approval for investment in financial sector activities abroad from regulatory authority concerned in India and abroad; and
    - (iv) fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.
9. On submission of ODI to RBI, it will allot a unique identification number to each JVs and WOS abroad which is required to be quoted in all correspondence including additional investment in the existing overseas concern within the specified limits.
  10. It has to be ensured to receive share certificate of any other documentary evidence of investment in foreign entity within six months, failing which an application for extension of the same has to be made.
  11. Annual Performance Report in the format specified in part III of form ODI, within 3 months of closing the accounts of JVs/WOS as long as it is in existence.
  12. It may be noted that an eligible Indian party making investment in a Joint Venture (JV)/Wholly Owned Subsidiary (WOS) outside India is required to route all its transactions relating to the investment through one branch of an AD Category – I bank designated and all communication from the Indian parties, to the Reserve Bank, relating to the investment outside India should be routed through the same branch of the AD Category – I bank that has been designated by the Indian investor for the investment.

**Question No. 3**

*Briefly analysis the Secretarial Standard five (5) issued by the ICSI. (5 marks)*

**Answer to Question No. 3**

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

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

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

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

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

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

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

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

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

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

- The name of Company Secretary present at the Meeting. The Companies Act does not contain any such requirement. Also, the Minutes should mention the

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

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

**Question No. 4**

*Discuss the Guidelines for consideration of Foreign Direct Investment proposals by Foreign Investment Promotion Board. (5 marks)*

**Answer to Question No. 4**

**Guidelines for consideration of FDI proposals by FIPB**

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

- All applications should be put up before the FIPB by its Secretariat within 15 days and it should be ensured that comments of the administrative ministries are placed before the Board either prior to/or in the meeting of the Board.

- Proposals should be considered by the Board keeping in view the time frame of thirty (30) days for communicating Government decision.
- In cases in which either the proposal is not cleared or further information is required in order to obviate delays presentation by applicant in the meeting of the FIPB should be resorted to.
- While considering cases and making recommendations, FIPB should keep in mind the sectoral requirements and the sectoral policies *vis-à-vis* the proposal(s).
- FIPB would consider each proposal in its totality
- The Board should examine the following while considering proposals submitted to it for consideration:
  - (i) whether the items of activity involve industrial licence or not and if so the considerations for grant of industrial licence must be gone into;
  - (ii) whether the proposal involves any export projection and if so the items of export and the projected destinations;
  - (iii) Whether the proposal has any strategic or defence related considerations.
- While considering proposals the following may be prioritized:
  - (i) Items falling in infrastructure sector.
  - (ii) Items which have an export potential.
  - (iii) Items which have large scale employment potential and especially for rural people.
  - (iv) Items which have a direct or backward linkage with agro business/farm sector.
  - (v) Items which have greater social relevance such as hospitals, human resource development, life saving drugs and equipment.
  - (vi) Proposals which result in induction of technology or infusion of capital.
- The following should be especially considered during the scrutiny and consideration of proposals:
  - (i) The extent of foreign equity proposed to be held (keeping in view sectoral caps if any).
  - (ii) Extent of equity from the point of view whether the proposed project would amount to a holding company/wholly owned subsidiary/a company with dominant foreign investment (i.e. 76% or more) joint venture.
  - (iii) Whether the proposed foreign equity is for setting up a new project (joint venture or otherwise) or whether it is for enlargement of foreign/NRI equity or whether it is for fresh induction of foreign equity/NRI equity in an existing Indian company.
  - (iv) In the case of fresh induction offerings/NRI equity and/or in cases of enlargement of foreign/NRI equity, in existing Indian companies whether there is a resolution of the Board of Directors supporting the said induction/

enlargement of foreign/NRI equity and whether there is a shareholders agreement or not.

- (v) In the case of induction of fresh equity in the existing Indian companies and/or enlargement of foreign equity in existing Indian companies, the reason why the proposal has been made and the modality for induction/enhancement (i.e. whether by increase of paid up capital/authorized capital, transfer of shares (hostile or otherwise) whether by rights issue, or by what modality.
- (vi) Issue/transfer/pricing of shares will be as per SEBI/RBI guidelines.
- (vii) Whether the activity is an industrial or a service activity or a combination of both.
- (viii) Whether the items of activity involves any restriction by way of reservation for the Micro & Small Enterprises sector.
- (ix) Whether there are any sectoral restrictions on the activity.
- (x) Whether the proposal involves import of items which are either hazardous, banned or detrimental to environment (e.g. import of plastic scrap or recycled plastics).

It may be noted that the Companies may not require fresh prior approval of the Government for bringing in additional foreign investment into the same entity, in the following cases:

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

#### **Question No. 5**

*Discuss Composition of Offences under Depository Act, 1996.*

*(5 marks)*

#### **Answer to Question No. 5**

Depositories Act, 1996 enacted to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto.

Section 22A of the Depositories Act, 1996 provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

**Part B (75 Marks)**

*[Answer ALL Questions from this part]*

**Question No. 6**

- (a) *Prepare a Due Diligence Checklist for Compliance with Competition Act 2002.*  
(8 marks)
- (b) *A Practising Company Secretary ignored some material discrepancies while issuing compliance certificate to a company. Explain the professional responsibility involved and state whether any penal provisions are prescribed for taking action in such circumstances.*  
(7 marks)

**Answer to Question No. 6(a)**

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.

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.

**Answer to Question No. 6(b)**

Company Secretaries must take adequate care while issuing Compliance Certificate. It is based on this certificate that confidence of the company, Government and trade and industry will build-up vis-a-vis our profession. Any failure or lapse on the part of a Practising Company Secretary in issuing a Compliance Certificate may not only attract penalty for false statement under Section 628 and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his negligence in issuing the Compliance Certificate. Therefore, it becomes imperative for the Practising Company Secretary that he exercises great care and caution while issuing the Compliance Certificate and also adheres to the highest standards of professional ethics and excellence in providing his services.

Section 628 of the Companies Act, 1956 deals with penalty for false statements. According to said Section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a statement

- (a) which is false in any material particular, knowing it to be false, or
- (b) which omits any material fact, knowing it to be material;

he shall, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

In view of this, a Practising Company Secretary will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate. However, a person will be penalised under Section 628 in case he makes a statement, which is false in any material particular, knowing it to be false, or which omits any material fact knowing it to be material.

**Question No. 7**

- (a) *Explain the significance of securities management and compliances by a Company Secretary under the Companies Act, 1956.* (7 marks)
- (b) *Discuss about Process of Due Diligence for Banks.* (8 marks)

**Answer to Question No. 7(a)**

The company has to issue various types of securities to meet its requirement of funds. The issuance of any kind of security is again subject to the compliances of various Acts, Rules, Regulations and Guidelines. Once the securities have come into existence, the transactions in the securities are also governed by various Acts, Rules, and Regulations. Not only the issuer of the securities but also the holder of the securities are required to comply with the statutory provisions to transact in the securities of the company.

The concept of securities management and compliances thus signifies and includes in its ambit examination, verification or checking of registers, records, forms, returns and documents relating to securities issued by a company and certification of timely and proper compliance of all statutory provisions related to securities applicable to a company.

Thus, securities management and compliances, can provide an umbrella mechanism to ensure better compliances of all the statutory provisions relating to securities by the companies.

The company secretary has a big role to play because it is he who has to ensure the management of securities issued by the company, timely compliance of relevant provision of law applicable to the securities so issued and maintain all records and documents relating to securities issued by the company under the Companies Act, 1956 and other regulations.

**Answer to Question No. 7(b)**

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

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

### *Reporting with Qualification*

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

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

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

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

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

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

### *Professional Responsibility*

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.

*“The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure . . . ., and the Board was duly constituted. During the period under*

*review the changes that took place in the Board of Directors of the Company are listed in the Annexure ....., and such changes were carried out in due compliance with the provisions of the Companies Act, 1956.”*

**Question No. 8**

(a) *The objectives of a legal due diligence exercise may vary from case to case.* (7 marks)

(b) *Discuss about Stages of Merger & Acquisition Due Diligence.* (8 marks)

**Answer to Question No. 8(a)**

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.

The objectives of a legal due diligence exercise may vary from case to case. However some of the common objectives in most of the cases would be as follows:

1. Gathering of information from the target company.
2. Uncovering of the risks of target company through a SWOT analysis.
3. Improving the bargaining position.
4. Cost benefit analysis.
5. Effect of risk and liability on the cost of the transaction.
6. Mapping of compliance requirements of the target company and the actual status.

**Answer to Question No. 8(b)**

<i>Stages</i>	<i>For Buyer</i>	<i>For Seller</i>
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> <li>— Compilation of list of data required</li> </ul>	<ul style="list-style-type: none"> <li>— Approach buyers</li> <li>— Negotiate initial terms</li> <li>— Execution of Non-Disclosure agreement</li> <li>— Creation of Data room</li> </ul>

<i>Stages</i>	<i>For Buyer</i>	<i>For Seller</i>
Due diligence	<ul style="list-style-type: none"> <li>— Inspection of Data room</li> <li>— Analysis of private documents</li> <li>— Evaluation of risk and return</li> <li>— Structure the terms and conditions</li> </ul>	<ul style="list-style-type: none"> <li>— Assistance in data room</li> <li>— Setting deadlines for offer</li> </ul>
Negotiations	<ul style="list-style-type: none"> <li>— Make final offer</li> <li>— Negotiate and agree on terms</li> </ul>	<ul style="list-style-type: none"> <li>— Compile final offers</li> <li>— elect best offer</li> <li>— negotiations</li> </ul>
Post diligence	<ul style="list-style-type: none"> <li>— Post merger integration and cultural adjustments</li> </ul>	<ul style="list-style-type: none"> <li>— Termination of data room and ownership exchange</li> </ul>

### **Question No. 9**

- (a) *Prepare a Check List on Major Regulatory Compliances under Environmental Due Diligence.* (8 marks)
- (b) *Briefly discuss about Common Anti-Competitive Practices under Competition Law.* (7 marks)

### **Answer to Question No. 9(a)**

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. a number of Central/State Legislations/Regulations etc., govern environmental aspects India. It includes the following Acts and Rules made thereunder:

- *The Water (Prevention and Control of Pollution) Act* was enacted in 1974 to provide for the prevention and control of water pollution, and for the maintaining or restoring of wholesomeness of water in the country.
- *The Water (Prevention and Control of Pollution) Cess Act* was enacted in 1977, to provide for the levy and collection of a cess on water consumed by persons operating and carrying on certain types of industrial activities.
- *The Air (Prevention and Control of Pollution) Act* was enacted in 1981 and amended in 1987 to provide for the prevention, control and abatement of air pollution in India.
- *The Environment (Protection) Act* was enacted in 1986 with the objective of providing for the protection and improvement of the environment.
- *Public Liability Insurance Act 1991* is to provide for damages to victims of an accident which occurs as a result of handling any hazardous substance.

- *National Green Tribunal Act 2010* for effective and expeditious disposal of cases relating to environmental protection and conservation of forests and other natural resources including enforcement of any legal right relating to environment and giving relief and compensation for damages to persons and property and for matters connected therewith or incidental thereto.

### **Rules**

- The Water (Prevention and Control of Pollution) Cess Rules, 1978
- The Water (Prevention and Control of Pollution) Rules, 1975
- The Air (Prevention and Control of Pollution) (Union Territories) Rules, 1983
- The Air (Prevention and Control of Pollution) Rules, 1982
- The Environment (Protection) Rules, 1986
- The Public Liability Insurance Rules, 1991, amended 1993
- Hazardous Wastes (Management and Handling) Rules, 1989

From the above facts, we can derive that there is no dearth of legislations in India. What is needed is the effective and efficient enforcement of the constitutional mandate and the other environmental legislations. This can be achieved with the co-ordinated efforts of the states as well as citizens.

### **Answer to Question No. 9(b)**

Anti Competitive Agreements 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.

The Competition Commission of India 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.

### ***Horizontal Agreements [Section 3(3)] of the Competition Act, 2002***

#### **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 there fore 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.

**Question No. 10**

(a) *Discuss about the CEO/CFO certification under Listing Agreement.*

*(8 marks)*

- (b) *Search and status report on the position of borrowings made by a company.*  
(7 marks)

**Answer to Question No. 10(a)**

As per Clause 49(IV)(F) of the listing agreement details the following provisions regarding CEO/CFO certification. The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
  - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
  - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit committee :
  - (i) significant changes in internal control over financial reporting during the year;
  - (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
  - (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

**Answer to Question No. 10(b)**

Search involves physical inspection of documents and status comprises of reporting of the information as made available by the search. A search report prepared by the Company Secretary in Practice 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 immoveable properties. This information is very vital for considering the company's request for grant of loans and other credit facilities. The search report enables the Bank/Financial Institution to study the credit-worthiness of the borrowing company.

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## TEST PAPER 3/2013

Time allowed : 3 hours

Max. Marks : 100

### Part A (25 Marks)

[Answer Question No.1 which is **COMPULSORY**  
and **ANY THREE** of the rest from this part]

#### Question No. 1

Write short note on:

(a) Secretarial Standard issued by the ICSI.

(b) Price Sensitive Information.

(5 marks each)

#### Answer to Question No. 1(a)

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

The ICSI has so far issued the following Secretarial Standards:

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

#### Answer to Question No. 1(b)

As per Regulation 2(ha) of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 "price sensitive information" means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

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

- (i) periodical financial results of the company;
- (ii) intended declaration of dividends (both interim and final);

- (iii) issue of securities or buy-back of securities;
- (iv) any major expansion plans or execution of new projects;
- (v) amalgamation, mergers or takeovers;
- (vi) disposal of the whole or substantial part of the undertaking;
- (vii) significant changes in policies, plans or operations of the company.

**Question No. 2**

*Briefly analysis the Secretarial Standard seven (7) issued by the ICSI. (5 marks)*

**Answer to Question No. 2****Secretarial Standard on Passing of Resolutions by Circulation (SS-7)**

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

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

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

- The proposed resolution with all the papers should be sent to all directors including interested directors and directors who are usually residing abroad.
- There should be a note with every such resolution setting out the details of the proposal and draft of resolution proposed and also indicating how to signify assent or dissent to the resolution proposed.
- The draft resolution alongwith necessary papers should be circulated by hand, or by post or by facsimile, or by e-mail or by any other electronic mode.
- The resolution is deemed to have been passed on the date on which it is approved by the majority of the Directors.
- In case a director does not append a date, the date of receipt by the company of the signed resolution should be taken as the date of signing.
- The minutes of the next meeting of the Board or, committee should record the text of the resolution passed and dissent, if any.

- Passing of resolution by circulation should be considered valid as if it had been passed at a duly convened meeting. This does not dispense with the requirement for the Board to meet at the specified frequency.
- The standard provides, as an Appendix, list of illustrative notes to be passed at a duly convened Board meeting and which cannot be passed by circulation.

**Question No. 3**

*Indian party desired to invest outside India. Advise the Indian Part on method of funding for the purpose of investment outside India. (5 marks)*

**Answer to Question No. 3**

Investment in an overseas may be funded out of one or more of the following sources:

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

**Question No. 4**

*Discuss about the compliance requirement with the terms and conditions of the listing agreement. (5 marks)*

**Answer to Question No. 4**

Compliance with the terms and conditions of the listing agreement:

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

- (i) Share transfers have been effected within the stipulated time period;
- (ii) The requirements of book closure have been complied with;
- (iii) The requirements of informing the Stock Exchange(s) regarding bonus or rights issues/dividend proposals complied with;
- (iv) Payment of dividend on shares, interest on debentures/bonds, redemption amount of redeemable shares or debentures/bonds;
- (v) The requirements of informing the Stock Exchange(s) regarding change in the composition of the Board of directors/managing director complied with;

- (vi) Further issue of Securities;
- (vii) Cash Flow Statement in the Annual Report, Consolidated Financial Statement and related party disclosures;
- (viii) Shareholding pattern containing details of promoters holding and non-promoters holding;
- (ix) Decision regarding issue of shares, forfeiture of shares, alteration of shares, cancellation of declared dividend, merger, amalgamation, de-merger, hiving off, voluntary delisting and other material decisions;
- (x) The Distribution Schedule has been filed with the Exchange(s);
- (xi) Quarterly unaudited financial results have been published in newspapers and a copy of these results is sent to the stock exchange;
- (xii) In any proposal to purchase shares of any other company, the requirements of clause 40A/40B of the listing agreement have been complied with;
- (xiii) Half-yearly results and Limited review Report by auditors;
- (xiv) Quarterly reporting of Segment wise Revenue, results and Capital Employed;
- (xv) Consolidated Quarterly Financial results of holding company;
- (xvi) The copies of annual accounts and notices of general meeting are regularly sent to the exchange;
- (xvii) Change of name due to new activity;
- (xviii) Explanation regarding variations in utilisation of funds and profitability;
- (xix) Registration of share Transfer;
- (xx) Loss of share certificate and issue of duplicate Certificate;
- (xxi) Amendments to Memorandum and Articles of Association are sent to the exchange(s);
- (xxii) The exchange is informed of important events like, strike, lockout or amalgamation;
- (xxiii) Clause 49 relating to Corporate Governance has been complied with;
- (xxiv) Clause 50 relating to Accounting Standards.

**Question No. 5**

Discuss the legal requirement for the appointment of Whole-Time Company Secretary and Compliance Certificate from a Company Secretary in Whole-Time Practice under Companies (Compliance Certificate) Rules, 2001

**Answer to Question No. 5**

As per Section 383 A(1) of the Companies Act, 1956 every company having such paid-up share capital as may be prescribed shall have a whole time secretary, and where the Board of directors of any such company comprises only two directors, neither of them shall be the secretary of the company.

It may be noted that every company not required to employ a whole time secretary under sub-section (1) and having a paid-up share capital of ten lakhs rupees or more shall file with the Registrar a certificate from a secretary in whole time practice in such

form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all provisions of this Act and a copy of such certificate shall be attached with Board's report referred to in section 217.

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

### **Part B (75 Marks)**

*[Answer ALL from this part]*

#### **Question No. 6**

- (a) Write a note on 'pre-issue due diligence' and 'post-issue due diligence'.  
(8 marks)
- (b) As a Practising Company Secretary, you are required to advise the acquirer company about the meaning of 'trigger point' and the different trigger points to be followed under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.  
(7 marks)

#### **Answer to Question No. 6(a)**

Due diligence spans the entire public issue process. 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 extend in advising the company on the processes and activities which are required to fill the gaps identified.

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.

The scope of pre-issue due diligence includes compliance with regard to eligibility, pricing, disclosure, lock in requirements etc as prescribed under SEBI(ICDR) Regulations 2009.

Post issue due diligence includes post issue requirements like dispatch of share certificates, refund orders, basis of allotment, post issue monitoring reports, redressal of investor grievances, co-ordination with depositories, registrars, bankers etc.

#### **Answer to Question No. 6(b)**

*Acquisition of 25% or more shares or voting rights:*

An acquirer, who along with Person Acting in Concerts (PACs), if any holds less

than 25% shares or voting rights in a target company and agrees to acquire shares or acquires shares which along with his/ PAC's existing shareholding would entitle him to exercise 25% or more shares or voting rights in a target company, will need to make an open offer before acquiring such additional shares.

*Acquisition of more than 5% shares or voting rights in a financial year:*

An acquirer who (along with PACs, if any) holds 25% or more but less than the maximum permissible non-public shareholding in a target company, can acquire additional shares in the target company as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31, only after making an open offer.

Maximum permissible non-public shareholding is derived based on the minimum public shareholding requirement under the Securities Contracts (Regulations) Rules 1957 ("SCRR"). Rule 19A of SCRR requires all listed companies (other than public sector companies) to maintain public shareholding of at least 25% of share capital of the company. Thus by deduction, the maximum number of shares which can be held by promoters i.e. Maximum permissible non-public shareholding) in a listed companies (other than public sector companies) is 75% of the share capital.

#### **Question No. 7**

- (a) *Discuss about Regulatory Framework on issue of American Depository Receipts and Global Depository Receipts.* (8 marks)
- (b) *The managing director of Banking Company invites you as a Practising Company Secretary to explain him about compilation and preparation of search report before lending funds to a private company. Explain briefly the issues involved in this regard.* (7 marks)

#### **Answer to Question No. 7(a)**

##### **Regulatory Framework in respect of issue of ADR and GDR**

- (a) *Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003.*

Global Depository Receipts in India are made under Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time. The important features of the amended scheme are as under

- Companies issuing GDRs do not require approval of Ministry of Finance.
- GDR issue shall not exceed the sectoral cap of FDI policy. If so FIPB approval is to be obtained.
- Indian companies restrained by SEBI from raising capital, is not eligible to issue GDRs.
- Indian companies issuing GDRs has to comply with the specified pricing norms.
- Unlisted companies floating GDRs has to get its shares simultaneously listed in Indian exchange/s.

- The proceeds of the issue cannot be used for investing in the stock market or real estate.
- The issue expenses shall not exceed the specified limit.
- The company has to comply with the reporting requirements of RBI.

(b) *Listing Agreement*

As FCCB and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003 requires unlisted companies floating GDRs, to get its shares simultaneously listed in Indian exchanges, with respect to underlying shares of the company issuing GDRs, all provisions on listing agreement and other filings with the stock exchanges in India has to be complied with.

(c) *Companies Act, 1956*

- The necessary compliances with respect to Board/share holder approval under Section 94 with respect to increase of authorised capital.
- Special resolution under Section 81(1A) for issuing Depository receipts.
- Special resolution under Section 31 for alteration of a capital clause referred in the Articles of Association.
- The underlying shares are to be offered to more than 50 people, as it is a public offer [Section 67(3)].
- Filing of Prospectus with ROC (Section 60).

(d) *SEBI (ICDR) Regulations 2009*

Though it is not applicable to GDRs as such, simultaneous listing of shares of unlisted companies floating GDRs, are to comply with SEBI (ICDR) Regulations 2009.

(e) *SEBI (SAST) Regulations 2011 (Take over Regulations)*

The take over regulations are to be complied with

- (a) when the GDR holders become entitled to exercise voting rights, in any manner whatsoever on the underlying shares; or
- (b) exchange such depository Receipts with underlying shares carrying voting rights.

### **Regulatory framework outside India**

#### *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.

### **Answer to Question No. 7(b)**

MCA-21 enables viewing of public documents of companies for which payment has been made by user. Form 8, Form 10, Form 17 and copies of certificates of registration thereof are available for inspection at the website. Before proceeding with the inspection it would be advisable to ensure that the format in which the search report is required.

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.

As 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.

### **Question No. 8**

*Write short note on the following:*

- (i) *Cultural Due Diligence*
- (ii) *Operational due diligence*
- (iii) *Compliance Management.* (5 marks each)

### **Answer to Question No. 8(i)**

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.

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

**Answer to Question No. 8(ii)**

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.

**Answer to Question No. 8(iii)**

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.

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. Installing proper compliance process is a must for the success of compliance programme. Systematic approach helps in chalking out a plan of action in right direction. Installing a process presupposes planning for the activity, identification of desired objective and resources, detailed plan of action with provision for eventualities and continuous monitoring and corrective measures.

**Question No. 9**

- (a) *As part of good corporate governance practices under Clause 49 of the listing agreement, a company is required to make disclosures on certain aspects. Critically examine.* (8 marks)

(b) *Why it is necessary for Environmental Due Diligence ?*

(7 marks)

**Answer to Question No. 9(a)**

**Disclosures under the Clause 49 of Listing Agreement**

*Basis of related party transactions*

Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

*Disclosure of Accounting Treatment*

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

*Board disclosures on risk management*

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

*Proceeds from public issues, rights issues, preferential issues etc.*

When money is raised through an issue (public issues, rights issues, preferential issues etc.), it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the audit committee.

*Remuneration of Directors.*

All pecuniary relationship or transactions of the non-executive directors *vis-à-vis* the company shall be disclosed in the Annual Report.

*Management*

As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on certain matters Industry structure and developments, Opportunities and Threats, Risks and concerns etc.

*Disclosures to shareholders*

Disclosures to directors pertains to information like resume of director with respect to his appointment, Disclosure of relationships between directors *inter-se* etc.

**Answer to Question No. 9(b)**

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. 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 includes:

- 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.

**Question No. 10**

- (a) *As a Practising Company Secretary Prepare a Check list for preparation of Due Diligence Report to Banks. (8 marks)*
- (b) *Environmental Management is a tool for value creation. Elucidate. (7 marks)*

**Answer to Question No. 10(a)****Check list for preparation of Due Diligence Report to Bank**

- Examined the registers, records, books and papers of the Company
- Check whether the management of the Company duly constituted
- Check the Board of Directors of the Company
- Check the shareholding pattern of the company
- Check the Memorandum of Association
- Check the Articles of Association
- Check whether the company has entered into transactions with business entities in which directors of the company were interested
- Check whether the company has advanced loans, given guarantees and provided any securities

- Check whether the Company has made loans and investments; or given guarantees or provided any securities to other business entities
- Check whether the amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company
- Check whether the Company has defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies
- Check whether the Company has created, modified or satisfied charges on the assets of the company
- Check the Principal value of the forex exposure and Overseas Borrowings of the company
- Check whether the Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within the stipulated time in compliance with the provisions of the Companies Act, 1956 and other relevant statutes
- Check whether the Company has insured all its secured assets
- Check whether 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
- Check whether the Company has declared and paid dividends to its shareholders
- Check whether the Company has insured fully all its assets
- Check whether the name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India
- Check whether the name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation
- Check whether the Company has paid all its Statutory dues and satisfactory arrangements had been made for arrears of any such dues
- Check whether the funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed
- Check whether the Company has complied with the provisions stipulated in Section 372A of the Companies Act in respect of its Inter Corporate loans and investments
- Check whether the Company 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
- Check whether 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
- Check whether the any 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

- Check whether the Company has (being a listed entity) complied with the provisions of the Listing Agreement
- Check whether the Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

**Answer to Question No. 10(b)**

Proper compliance of laws relating to Environment will increase the credibility and would also create value for a business organisation. Companies do earmark separate budget to meet the business expenditure relating to investments for meeting environmental compliances. There is a strong evidence and proof that improved environmental performance is positively correlated with increased competitiveness. Further, the effective environmental systems based on fundamentally sound regulatory structures can play an important role in encouraging business organisations to improve environmental performance, which can strengthen broader competitiveness related goals. Now-a-days, people are willing to pay more for a product which is environment friendly for e.g. lead free paint, jute bags instead of plastic, green homes etc and business houses are also being attracted to the liberalised policies of Indian Government which has encouraged the same. Companies should not view the total amount to be spent on protection of environment as an expenditure. They should consider that it is an investment for creating value, for building goodwill and for making the presence felt. Reputation of an organisation often correlated with the way they function i.e. compliance of rules and regulations, adherence to environment safety, health policy, creating awareness to the workers/ employees and also to the outsiders regarding various safety techniques and policies to be observed while entering into a factory, hazardous industry, mines etc. and last but not least is accomplishing the task of corporate social responsibility etc.

Because of the various advantages and value creation, almost all businesses across the world come forward to introduce and implement proper implementation of Environmental Management. The advantages of proper environmental management are as follows:-

- (a) It avoids punishment which includes prosecution including fines.
- (b) Eliminates increased liability to environmental taxes.
- (c) Avoids loss in value of land.
- (d) Avoids destruction of brand values, loss of sales, consumer boycotts and inability to secure finances.
- (e) Avoids loss of insurance cover and contingent liabilities.
- (f) Fixes and ensures more accurate and comprehensive information about responsibility of business houses towards environment for improving corporate image with stakeholders, customers, local communities, employees, government and bankers.
- (g) Helps to attain competitive advantage in respect of identification of costs and benefits associated with it.

- (h) It will boost employee morale and organisation attains a good reputation in the market.
  - (i) Ultimately add value to the economy as a whole.
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