

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2009

**DUE DILIGENCE AND CORPORATE
COMPLIANCE MANAGEMENT**

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer SIX questions including Question No. 1 which is **COMPULSORY**.

Question 1

(a) *State, with reasons in brief, whether the following statements are correct or incorrect:*

- (i) *The issuer and merchant banker need not ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.*
- (ii) *A private placement is an issue of shares or convertible securities by a company to a select group of persons under section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue.*
- (iii) *A 'takeover bid' is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time.*
- (iv) *As per clause 49 of the listing agreement in respect of good corporate governance, a director shall not be member in more than 20 committees or act as chairman of more than 10 committees across all companies in which he is a director.*
- (v) *A company can deliver the share certificate at any time after receiving the application for registration of transfer as per the Companies Act, 1956.*
(2 marks each)

(b) *Critically examine and comment on the following :*

- (i) *All preferential issues by the listed companies should be approved by the shareholders' resolution in the meeting of shareholders.*
- (ii) *A depository participant is the agent of the investor in the depository system providing the link between the company and investor through the depository.*
(5 marks each)

Answer 1(a)(i)

The statement is incorrect.

As per SEBI (Issue and Listing of Debt Securities) Regulations, 2008, it is the duty of the issuer & merchant banker to ensure that the security created to secure the debt securities is adequate for ensuring 100% asset cover for the debt securities.

Answer 1(a)(ii)

The statement is correct.

A Private Placement of Securities is not like that of Public Offerings of Securities.

Instead offering the securities to the public, these are being offered to select group persons under the Section 81 of the Companies Act, 1956. Private placement is a faster way for a company to raise capital. It is generally known by the name preferential allotment, which has to comply with Chapter XIII of SEBI (DIP) Guidelines, 2000, in case, the issuer is a listed company.

Answer 1(a)(iii)

The statement is correct.

A “takeover bid” is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquire sufficient number of shares that gives the offerer company, the voting control of the target company.

Answer 1(a)(iv)

The statement is incorrect.

As per Clause 49 of the listing agreement, a director shall not be member in more than 10 committees or act as Chairman of more than 5 committees across all companies in which he is a director.

Answer 1(a)(v)

The statement is incorrect.

Under Section 113 of the Companies Act 1956, a Company is required to deliver the share certificate within 3 months after the allotment of any securities and within 2 months after the application for registration of transfer of any such securities.

Answer 1(b)(i)

Preferential issues are governed under Section 81(1A) of the Companies Act, 1956 and Chapter XIII of the SEBI(DIP) Guidelines, 2000. While Section 81(1A) requires the company to obtain shareholders approval through special resolution, Chapter XIII of SEBI(DIP)Guidelines, 2000 stipulates that allotment pursuant to any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument, shall be completed within a period of 15(fifteen days) from the date of passing of the resolution. If, the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority or the Central Government, the allotment shall be completed within 15 days from the date of such approval. If SEBI has granted relaxation to the issuer in terms of regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential allotment of shares, fully convertible debentures and partly convertible debentures, shall be made by it within such time as may be specified by the Board in its order granting relaxation.

Answer 1(b)(ii)

Just as brokers act as an agent of the investor at the stock exchange a depository participant (DP) is the representative (agent) of the investor in the depository system

providing the link between the companies and investor through the depository. The depository participant maintains securities account balance and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, financial institutions like banks, custodians, stockbroker etc. can become participants with the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the depository can be compared to a bank, DP is like a branch of that bank with which an account can be opened. The main characteristics of a depository participant are as under:

- Acts as an agent of depository
- Customer interface of depository
- Demat Account opening
- Facilitates dematerialization
- Instant transfer on pay-out
- Credits to investor in IPO, rights, bonus etc.
- Settles trades in electronic segment etc.

Question 2

(a) Choose the most appropriate answer from the given options in respect of the following :

(i) Public issue is not governed by the —

- (a) Companies Act, 1956
- (b) Foreign Exchange Management Act, 1999
- (c) Payment of Bonus Act, 1965
- (d) Securities Contracts (Regulation) Act, 1956.

(ii) In case of underwriting of rights issue, if minimum subscription is not received, the entire subscription should be refunded within —

- (a) 45 days
- (b) 60 days
- (c) 42 days
- (d) 30 days.

(iii) A downstream merger occurs when —

- (a) There is a merger of parent company into its subsidiary company
- (b) There is a merger of subsidiary company into its parent company
- (c) There is a merger of a healthy company with a financially weak company
- (d) There is a merger of a subsidiary company into its parent company where the parent company owns substantially all of the shares of the subsidiary company.

- (iv) 'Overseas Custodian Bank' means a banking company which is established in a country —
- (a) Inside India
 - (b) Outside India
 - (c) Inside as well as outside India
 - (d) Either inside or outside India.
- (v) If a company or any other person contravenes any provision of the rules for which no punishment is provided under the Companies (Issue of Indian Depository Receipts) Rules, 2004, the company and every officer in default shall be punishable with fine which may extend to —
- (a) Equal the amount of IDR issue
 - (b) Twice the amount of IDR issue
 - (c) Thrice the amount of IDR issue
 - (d) Four times the amount of IDR issue.
- (vi) Payment of foreign technology collaboration by Indian companies under the FEMA regulations are allowed under automatic route subject to the limitation of the lump sum payments not exceeding —
- (a) US \$5 million
 - (b) US \$10 million
 - (c) US \$2 million
 - (d) US \$3 million. (1 mark each)
- (b) Write a note on 'intellectual property due diligence'. (4 marks)
- (c) Distinguish between the following :
- (i) 'Due diligence' and 'audit'.
 - (ii) 'American depository receipts (ADRs)' and 'global depository receipts (GDRs)'. (3 marks each)

Answer 2(a)(i)

- (c) Payment of Bonus Act, 1965

Answer 2(a)(ii)

- (c) 42 days.

It may be noted that, this period has been reduced to 15 days vide SEBI Circular dated August 28, 2008.

Answer 2(a)(iii)

- (a) There is a merger of parent company into its subsidiary company

Answer 2(a)(iv)

- (b) Outside India

Answer 2(a)(v)

- (b) Twice the amount of IDR issue

Answer 2(a)(vi)

- (c) US \$2 million

Answer 2(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.

Answer 2(c)(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 assurance. i.e. identification of risks if any.
Type	Post mortem analysis	It is required for future decision.
Nature	Always uniform	Varies according to the nature of transaction
Repetitiveness	Recurring event	Occasional event

Answer 2(c)(ii)**American Depositary Receipts (ADR)**

An American Depositary Receipt (ADR) is a dollar denominated form of equity ownership in the form of depository receipts in a non-US Company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

Global Depository Receipts (GDR)

Global Depository Receipts means any instrument in the form of a Depository receipts or certificate created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

Question 3

- (a) *As a Practising Company Secretary, you have been asked to carry out the due diligence of XYZ Ltd. for a possible acquisition of the controlling interest from the owners of the said company. Explain briefly the possible hurdles that may occur while carrying out the due diligence and the steps needed to overcome such hurdles.* (6 marks)
- (b) *Anshul Power Generation Ltd. is contemplating setting-up an audit committee as part of good corporate governance. As a Company Secretary of the company, advise the company on the constitution, composition, quorum and the role of audit committee.* (6 marks)
- (c) *Explain the following terms used in due diligence report —*
- (i) *Deal breakers*
 - (ii) *Deal diluters.* (2 marks each)

Answer 3(a)**Possible Hurdles in Carrying out a Due Diligence and Remedial Actions**

1. *Non availability of in formation*
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 in correct 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 3(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.

Answer 3(c)(i)

After completion of Due Diligence, the professionals submit a report which is in general called 'Due Diligence Report'. The findings mentioned the reports are very significant and the outcome of the report may be deal-makers, Deal-Breakers, Deal-Diluters, Deal-cautioners.

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

Answer 3(c)(ii)

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

Question 4

- (a) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
 - (i) *Shares issued under an Employee Stock Purchase Scheme (ESPS) are subject to lock-in for a minimum period of _____ year from the date of allotment.*

- (ii) *The credit rating is required to be obtained from atleast _____ registered credit rating agencies under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.*
- (iii) *A public limited company is required to appoint the Company Secretary to act as compliance officer under clause _____ of the listing agreement.*
- (iv) *As per clause 49 of listing agreement, at least _____ of the Board should include independent directors where chairman of the Board is a non-executive director.*
- (v) *An American Depository Receipt (ADR) is a _____ denominated form of equity ownership in the form of depository receipts in a non-US company.*
- (vi) *Pre-issue paid-up capital and free reserves of the issuing company should be at least _____ under the Companies (Issue of Indian Depository Receipts) Rules, 2004 for the issue of IDRs. (1 mark each)*
- (b) *As a Practising Company Secretary, you have been appointed as secretarial auditor of Lilly Ltd. Explain briefly how you would undertake the process of secretarial audit. (10 marks)*

Answer 4(a)

- (i) Shares issued under an Employee Stock Purchase Scheme (ESPS) are subject to lock-in for a minimum period of **One** year from the date of allotment.
- (ii) The credit rating is required to be obtained from atleast **Two** registered credit rating agencies under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.
- (iii) A public limited company is required to appoint the Company Secretary to act as compliance officer under clause **47(a)** of the listing agreement.
- (iv) As per clause 49 of listing agreement, at least **1/3** of the Board should include independent directors where chairman of the Board is a non-executive director.
- (v) An American Depository Receipt (ADR) is a **Dollar** denominated form of equity ownership in the form of depository receipts in a non-US company.
- (vi) Pre-issue paid-up capital and free reserves of the issuing company should be at least **US\$ 50 millions** under the Companies (Issue of Indian Depository Receipts) Rules, 2004 for the issue of IDRs.

Answer 4(b)

A Practising Company Secretary should follow the following process for conducting Secretarial Audit :

1. Before embarking on a assignment one should familiarize himself thoroughly with relevant Acts, Rules, Regulations, Orders, Notifications, Guidelines, Circulars by the Government from time to time.

2. Where the position of law is not clear, he should request the company to obtain legal opinion in order to be doubly sure about the compliances.
3. Where certain facts cannot be personally checked, he should obtain a certificate from the Company in order assure himself that proper compliance have been made.
4. He should also keep himself abreast of latest judicial pronouncements on all import issues.
5. Private Companies, Government Companies and Section 25 Companies are exempt from some provisions of Companies Act. These should be kept in view by the Secretarial Auditor.
6. The Secretarial Auditor should preserve the working sheets and other papers, the details of the documents instead prepared etc. for future references and queries if any.
7. While undertaking Secretarial Audit/Consultancy, as required, the following should be examined carefully:
 - Memorandum and Articles of Association (Extent of applicability of Table A).
 - Certificate of Incorporation.
 - Certificate of Commencement of Business.
 - Annual Reports.
 - Minutes Books of Board/Committee/General Meeting.
 - Register of Members/Debentureholders.
 - Register of Directors.
 - Register of Loans, Guarantee, Security and Investments.
 - Register of Charges.
 - Foreign Register of Members and Debentureholders, if any.
 - Copies of Annual Returns.
 - Register of Contracts.
 - Register of Directors' Shareholdings.
 - Share Transfer Books.
 - Correspondence with the Ministry of Corporate Affairs, Registrar of Companies, MRTP Commission, Ministry of Industry, Ministry of inance, Stock Exchanges etc.
 - Listing Agreement with the Stock Exchange.
 - Register of investments of the company not held in its name.

- Register of Buy-back of Securities under Section 77A(9).
 - Copies of various e-forms filed under Section 610B of the Companies Act, 1956.
 - Various advertisements/press release issued by the company during the year.
 - Other registers as may be notified from time to time under various rules.
8. As soon as the assignment is over the Secretarial Auditor should submit his report to the Board of Directors. He may also submit interim report also from time to time if necessary. The report should set out in detail the scope of the work, his observations on irregularities noticed, weakness in the policies and procedures etc.

Question 5

- (a) *Sanjay is a Practising Company Secretary and has been engaged as internal auditor of the operations of depository participants. Do you feel it is mandatory on the part of the depository participants to appoint an internal auditor ? What should be the contents of the internal audit report ?* (8 marks)
- (b) *As a Practising Company Secretary, you have been assigned to work out preliminary considerations for setting-up a joint venture. State the preliminary considerations to be taken care of in this regard.* (4 marks)
- (c) *A depository participant is required to enter into two important agreements in the course of trading in dematerialised securities. Explain.* (4 marks)

Answer 5(a)

Yes it is mandatory on the part of the Depository Participant to appoint an internal auditor.

As per Circular issued by the two Depository Service providers in India i.e. NSDL & CSDL every depository participant shall ensure that an internal audit in respect of the operations Depository is to be conducted either by a qualified Company Secretary or a Chartered Accountant holding a Certificate of Practice and a copy of the internal audit report shall be submitted to the Depository.

The 'Internal Audit' report should contain the following aspects:-

1. Comments on the maintenance of records.
2. Observations about discrepancies or weakness in the internal control system.
3. Comments on the used authorization and data security systems.
4. Instances of non-adherence to the operational procedures prescribed relating to functions of participant.
5. Instances of non-compliance with the relevant legislations governing the depository operations.
6. General observations & recommendations.

7. Competence with the provisions of SEBI Act, Regulations, Bye Laws, Business Rules, Agreements.

Answer 5(b)

Preliminary considerations

- *Selection* : Selection of an appropriate co-venturer can have long lasting implications for the operation and success of the venture as the ability of the co-managing parties to co-exist and make unanimous decisions is essential to the success of a joint venture.
- *Setting out the objectives and expectations* : Setting out the objectives and expectations of the venture is pre-requisite. It is essential that the nature, scope and duration of the joint venture be identified.
- *Employ competent professionals* : Competent professional like CS, Legal experts experienced in drafting joint venture and strategic alliance agreements should be retained as consultants, to structure the deal with proper legal advice.
- *Negotiation* : It is appropriate that negotiations be conducted at the level of more senior management.
- *Attitude* : Negotiations for alliances should not be entered into with an adverse approach to the opposing party.
- *MOU* : The next step is to prepare memorandum of understanding, setting out the objectives of the joint venture prior to finalising the joint venture agreement. The MOU may set out the key features of the proposed joint venture arrangements and can represent a broad outline of the definitive agreement.
- *Due Diligence* : After the parties have agreed on the basic terms of the joint venture arrangement a fixed period of time is often set in which to conduct a detailed and comprehensive review of all information pertinent to the proposed business venture prior to the execution of the joint venture agreement. This process is referred to as “due diligence”.

Answer 5(c)

The two important agreements to be entered into by Depository Participants (DP) are :

1. *Standard Agreement with the Depository (NSDL)/(CDSL)*

Important clauses needing compliance on part of the DP are :-

- (a) Adherence to the SEBI Act 1992, the SEBI (Depositories and Participants) Regulations 1996, Byelaws and the Business Rules of the Depository.
- (b) Payment of requisite fees and charges as prescribed.
- (c) Compliance with valid instructions of the investor.
- (d) DP to reconcile its own records with the Depository on a daily basis, to maintain systems to comply with insurance mechanism to contribute to

Investors Protection Fund, to comply with accounting requirements, to resolve grievances etc.

2. Standard agreement with the Investor

Important clauses needing compliance by DP are as under:

- (a) The DP shall strictly adhere to the instructions of the client with regard to transfer to and from the Accounts of the Client.
- (b) The DP shall provide a statement of Accounts to the client at regular intervals unless otherwise agreed.
- (c) The DP shall resolve all legitimate grievances of the client within a stipulated period of time.

Question 6

- (a) *Anmol Milk Products Ltd. is planning to expand its operation by financing Rs.75 crore through a term loan from the IDBI Bank Ltd. The company has applied for a term loan and the assets of the company will be mortgaged to the lending bank as security.*

The bank has approached you, being a Practising Company Secretary, to furnish a certificate in respect of necessary powers of the company and its directors to enter into an agreement. State the general points to be kept in mind for furnishing such a certificate. (6 marks)

- (b) *Enumerate the points to be checked by a Secretarial Auditor in respect of the Air (Prevention and Control of Pollution) Act, 1981.* (6 marks)

- (c) *Describe the role of a Company Secretary in Practice in securities management and compliances under the SEBI Act, 1992 and its regulations.* (4 marks)

Answer 6(a)

Requirement of Industrial Development Bank of India

The following points would be kept in mind by the company Secretary in Practice while furnishing of such certificate –

The Memorandum and Articles of Association of the Company has to be examined for this purpose. Particularly the objects clause of the Memorandum of Association has a specified recital pertaining to borrowing powers of the company. The standard clause pertaining to borrowing powers included in the incidental or ancillary objects read as follows-

“To borrow or raise money or to receive money on deposit for the purposes of the company, in such manner and upon such terms as may seem expedient, and to secure the repayment thereof and of moneys owing or obligations incurred by the company and to create, issue and allot redeemable or irredeemable bonds, mortgages or other instruments, mortgage debentures (such bonds or debentures being made payable to bearer or otherwise and issuable or payable either at par, premium, discount or as fully paid), and for any such purposes to charge all or any part of the property and profits of the company both present and future including its uncalled capital.”

Compliance of the provisions of Section 149 of the Companies Act, 1956, in respect of public limited companies has to be ensured. Exercise of borrowing powers in contravention of Section 149 attracts levy of fine.

Resolutions passed at the meeting of the board/ general meeting for exercising the power of borrowing have to be checked;

Section 292 of the Companies Act requires inter alia, that the power to borrow moneys can be exercised by the Board of Directors only by means of resolution passed at meetings of the Board. This power of borrowings may also be delegated to any committee of directors, managing director, manager or any other principal officer. The delegation should be only by means of resolution passed at board meeting and not by circulation. Every resolution delegating this power should specify the total amount up to which moneys may be borrowed by the delegate.

The certificate will have to refer to the relevant clause(s) of the Memorandum of Association of the company, which gives specific powers to the company, and secure the repayment of the same by mortgage, charge, lien etc. The opinion will also have to refer to the relevant articles of the Association and the general body resolution, if any, under which the Board of Directors are authorized to borrow or raise moneys, secure the repayment thereof and execute on behalf of the company, bonds deeds, documents etc. The opinion should also spell out the limitations and restrictions, if any, on the powers of the Board of directors to borrow or raise money.

Answer 6(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)*

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?

Answer 6(c)

Role of Company Secretary in Practice

The Securities and Exchange Board of India Act, 1992/rules/regulations/ guidelines/ circulars

1. SEBI has authorized the practicing company secretary to appear before the Securities Appellate Tribunal as an authorized representative of an appellant
2. Practicing Company Secretary can, certify non-promoter holdings as per clause 35 of Listing Agreement in demat mode in case of the companies which have established connectivity with both the depositories.
3. PCS is authorized to o issue certificate of compliance of conditions of corporate governance for companies who have listed their equity shares, debt instruments and Indian Depositories in stock exchanges. .
4. PCS can issue certificate regarding maintenance of adequate security cover in respect of listed debentures every quarter.
5. PCS can conduct Internal Audit of Portfolio Managers.

6. PCS can issue a certificate to listed companies to the effect that all refund orders/certificates to allottees of the previous issues were dispatched within prescribed time and manner and securities were listed on the stock exchanges specified in the offer document.
7. PCS is authorized to issue a certificate to the effect that provisions of SEBI Guidelines, 2000 relating to Bonus Shares have been complied with.
8. PCS is authorised to conduct Internal Audit of sub-brokers.

Question 7

- (a) Write short notes on any two of the following :
- (i) Takeover defences
 - (ii) Appraisal of register of members/debentureholders
 - (iii) Risks on trading in debt securities. (4 marks each)
- (b) Distinguish between **any two** of the following:
- (i) 'Dematerialisation' and 'rematerialisation'.
 - (ii) 'Financial collaboration' and 'technical collaboration',
 - (iii) 'Depository' and 'depository participant'. (4 marks each)

Answer 7(a)(i)

Take Over Defenses

Hostile takeovers directly made to the shareholders of target company has resulted in a multiple defensive strategies by corporate from being taken over by the company.

Few of the defensive strategies are as follows.

1. *Packman Defense*
Under this strategy target company attempts to purchase the shares of acquirer company provided it has substantial cash flow or liquidable asset.
2. *Shark Repellants*
An increasingly used defense mechanism being used is anti-takeover amendments to the company's Articles of Association which is called shark repellants
3. *Poison pills*
Creation of securities (which is also called poison pills) which provide their holders with special rights exercisable only after a period of time following the occurrences of triggering event.
4. Refusal by the Board to register a transfer is also being adopted as a defensive strategy.

Answer 7(a)(ii)

While conducting share transfer Audit, the following issues are to be considered with respect to appraisal of Register of members/ debentures.

Check whether a company has properly maintained its register of members and register of debenture holders with respect of following aspects:

- (a) Whether the registers are maintained in the form prescribed under the companies (Issue of Share Certificates) Rules, 1960 or as near there to as circumstances admit.
- (b) Whether the details of the transfers have been posted in the proper folios in the register of members. In case of transferee being a new member whether new folio has been allotted to him. In case after recording the transfer the holding of a member becomes nil whether the folio has been properly closed.
- (c) Whether entries in the register are authenticated by the Secretary or any other person authorized by the Board.
- (d) Whether in case of Company having more than 50 members, an index of members is maintained.
- (e) Whether every change in the register of members has been recorded in the index within stipulated time.

Answer 7(a)(iii)

The risk on Trading Debt Securities may be :

- 1. *Default Risk* is the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security.
- 2. *Interest Rate Risk* is the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments.
- 3. *Reinvestment Rate Risk* is the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.
- 4. *Counter Party Risk* refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.
- 5. *Price Risk* refers to the possibility of not being able to receive the expected price on any order due to a adverse movement in this price.

Answer 7(b)(i)

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:

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

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

Answer 7(b)(ii)***Financial Collaboration v. Technical Collaboration***

Financial collaboration involves Foreign Direct Investments in the form of Equity, FCCBs, etc., and in Technical collaboration in involves payment of royalty, technical know-how fee etc. Both forms of investment may take place under automatic route where post facto approval of RBI is obtained when the investment / payments are within the limits. When it exceeds the specified limits, it requires prior approval of central government.

Answer 7(b)(iii)**Depository**

A depository is to securities as a bank is to cash. A depository holds securities of investors in electronic form. It facilitates settlement of trades in, and transfer, transmission, lending, borrowing and pledging of, securities by way of book-entry, as and when instructed by investors.

Depository Participant

A participant is assigned the role to act as the agent of a Depository under the Act and cannot act unless registered with SEBI. The primary function of depository participants, as the agent of the depository, is to provide securities' related services offered by the depository to the clients.

Question 8

Critically examine and comment on any four of the following :

- (i) *A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction.*
- (ii) *In case of preferential issue of shares by listed companies, valuation is to be done by an independent qualified valuer.*

- (iii) *Under the Employee Stock Option Scheme, the companies have freedom to determine the exercise price.*
- (iv) *A conglomerate merger involves coming together of two companies in different industries.*
- (v) *Securities held in a depository account can be pledged or hypothecated against a loan, credit or guarantee availed of by the beneficial owner of such securities.*
(4 marks each)

Answer 8(i)

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 8(ii)

As per Chapter XIII of SEBI (DIP) Guidelines 2000, in case of preferential allotment of shares to promoters, their relatives, associated and related entities, for consideration other than cash, valuation of assets in consideration for which the shares are proposed to be issued, should be done by an independent qualified valuer. The word valuer shall mean Chartered Accountant or Merchant Banker appointed to determine the value of intellectual property rights or other addition. This is defined under SEBI (Issue of Sweat Equity) Regulations 2002.

Answer 8(iii)

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.

Answer 8(iv)

Conglomerate Merger

A conglomerate merger involves coming together of two companies in different industries i.e., the businesses of the two companies are not related to each other, neither horizontally nor vertically. They lack any commonality either in their end product, or in the rendering of any specific type of service to the society. This is the type of merger of companies which are neither competitors, nor complementaries nor suppliers of a particular raw material nor consumers of a particular product or consumable. A conglomerate merger is one which is neither horizontal nor vertical. In this the merging companies operate in unrelated markets having no functional economic relationship.

Answer 8(v)

Securities held in a depository account can be pledged or hypothecated against a loan, credit, guarantee etc, availed by the beneficial owner of such securities. For this, it is imperative that both the parties to the agreement, to have a beneficiary account with a depository. It is however not necessary that both of them have their depository account with the same participant or same depository. If a beneficial owner intends to create a pledge on a security, owned by him, Regulation 58 of SEBI (Depositories and Participants) Regulations, 1998 have to be borne in mind, which prescribes the procedure to be followed such as making of application to depository through Depository Participant, creation of charge, invocation of pledge etc.
