Solved Scanner **Appendix**

CS Prof. Prog. M - IV (Old Syllabus)

(Solution of December - 2014)

Paper - 7: Due Diligence and Corporate Compliance Management

Chapter - 1: Due Diligence - An Overview

2014 - Dec [1] {C} (i)

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

2014 - Dec [7] (b) (i)

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

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

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

Chapter - 2: Due Diligence - Equity Issues

2014 - Dec [4] (a)

(i) (a) **Eligibility to Participate**

An employee is eligible to participate in Employee Stock Option Scheme (ESOS) of the company.

It may be noted that where such employee is a director nominated by an institution as its representative on the Board of Directors of the company:

- The contract/agreement entered into between the institution nominating its employee as the director of a company and the director so appointed shall, *inter alia*, specify the following:
  - ⇒ whether options granted by the company under its ESOS can be accepted by the said employee in his capacity as director of the company;
  - ⇒ that options, if granted to the director, shall not be renounced in favour of the nominating institution; and
  - ⇒ the conditions subject to which fees, commissions, ESOSs, other incentives, etc. can be accepted by the director from the company.
- the institution nominating its employee as a director of a company shall file a copy of the contract/agreement with the said company, which shall, in turn, file the copy with all the stock exchanges on which its shares are listed.
- the director so appointed shall furnish a copy of the contract/agreement at the first Board Meeting of the company attended by him after his nomination.

(b) Check that employee is not a promoter nor belongs to the promoter group.

(c) Check that a director who either himself or through his relative or through anybody corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating as he is not eligible to participate in the scheme.

(ii) Pricing and Lock-in-Period

The companies granting option to its employees pursuant to the scheme have the freedom to determine the exercise price subject to adherence to the accounting policies. In case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, is required to be disclosed in the Director's Report and also the impact of this difference on profits and on Earnings per Share of the company shall also be disclosed in the Director's Report.

The company has the freedom to specify the lock-in-period for the shares issued pursuant to exercise of option.

Chapter - 4: Takeovers and Acquisitions

2014 - Dec [1] {C} (iv)

Cultural differences look like playing both ways. Although distant cultural environments make the integration process harder, the lack of culture-fit or cultural compatibility has often been used to explain M&A failure. Cultural differences have also been considered a source of lower commitment to work, making co-operation more difficult, particularly from employees of the acquired company. In this regard, scholars have largely given account of the lack of co-operation momentum stemming from a "we" versus "them" attitude, resulting in hostility among employees.

2014 - Dec [2] (b) (i)

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under Regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

If the target company's shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement (SPA) triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement (PA);

- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- Volume weighted average market price for sixty trading days preceding the PA.

If the target company's shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement (SPA) triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement (PA);
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples and such other parameters that are customary for valuation of shares of such companies.

2014 - Dec [8] (iv)

The main distinction between a friendly takeover and hostile takeover is whether there is a mutual understanding between the acquirer and the takeover company. When there is a mutual understanding, it is friendly takeover otherwise it is termed as hostile takeover.

Chapter - 5: Compliance of Listing Agreement

2014 - Dec [1] {C} (v) As per Clause 49(IV)(A), the company through its Board of Directors shall constitute the nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

Provided that the chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

2014 - Dec [8] (i)

As per Clause 16 of Listing Agreement, the Company agrees to close its Transfer Books for purposes of declaration of dividend or the issue of rights or bonus shares or issue of shares for conversion of debentures or of shares

arising out of rights attached to debentures or for such other purposes as the Exchange may agree to or require and further agrees to **close its Transfer Books at least once a year at the time of the Annual General Meeting** if they have not been otherwise closed at any time during the year and to give to the Exchange the notice in advance of at least seven working days or of as many days as the Exchange may from time to time reasonably prescribe, stating the dates of closure of its Transfer Books (or, when the Transfer Books are not to be closed, the date fixed for taking a record of its shareholders or debenture holders) and specifying the purpose or purposes for which the Transfer Books are to be closed (or the record is to be taken) and to send copies of such notices to the other recognised stock exchanges in India.

Provided further that in case of a company on whose stocks derivatives are available or whose stocks form part of an index on which derivatives are available, shall give a notice period of atleast seven working days to Exchanges for corporate actions like mergers, de-mergers, splits and bonus shares.

The company further agrees that the minimum time gap between the two book closures and/or record dates would be atleast 30 days.

Chapter - 9: Setting up of Business Units and Joint Ventures in India

2014 - Dec [5] (c)

Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issues a "Consolidated FDI Policy Circular" on an yearly basis elaborating the policy and the process in respect of FDI in India, that incorporates the amendments made to the regulations. Reserve Bank of India also compiles all the circulars issued, through a master circular on foreign investment in India(master circular)which is issued on 1st July of every year.

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

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

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

Eligibility for Investment in India

(i) A person resident outside India or an entity incorporated outside India, can invest in India, subject to the FDI Policy of the Government of India. A person who is a citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI Scheme, with the prior approval of the FIPB. Further, a person who is a citizen of Pakistan or an entity incorporated in Pakistan, may with the prior approval of the FIPB, can invest in an Indian Company under FDI Scheme, subject to the prohibitions applicable to all foreign investors and the Indian Company, receiving such foreign direct investment, should not be engaged in sectors / activities pertaining to defence, space and atomic energy.

(ii) NRIs, resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in shares and convertible debentures of Indian Companies under FDI Scheme on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

(iii) Overseas Corporate Bodies (OCBs) have been de-recognised as a class of investor in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under adverse notice of the Reserve Bank can make fresh investments under the FDI Scheme as incorporated non-resident entities, with the prior approval of the Government of India, if the investment is through the Government Route; and with the prior approval of the Reserve Bank, if the investment is through the Automatic Route. However, before making any fresh FDI under the

FDI scheme, an erstwhile OCB should through their AD bank, take a one time certification from RBI that it is not in the adverse list being maintained with the Reserve Bank of India.

Chapter - 10: Setting up of Business Units and Joint Ventures Abroad

2014 - Dec [1] {C} (vi)

As per Regulation 7(1), an Indian party may make investment in an entity outside India engaged in financial services activities:

Provided that the Indian party

(i) has earned net profit during the preceding three financial years from the financial services activities;

(ii) is registered with the regulatory authority in India for conducting the financial services activities;

(iii) has obtained approval from the concerned regulatory authorities both in India and abroad, for venturing into such financial sector activity;

(iv) has fulfilled the prudential norms relating to capital adequacy as prescribed by the concerned regulatory authority in India.

any additional investment by an existing JV/WOS or its step down company in the Financial Services Sector shall be made only after complying with the conditions stipulated in sub-clause (1).

2014 - Dec [7] (b) (iii)

Overseas Direct Investments by proprietorship concern / unregistered partnership firm in India

The following terms and conditions are required to be complied with for considering the proposal of ODI, by a proprietorship concern / unregistered partnership firm in India, by the Reserve Bank under the approval route:

(a) The proprietorship concern / unregistered partnership firm in India is classified as 'Status Holder' as per the Foreign Trade Policy issued by the Ministry of Commerce and Industry, Govt. of India from time to time.

(b) The proprietorship concern / unregistered partnership firm in India has a proven track record, i.e., the export outstanding does not exceed 10% of the average export realisation of the preceding 3 years and a consistently high export performance.

(c) The Authorised Dealer bank is satisfied that the proprietorship concern / unregistered partnership firm in India is KYC (Know Your Customer) compliant, engaged in the proposed business and has turnover as indicated.

(d) The proprietorship concern / unregistered partnership firm in India has not come under the adverse notice of any Government agency like the Directorate of Enforcement, Central Bureau of Investigation, Income Tax Department, etc. and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India and

(e) The amount of proposed investment outside India does not exceed 10 per cent of the average of last 3 years' export realisation or 200 per cent of the net owned funds of the proprietorship concern / unregistered partnership firm in India, whichever is lower.

Chapter - 11: Legal Due Diligence

2014 - Dec [8] (iii)

There is no definitive process of a legal due diligence. The investigative aspects as well as Legal Due Diligence process varies depending upon the scope of work dictated by the client, the focus, special areas of weakness, the type of business, etc.

Chapter - 12: Compliance Management

2014 - Dec [1] {C} (ii)

Corporate audit 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.

2014 - Dec [8] (ii)

A critical component of an effective compliance program is the ability to monitor and audit compliance in a "real time manner." Yet, as companies cross geographical and industry boundaries, it is becoming harder to perform this role in the traditional manner. As a result, companies are increasingly seeking technology solutions.

Information Technology can play an effective role in implementation of a Corporate Compliance Management Programme across various departments of an organization in terms of real-time compliance reminders, generation of reports, sending warning signals, generation of compliance calendar etc.
Many companies are introducing comprehensive web-based compliance systems that links various offices /units for better co-ordination and continued compliance. Companies prefer to introduce full-fledged compliance management systems for smooth compliance of multiple laws. Web-based compliance software are available industry-wise and tailor made compliance software can also be made according to company specifications which has to be updated on continuous basis.

Chapter - 13: Secretarial Audit

2014 - Dec [3] (d)

Section 204(1) of the Companies Act, 2013 provides for mandatory secretarial audit for every listed company and companies belonging to other prescribed class of companies. Such companies are required to annex a secretarial audit report with its Board's report. As per Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, read with Section 179 of the Companies Act, 2013 secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting.
Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, has prescribed the following class of companies for the purposes of the above said section:
(a) every public company having a paid-up share capital of ₹ 50 crores or more; or
(b) every public company having a turnover of ₹ 250 crores or more.

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

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

Chapter - 14: Share Transfer Audit

2014 - Dec [3] (c)

Where the Article of association of a company give power to the Board to refuse registration of a transfer of shares such power must be exercised by a resolution of the Board. The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse *mala fide*, i.e., they act oppressively or corruptly, Tribunal will interfere and order registration.

The refusal to register transfer of shares on the ground that the transferor had been indulging in acts which were against the interests of the company shall not be tenable. [*Pawan Gupta v. Hicks Thermometers (India) Ltd.]*

Hence, in the given case, Nagma is not entitled to get the shares transferred in her name.

2014 - Dec [5] (b)

In the given case SSL had taken a loan from a scheduled bank and the 190 lakh shares were issued to the bank as security till the repayment of the loan. Hence, as per my view, FCSL cannot get the shares transferred in its name.

Chapter - 15: Compliance Certificate

2014 - Dec [1] {C} (iii)

Sections 206(5) and 206(6) empowers the role of Central Government to direct for inspection of any company, by appointing an inspector or by directing a statutory authority.

Section 206(5) provides that without prejudice to the foregoing provisions of this section, the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it for the purpose.

Section 206(6) states that the Central Government may, having regard to the circumstances by general or special order authorise any statutory authority to carry out the inspection of books of account of the companies.

2014 - Dec [3] (a), (b)

(a) Lien on shares is permissible only if article of company authorise. As per Regulation 9 of Table F of the Companies Act, 2013 the Company has lien on share for unpaid call or for any other amount due from shareholder. When the right of lien is exercised by company, shares are not transferred.

The Board of Directors may, however, at any time declare any share to be wholly or in part exempt from the said provision. Hence, the decision of the Board of Directors of M/s Divya Refinery Ltd. to relax the provisions of lien in respect of shares held by Neeraj is in order and valid. Further the Company's lien is extended to all dividends payable on such shares.

(b) MD vested with full powers of the management of the affairs of the Company and is authorized to sign all papers of the Company, also has full powers to borrow money on a Promissory Note even without a Board Resolution.

Hence, Company cannot refused to accept the liability on the plea that the Chairman had borrowed funds without authorization from the company.

2014 - Dec [4] (b), (c)

(b) As per Section 161(4), Board of Directors can fill- up casual vacancies if, the office of any director appointed by the company in general meeting is vacated before his term of office and hence the appointment of Mr. Sukant was in order.

In normal course, Mr. Sukant could have held his office as director up to the date to which Mr. Rishi would have held but Mr. Sukant expired on 6th December, 2014 and again a vacancy has arisen in the office of director owing to death of Mr. Sukant who was appointed by the board to fill-up the casual vacancy. Vacancy created by death of director is casual vacancy. But when the person is appointed as director in casual vacancy and he died, it is not casual vacancy.

Hence, the present vacancy cannot be considered as casual vacancy as stated in Section 161(4) and therefore the board cannot fill- up the same. The board may however appoint Mrs. Shivani, wife of Mr. Sukant, as an additional director if, article authorize it as per Section 161(1) of the Companies Act, 2013. If Mrs. Shivani is appointed as additional director, she will hold the office until the conclusion of the next annual general meeting.

(c) (i) Minutes book must be a bound book and cannot be a loose leaf binder. However, the Department of Company Affairs agreeable to permit the loose leaf minutes book, provided the company takes appropriate safeguards against interpolation of the leaves in the books such as serial numbering of pages, authentication of each page of the book, safe custody of the key, if any, to the loose leaf register. The company should also arrange for the loose leaf minutes to be bound into books at regular intervals of, say, 6 months.

(ii) According to Section 174(1), the quorum for a meeting of the Board of Directors shall be 1/3rd of its total strength (any fraction contained in that 1/3rd to be rounded off to one) or two directors, whichever is higher. "Total Strength" shall not include directors whose places are vacant.

As per Section 174(4) of the Companies Act, 2013, if a meeting of the Board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place or if that day is a National holiday, at the same time and place. The provisions of Section 174 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that section could not be held for want of a quorum.

Hence, a proposal to buy another business for cash which was approved and carried out is contravened the provisions of Section 174(1).

2014 - Dec [5] (a)

As per Section 180(1)(c) Board of Directors can borrow money upto the aggregate of paid-up capital of the and its free reserves. If money already borrowed together with the money proposed to be borrowed is in excess of above limit, borrowing is allowed but with permission of members in general meeting. If consent of members is not obtained, debt in excess of this limit shall be void.

If the borrowings by the directors is *ultra vires* their powers, the directors may be personally liable to the lender on the ground of breach of warranty of authority. For *ultra vires* amount of loan directors are personally liable. In the given company can repudiate its liability to repay the money.

2014 - Dec [7] (a) (i), (ii), (iii)

(i) Issue of Sweat Equity Shares

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

In case of Listed Company, ensure that the issue of Sweat Equity Shares is in compliance with the SEBI (Issue of Sweat Equity) Regulations, 2002.

In case of an unlisted company

Check whether

1. The issue is authorised by a special resolution passed by the company, ensuring that the special resolution authorising the same is valid for making the allotment within a period of not more than 12 months from the date of passing of the special resolution.
2. Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business.
3. The company has not issued sweat equity shares for more than 50% of the existing paid-up equity share capital in a year or shares of the issue value of ₹ 5 crores, whichever is higher. Further it is to be ensured that the issuance of sweat equity shares in the Company has not exceeded 25%, of the paid-up equity capital of the Company at any time.

4. The company is maintaining Register of Sweat Equity Shares in Form No. SH.3
5. The Register of Sweat Equity Shares is maintained at the registered office of the company or such other place as the Board may decide.
6. The entries in the register are authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

(ii) An issue of secured debentures may be made, provided the date of its redemption has not exceed 10 years from the date of issue. Where the company is engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding 10 years but not exceeding 30 years (Rule 18 Companies (Share Capital and Debentures) Rules, 2014.

Check whether

1. The company has appointed a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than 60 days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders.
2. A trust deed in Form No. SH. 12 or as near thereto as possible has been executed by the company issuing debentures in favour of the debenture trustees within 60 days of allotment of debentures.
3. The company has created a Debenture Redemption Reserve for the purpose of redemption of debentures.

(iii) **Removal of Director**

Check whether

1. A special notice as required under sub-section (2) of Section 169 was given to the company to remove a director.
2. The company has sent forthwith a copy thereof to the director concerned and the director was provided opportunity to be heard on the resolution at the meeting.
3. The representation, if any, made by concerned director was notified to the members on the request of the director along with the notice of the resolution.

4. A copy of the representation was not sent because the same was received too late or because of company's default, it was read out at the meeting.
5. The director who was removed from office was not reappointed as a director by the Board of Directors.

Chapter - 16: Search/Status Reports

2014 - Dec [8] (v)

The scope of a Search report depends upon the requirements of the lender who advances funds to the Company.

A Search report prepared enables the Bank/Financial Institution to evaluate the extent up to which the company has already borrowed money and created charges on the security of its movable and/or immovable properties. This information is very vital for considering the company's request for grant of loans and other credit facilities. The Bank/Financial Institution, while assessing the company's needs for funds, can take a conscious decision regarding the quantum of loan/credit facility to be sanctioned, sufficiency of security required and its nature, as also other terms and conditions to be stipulated. The Search report, thus, acts as an important source of information enabling the lending Bank/Institution to take an informed and speedy decision and also assures it about the credit-worthiness or otherwise of the borrowing company.

Chapter - 17: Securities Management and Compliance

2014 - Dec [6] (b)

Company Secretary of a listed company, in addition to Board Meeting and other documentation and filing formalities are expected to do the certain activities relating to securities laws and compliance. The following are the few of the main activities:

- Compliance with SEBI and Listing Agreement
- Publication of financial results
- Intimations and disclosures to stock exchanges and SEBI
- Implementation of Employee Stock Option plans if any
- Cautious about takeovers
- Continuous watch on stock price movements
- Watch on insider trading

- Taking steps to prevent money laundering activities
- Carrying out necessary certifications required by stock exchanges as compliance officer of the company.

2014 - Dec [7] (b) (ii)

In 1992, the Indian Parliament passed the Securities and Exchange Board of India Act, 1992, to establish the Securities and Exchange Board of India (SEBI) in its new incarnation as an empowered regulator of the Indian securities market. SEBI was established to strengthen the oversight of the securities market in India in the wake of a securities scam that surfaced in 1992.

Chapter - 18: Objective Questions

2014 - Dec [2] (a)

(i) (c) Right Issue
(ii) (d) High Court
(iii) (a) Rateably
(iv) (b) Board Meeting
(v) (c) Corporate Filing and Dissemination System
(vi) (d) The shareholders

2014 - Dec [6] (a)

(i) Counter Party
(ii) SEBI
(iii) Indian Company
(iv) Delete
(v) MCA21
(vi) 15 Days

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