Due Diligence

Lesson 16

KEY CONCEPTS

■ Due Diligence ■ Risk Assessment ■ Pre Diligence ■ Post Diligence ■ Non-Disclosure Agreement ■ Legal Due diligence ■ Due Diligence Techniques

Learning Objectives

To understand:

- Concept of Due diligence
- Objectives of Due Diligence
- Need of Due Diligence
- Scope of Due Diligence
- Advantages of Due Diligence
- Process and stages of Due Diligence
- Techniques of Due Diligence and Risk Assessment
- Types of Due Diligence

Lesson Outline

- Overview of Due Diligence
- Stages/Process of Due Diligence
- Legal Due Diligence
- Financial Due Diligence
- Bank Due Diligence
- Due Diligence for Takeover
- Due Diligence for Labour Laws
- FEMA Due Diligence
- FCRA Due Diligence
- Various other types of Due Diligence
- Bank Due Diligence
- Non-Disclosure Agreement
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References (Including Websites/ Video Links)

REGULATORY FRAMEWORK

- SEBI (SAST) Regulations, 2011
- Foreign Contribution (Regulation) Act, 2010
- Foreign Contribution (Regulation) Rules, 2011
- Foreign Exchange Management Act, 1999

OVERVIEW AND INTRODUCTION: DUE DILIGENCE

Due diligence refers to investigation into the affairs of an entity prior to its acquisition, restructuring, fund raising or other similar transaction. Due Diligence is not restricted to check the facts but also to evaluate, interpret and communicate the facts so as to ensure that prospective investors make an informed investment decision. It is process of gathering information about the target company, its business and the environment in which it operates.

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

A Due diligence is an interactive process that includes:

- Inquiring financial and operational data
- Analysing financial and operational data
- Interpreting financial and operational data
- Assessment of risks and opportunities

As a part of the business strategy, the Companies before making any relationship with the other party conduct the background checks of the client, customer, supplier etc. to ensure that the parties to the transaction have the disclosed the information as required to proceed with the transaction and is a process to completely understand a business capability and its past performance.

CASE STUDIES

In 1998, a German company Daimler Benz merged with Chrysler Group for a value of $36 billion. However, the merger was not successful and the value of Chrysler fell to $7.4 billion after a couple of years. According to various experts, Daimler failed to conduct a proper due diligence process which resulted in over-valuation of the target company.

Bank of America and Countrywide (2008): US$2 billion

When Bank of America acquired Countrywide at the beginning of 2008 for a price of "just" US$2 billion, many thought it was a shrewd investment.

Even though every economic indicator in the United States was already pointing downward, the deal in theory stood to combine the country's biggest retail bank with its biggest mortgage provider.

This does have a ring to it. The issue is that what constituted 'mortgage' in the first decade of the 21st century in the United States was yet to become apparent.

Bank of America had basically acquired bad debt for US$2 billion. It ultimately ended up paying US$50 billion for the acquisition, making one wonder where the financial due diligence was when it was needed most.

Source: https://dealroom.net/blog/biggest-mergers-and-acquisitions-failures

While exploring any business opportunity, it is the foremost requirement for a corporate to investigate and evaluate the potential and risk associated with such business. The due diligence covers the activities relating to pre-transaction, during the transaction and post transaction exercise with all relevant aspects of the past, present, and predictable future of the any business.

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

In any transaction, the seller does investigation of a buyer to ensure that the buyer has adequate resources to complete the transaction, as well as other business aspect covering the technical and human resource, cultural, taxation etc. which would affect the company after entering into the transaction. The chapter covers the various types of due diligence performed by the company on voluntarily and for entering to the any business transaction or before going for any corporate action relating to the merger, de-merger, amalgamation, take over, joint venture etc.

CASE STUDIES

Amazon began due diligence to buy MX Player

In March 2023, Amazon.com Inc. made advanced talks to acquire MX Player, the video streaming platform owned by Times Internet. Amazon owns the subscription streaming service Prime Video and an ad-supported MiniTV service in India. Amazon launched the free MiniTV service in May 2021 within the Amazon shopping app for phone users.

In 2018, Bennett Coleman & Co Ltd (BCCL)-owned Times Internet, acquired MX Player for ₹1,000 crore (around $140 million at that time) to mark its entry into video streaming.

The US e-commerce giant has hired one of the Big Four accounting firms to carry out due diligence of MX Player exclusively, and the process is expected to take 30-40 days. As per the anticipations of experts, a deal could happen within two months if all goes well.

Earlier, Times Internet was asking for over $100 million for MX Player, while Amazon's internal team valued it at around Rs.500 crore ($60 million). The deal is likely to be in the range of Rs.600-900 crore.

(Source: *https://www.livemint.com/companies/news/amazon-begins-due-diligence-to-buy-mx-player-11679247835309.html)*

Mukesh Ambani-controlled Reliance Industries and New York Stock Exchange-listed Walt Disney have reportedly appointed law firms and started antitrust due diligence of their planned mega media and entertainment merger. Reliance has appointed law firm Khaitan & Co and Shardul Amarchand Mangaldas, while Disney has roped in AZB & Partners.

the Reliance and Disney merger, would bring together two streaming services and 120 television channels and create an entertainment superpower.

(Source: https://www.businesstoday.in/latest/corporate/story/reliance-industries-disney-start-antitrust-diligence-on-media-merger-report-411900-2024-01-04)

KEY POINTS DESCRIBING DUE DILIGENCE

- It is not limited to accounting analysis but has a business oriented approach;
- It analysis the information on the basis of the actual facts;
- Considers the industry of the target company;
- Examines the business affairs having a significant impact on the prospects of the business;
- Explores significant business practices and business models;
- Examination of relevant aspects of the past, present and near future of the business;
- Assesses the advantages and risks associated with a particular transaction.

CASE STUDIES

- In September 2008, UAE based Etisalat acquired 45% stake in the Indian telecom operator Swan Telecom (renamed as Etisalat DB) for $900 million. A year later, the Supreme Court of India revoked 2G licences awarded to Swan Telecom due to impropriety in obtaining the licences. The due diligence process carried out by Etisalat failed to detect any impropriety in obtaining telecom licenses. Etisalat faced significant financial
- losses of upto 827 million dollars and later took an exit from the company. Thereafter, Etisalat issued legal proceedings against the promoters of Swan Telecom (renamed as Etisalat DB) on the grounds of fraud and misrepresentation.

In a setback to Nirma, the Supreme Court dismissed its appeal against a Securities Appellate Tribunal (SAT) decision which upheld SEBI's order rejecting the company's request for withdrawal of the open offer for Shree Rama Multi Tech, an Ahmedabad-based packaging firm, whose pledged shares the detergents maker had invoked.

Nirma has to complete the open offer for Shree Rama Multi Tech for a minimum price of Rs 18.60 per share. Shares of Shree Rama Multi-Tech surged 20% to close at Rs 5.74 as there were no sellers, only buyers.

Nirma approached Supreme Court after SAT upheld the SEBI order in which the market regulator refused to allow Nirma to withdraw the open offer for the shares of Shree Rama Multi-Tech.

Nirma invoked the pledged shares of Shree Rama Multi Tech in 2005 after the latter defaulted in payment. This has resulted in Nirma Group's stake increasing to 24.25% triggering the mandatory open offer. In keeping with the takeover code the company came out with an open offer to acquire a further 20% in Shree Rama Multi-tech.

However, later, Nirma wanted to revise the offer as the market price of the stock was much below its offer price. But SEBI did not approve the revision. Subsequently, Nirma applied to SEBI for a withdrawal of the open offer as they alleged that the erstwhile promoters of Rama Multi Tech had siphoned off funds from the company and that this came to light only after the public announcement for the open offer was made.

But, SEBI refused to accept the circumstances and pointed out that Nirma should have done their due diligence before invoking the pledge and should not have acquired the shares if the circumstances so warranted. The SC directed Nirma to complete its open offer.

Read more at: *https://economictimes.indiatimes.com/supreme-court-dismisses-nirmas-appeal-against-sat-decision/articleshow/19974110.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst*

OBJECTIVES OF DUE DILIGENCE

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

- Identifying the significant matters
- Discovering threats and weaknesses
- Good investment decision
- Ensures security in a particular transaction
- Developing Shareholders confidence
- Collects material information

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

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

Transactions that require proper Due Diligence:

- Joint Enterprise Collaborations;
- Partnerships;
- Mergers and Acquisitions;
- Strategic Alliance;
- Business Coalition;
- Outsourcing Agreement;
- Technology or Product Licensing;
- Joint venture through
  - Technical or Financial Collaboration;
  - Venture Capital Investment;
  - Public Issue etc.

about what has been discovered and brainstorm the different scenarios of what can go wrong before going ahead with the deal.

Once a purchase price is agreed upon, the prospective buyer usually enters into a conditional agreement with a due diligence clause with the target business, in which the buyer has a limited period to conduct due diligence. During this time, the potential buyer requests full access to all relevant materials in the target business, customer, vendor, financial and other information in order to conduct a thorough investigation. Here, it is to be ensured that the potential buyer does not use this information for its own benefit if it decides to back out of the deal, hence a confidentiality agreement is usually signed to protect the target businesses' interests. But a possibility of re-negotiation of the purchase price or cancellation of the agreement on the part of buyer is seen if the information found is not acceptable to the potential buyer. Again after due diligence, the goal is to either reaffirm the purchase price or renegotiate, depending on what was discovered under Due diligence. But the ultimate goal is to make a rational decision based on the facts.

CASE STUDIES

PhonePe's due diligence on ZestMoney was unsatisfactory

In April 2023 the Walmart-backed PhonePe has called off its deal with Zest Money over due diligence concerns. The due diligence that PhonePe carried for nearly six months while evaluating the much-anticipated acquisition of ZestMoney did not meet its bar.

ZestMoney facilitates Buy Now Pay Later (BNPL) loans by disbursing the purchase amount from the lending partner directly to the merchant, allowing the customer to repay the lender in installments. PhonePe initiated talks to acquire ZestMoney to bolster its digital lending forays.

(Source: *https://www.moneycontrol.com/news/business/startup/due-diligence-deal-did-not-meet-our-bar-phonepes-sameer-nigam-on-why-the-zestmoney-deal-fell-through-10361941.html*)

Hindustan Motors, European partner complete due diligence for EV project

In October 2022, Hindustan Motors Ltd and its European partner have completed due diligence for the proposed electric two-wheeler project. The Joint Venture (JV) is likely to launch the electric vehicles in the next financial year at Hindustan Motors' Uttarpara plant in West Bengal.

According to the company's statement, after the formation of JV, around six months are required to start a pilot run. The structure of the JV is being finalised, including the proportion of equity to be held by the partners.

NEED FOR DUE DILIGENCE

- To confirm that the business is what as it appears;
- To create a trust between two unrelated parties;
- To access the risks and opportunities of a proposed transaction;
- To reduce the risk of post transaction;
- To investigate into the affairs of business as a prudent business person;
- To confirm all material facts related to the business;
- Representation & warranties for indemnification;
- Negotiation price concessions;
- To verify that the transaction complies with investment or acquisition criteria;
- To investigate & evaluate a business opportunity;

- To determine compliance with relevant laws and disclose any regulatory restrictions on the proposed transaction;
- To evaluate the condition of the physical plant and equipment; as well as other tangible and intangible assets;
- To ascertain the appropriate purchase price and the method of payment;
- To determine details that may be relevant to the drafting of the acquisition agreement.
- To discover liabilities or risks that may be deal-breakers;
- To analyze any potential antitrust issues that may prohibit the proposed M&A;
- To evaluate the legal and financial risks of the transaction.

CASE STUDIES

1. *Bharti – Zain Deal*

   Airtel acquired Zain a Kuwait based telecom company's assets in Africa's 15 countries. The company suffered low EBITDA even after 5 years. Various reasons like Africa's economy contributed to the failure of the acquisition. The due diligence of Bharti lacked somewhere to appreciate and identify the risks of failure in this acquisition. A comprehensive and complete due diligence could have placed Bharti Airtel in a better position.

2. *In Satyam Fraud case*, Accounting regulator ICAI's probe panel has hit out at banks for not doing due diligence on Satyam Computer Services before giving loans. The banks that gave loans to Satyam during 2000-08, despite the company claiming huge surpluses, were HDFC Bank (Rs 530 crore), Citibank (Rs 223.87 crore) Citicorp Finance (Rs 222.28 crore), ICICI Bank (Rs 40 crore) and BNP Paribas (Rs 20 crore), totalling Rs 1,221.16 crore.

SEBI Penalised 5 Ex-directors of Bombay Dyeing, Others over Alleged Due Diligence Lapses

The Securities and Exchange Board of India (SEBI) has penalised five former independent directors of Bombay Dyeing and Manufacturing Company (BDMCL) with a total fine of Rs59 lakh for alleged failure to carry out adequate due diligence and exercise independent judgement as members of the audit committee.

(Source: *https://www.moneylife.in/article/sebi-penalises-5-ex-directors-of-bombay-dyeing-others-over-alleged-due-diligence-lapses/68779.html)*

SCOPE OF DUE DILIGENCE

Due diligence is generally understood by the legal, financial and business communities/ potential investors to mean the disclosure and assimilation of public and proprietary information related to the assets and liabilities of the business being acquired. This information includes financial, human resources, tax, environmental, legal matters, intellectual property matters etc.

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

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

The investigation or inspection would cover below mentioned aspects:

- To determine tax structure and its implications;
- To assist in determining the final value of financial investment;
- To determine overvalued assets or under recorded liabilities, hidden assets or liabilities;
- Ensuring the all applicable law compliances;
- Ascertaining the penalties in case of non- compliances of statutory laws applicable to the company;
- Assessing the quality of management and identification of key employees of the Target Company;
- To assess the commercial and technical feasibility;
- To assess the resource availability of the business;
- To synergise between the organisations (In case acquirer company and target company);
- Litigation and assessment of feasibility of pursuing litigation;
- Financial statements;
- Assets - real and intellectual property, brand value etc.;
- Unpaid tax liens and/or judgments;
- Past business failures and consequential debt;
- Exaggerated credentials/Fraudulent claims;
- Misrepresentations or character issues;
- Cross-border issues - double taxation, foreign exchange fluctuation, sovereign risk, investment climate, cultural aspects.
- Reputation, goodwill and other intangible assets.

Silicon Valley Case Study

Silicon Valley has gained a reputation for being home to numerous "unicorn" companies, startups valued at over $1 billion. While these companies may appear to be the future of tech innovation, they often have inflated valuations that are not supported by their financial performance. This is partly due to a lack of due diligence from investors who are eager to get in on the ground floor of the next big thing.

Due diligence is the process of conducting a thorough investigation into a company's financial, legal, and operational status before investing in it. It helps investors assess the risks and potential returns of a potential investment, as well as identify any red flags that may indicate fraud or mismanagement. Despite its importance, many investors in Silicon Valley have been criticized for neglecting due diligence in their eagerness to invest in the next "unicorn" startup.

Through this case the importance of due diligence is re-iterated. Proper due diligence can help investors make informed decisions and avoid costly mistakes, leading to more sustainable growth and long-term success.

(Source: https://businesscloud.co.uk/news/how-silicon-valley-is-suffering-due-to-a-lack-of-due-diligence-from-investors/)

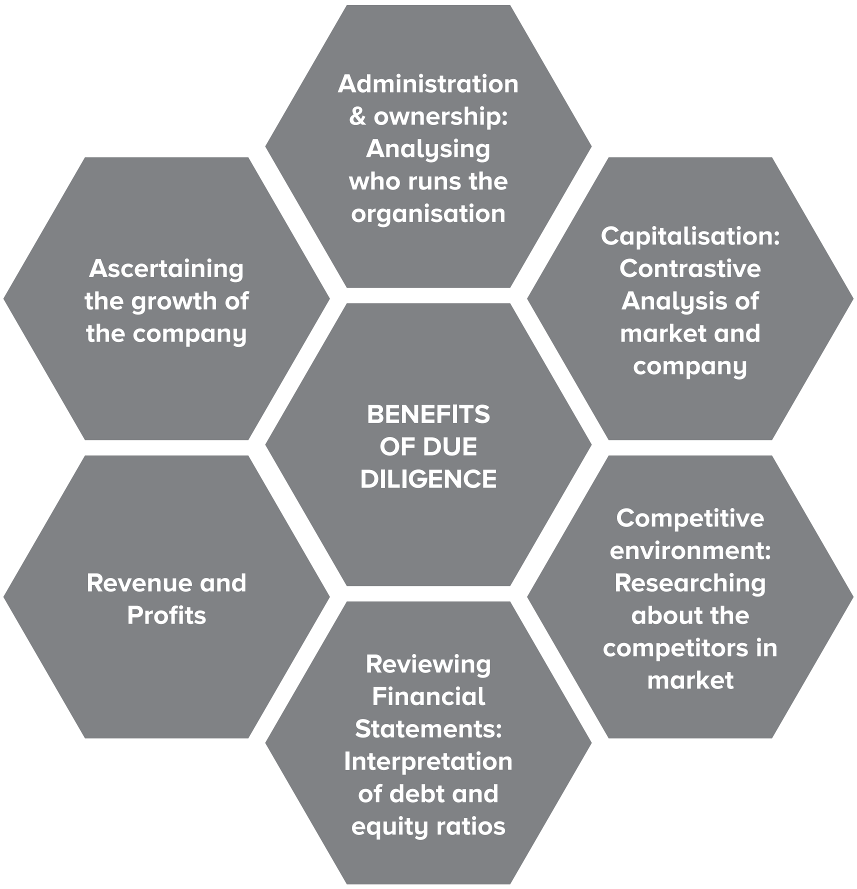
In 2011, US based company, Hewlett-Packard carried out only six hours of due diligence on the finances of the British software company Autonomy before buying it for £8bn, in a deal that ended in disaster and a $5bn (£3.8bn) fraud case. HP failed to notice the accounting improprieties during the due diligence process and was sued by its shareholders for negligence in missing red flags and not performing adequate due diligence related to Autonomy purchase. The former CFO Cathie Lesjak of HP later admitted that not only did she never read the preliminary due diligence report prepared by accounting firm KPMG, no further due diligence was conducted.

Source: *https://blog.ipleaders.in/consequences-inadequate-due-diligence-processes/*

In June 2008, Japanese company Daiichi Sankyo paid $4.6 billion and acquired a 64% state in Indian drug making company Ranbaxy Laboratories Limited. After a couple of months, the United States Federal Drug Administration (USFDA) banned 30 generic drugs manufactured from three of Ranbaxy's units in India citing gross violation of approved manufacturing norms, forgery of documents and fraudulent practice. Daiichi initiated legal proceedings against the former promoters of Ranbaxy for allegedly concealing facts and supressing regulatory issues with USFDA during the due diligence process. In 2016, Singapore arbitration tribunal ordered the promoters to pay around $525 million to Daiichi in damages on grounds of fraudulent misrepresentation and concealment of material facts. The arbitral award was later upheld by the Delhi High Court after being challenge by the promoters in India.

ADVANTAGES OF DUE DILIGENCE

- It analyses who administers, owns and run the organisation.
- It examines the company and the market in a contrast way to assess the volatility of the market.
- It researches about the competitors of the target company existing in the market.
- It reviews the financial statements of the company such calculating debt equity ratio, etc.
- It examines the rise or fall in revenue/profits of the company.
- It expects the growth of the company with maximisation of the profits of the organisation.



CASE STUDY

1. Zee Entertainment – Sony India Merger

Zee Entertainment Enterprises Limited (ZEEL) and Sony Pictures Networks India (SPNI), two of India's biggest media conglomerates, have taken the first steps towards a multibillion-dollar merger. The Zee board of directors approved the merger between the two companies. The agreement has the potential to make the newly created company one of the country's largest and most sought after.

Sony Pictures Entertainment would invest $1.575 billion in the newly consolidated firm as part of the acquisition. On September 22nd, Zee's board of directors gave in-principle permission for the execution of a non-binding term sheet with SPNI. In addition, the two parties will sign a non-compete agreement.

According to R Gopalan, chairman of Zee Entertainment, "ZEEL continues to chart a strong growth trajectory and the board firmly believes that this merger will further benefit ZEEL,", "The value of the merged entity and the immense synergies drawn between both the conglomerates will not only boost business growth but will also enable shareholders to benefit from its future successes."

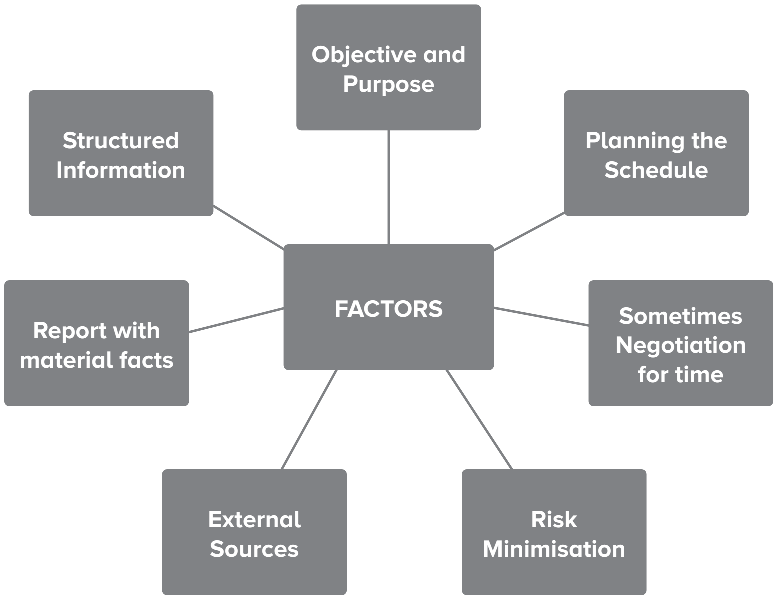
Results:

With the Zee-Sony merger, viewers of the Sony network in India will gain access to over 260,000 hours of Zee television content and also its film library with rights to more than 4,800 movie titles across languages. On the cost front, too, the merged entity will have an advantage. In terms of content offering, Sony is strong in General Entertainment and Sports and Zee has an edge in regional content. With this merger Zee has gained access to Sony's 10 sports channels. Although the deal is not executed yet.

2. ABC Limited (manufacturing company in food segment) is considering merging with a smaller food manufacturer company (DEF Limited), with the aim to absorb their operations. After agreeing in principle, the ABC Limited enters the due diligence phase and performs in-depth research on the company they are considering to acquire i.e. DEF Limited. During this step, the ABC Limited asks the DEF Limited, for extensive financial information.

After completing its thorough financial diligence of the DEF Limited, the ABC Limited directs the research team to evaluate the value of the IP assets, namely their brands and logos. This entire process brought positive reactions from all involved. The ABC Limited was content because it had bigger plans with this merger and its objectives combined. This becomes a positive opportunity for both to expand into a larger company.

FACTORS TO BE KEPT IN MIND WHILE CONDUCTING DUE DILIGENCE



1. Objectives and purpose

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction. The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision as to whether or not to complete the transaction as proposed. It should provide a basis for determining or validating the appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction.

The following factors may be kept in mind in this regard:

(i) Be clear about your expectations in terms of revenues, profits and the probability of the target company to provide you the same.

(ii) Consider whether you have resources to make the business succeed and whether you are willing to put in all the hard work, which is required for any new venture.

(iii) Consider whether the business gives you the opportunity to put your skills and experience to good use.

(iv) Learn as much as you can about the industry you are interested in from media reports, journals and people in the industry.

2. Planning the schedule

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

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

3. Negotiation for time

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

4. Risk Minimisation

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

The asset position and profitability of the company are vital. Since, due diligence exercise deals with the overall business, it is important to consider aspects such as:

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

5. Information from external sources

The company's customers and vendors can be quite informative. It may be found from them whether the target company falls in their most favored clients list. Any flaws that the audit uncovers help to re-negotiate down the sale price. Hence, the Due diligence is "a chance to get a better deal".

6. Limit the report with only material facts

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

7. Structure of information

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

Challenges in conducting due diligence

A professional may face many challenges while conducting due diligence. He needs to deal with these challenges and bring the best result of due diligence. Few examples of the challenges faced are as under:

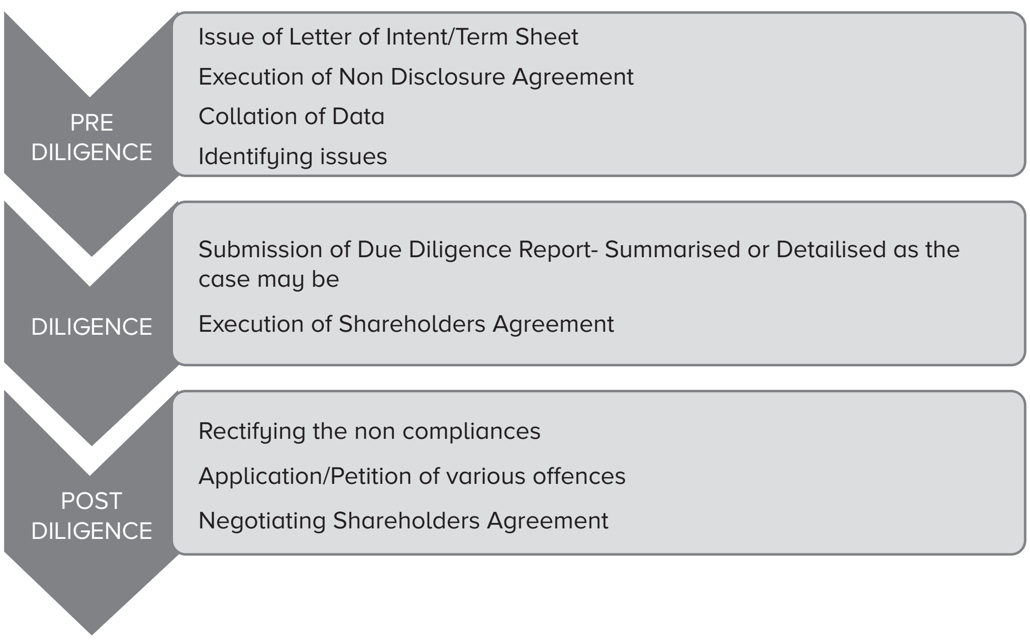
i) Non-availability of the information or incomplete information: For eg. Non availability of evidence related to compliances. While dealing with difficulty, he can try to find the alternate source of getting the information.

ii) Lack of time: Many a times a professional cannot check all the information due to paucity of time. A professional may confine the scope of checking in this scenario.

iii) Non-cooperation by the employees: It is possible that few of the employees may start non-cooperating as this may lead to focus on their mistakes. Reporting to the concerned authority may be a good solution in this scenario.

PROCESS AND STAGES OF DUE DILIGENCE

A due diligence process can be divided into three stages i.e. (i) Pre Diligence, (ii) Diligence, and (iii) Post Diligence.



(i) STEP 1: Pre diligence

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

1. **Signing the Letter of Intent (LOI) :** The first and foremost step for the management of the target company, is that the investor is to sign a Letter of Intent (LOI) or a term sheet which underlines the various terms on which the proposed deal is going to be concluded. It includes:

Scope –

- Areas to be covered;
- Manner of maintenance and collection of data;
- Final work product-
  - Due Diligence Report
  - Only Executive Summary
  - Comprehensive Bible with Executive Summary, detailed report on all segments, data sheets
- Timelines - Time within which the exercise is to be complete.

2. **Execution of the Non-Disclosure Agreement (NDA)/ Engagement letter:** After the receipt of the LOI the investors sign an NDA with the various agencies who is going to conduct the due diligence, be it finance, accounting, legal or a secretarial diligence.
3. **Receipt of documents from the company and review of the same with the checklist of documents already supplied to the company:** The company would usually receive a checklist from the agency conducting the diligence. The checklist is invariably exhaustive in nature, and therefore, the company may either collate and compile the documents in-house or outsource this to an external agency.
4. **Identifying the issues:** The next step is to identify the issues existing therein that may be relevant.
5. **Organising the papers required for a diligence:** The next is to organise all the paper, documents and information requiste for conducting due diligence.
6. **Creating a data room:** While the data is being collated care should be taken to ensure that there are no loose ends that may probably arise.

Key points to be considered in regard to data room:

Some of the important things that one should take cognizance of from the corporate viewpoint are the following:

- Do not delay deadlines (leads to suspicion).
- Mark each module of the checklist provided separately.
- In case some issues are not applicable spell it out as “Not Applicable”.
- In case some issues cannot be resolved immediately, admit it.
- Put a single point contact to oversee the process of diligence.
- Keep a register, to track people coming in and going out.
- An overview on the placement of files.
- Introduction to the point person.

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

1. Be warm and receptive to the professionals who are conducting diligence.
2. Enquire on the Due Diligence team.
3. In case of any corrections - admit and rectify.

As regards the process of diligence, as a professional care should be taken to scrutinize every document that is made available and ask for details and clarifications, since the Due diligence is a time bound activity and is needed to be wrapped up at the earliest. However, the company may be provided an opportunity to clear the various issues that may arise out of the diligence.

Getting Ready Components of the Deliberative Overview

(a) Transaction Structure i.e. concerned parties, whether structured as share or asset purchase, tax considerations, restrictive covenants, etc.;

(b) Transaction Funding i.e. how is funding contemplated and preliminary consideration of any significant issues in respect thereof;

(c) Regulatory Issues such as restriction on foreign holding, subsidiaries, approvals, competition law issues and foreign exchange considerations;

(d) International Aspects including the question of engaging overseas professional advisers; Timelines i.e. determination of time schedules for various stages of the contemplated Transaction;

(e) Confidentiality Agreements i.e. whether Target seeks powers to restrict the release of certain information or data and review of covenants in relation thereto (Particularly in a listed company);

(f) Exclusivity or Lock-In Arrangements as per negotiations between the parties;

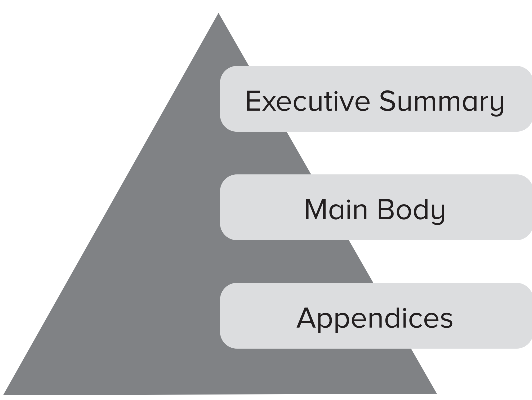
(g) Data Room Guidelines regarding the due diligence process on Target entity;

(h) Overall Due Diligence Strategy and consideration of the due diligence checklist as is usually circulated prior thereto; and

(i) Specialized Issues such as industry-segment and relevant sector-specific issues including any specialized legislative requirements and such other details.

(ii) STEP 2: Diligence Report

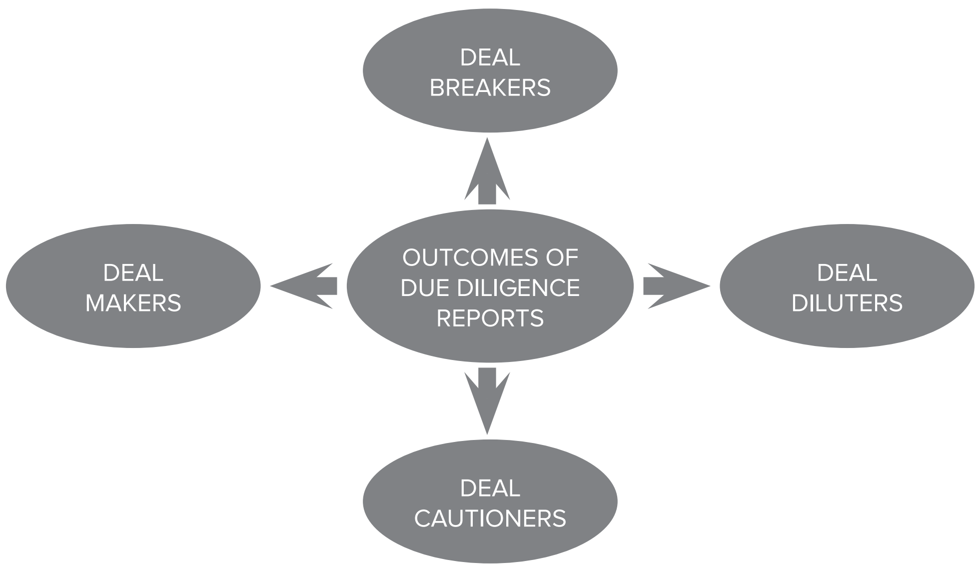
After the diligence is conducted, the professionals submit a report which in common parlance which is called as Due Diligence report. These reports can be of various kinds, a summary report; a detailed report or the like; and the findings mentioned in the report can be very significant, in as much as the deal is concerned. The due diligence report would typically consist of the following three sections: –



- **Executive Summary:** This draws to the attention of the Acquirer, any items of concern or otherwise requiring attention and could usually start with the most critical points or deal breakers.
- **Main Body:** This would ideally follow the order and headings of the terms of reference or the checklist.
- **Appendices:** This section includes data sheets and/or documentation which are relevant to a critical issue.

The most important part of due diligence is writing of report in a presentable form. If the report does not provide the actual view of the organization than the activity will become worthless. Identifying the problem is not the only work of due diligence. A good diligence report should also provide the suggestions for solving the problem. The report may interalia cover General Information, Financial Data, relevant business agreements, pending litigations, contingent liabilities, details of intangible assets like IPRs, marketing position, Internal Controls, Environmental compliance, position of CSR aspects, Human resource assets and the culture of the organisations. The report should also make the reference and purpose of the conducting DD. For eg. Whether it is conducted due to statutory requirements or for entering into Business transaction or as a fact finding analysis. The report should also include the source of information. List of document reviewed including the documents not available should also be the part of the report. Assumptions wherever made should be part of report. Reference to reliance on certain undertakings and certificates should also made part of DD report. Risk analysis section should also one of the mandatory part of the DD report. The report shall also state the confidentiality and restriction clause providing the limited use of the report, wherever feasible.

OUTCOMES OF DUE DILIGENCE REPORTS



- *Deal Breakers*: In their report, the findings can be very glaring and may expose various non-compliances that may arise - any criminal proceedings or known liabilities.
- *Deal Diluters*: The findings arising out a diligence may contain violations which may have an impact in the form of quantifiable penalties and in turn may result in diminishing the value of company.
- *Deal Cautioners*: It covers those findings in a diligence which may not impact the financials, but there exist certain non-compliances which though rectifiable, require the investor to tread a cautious path.
- *Deal Makers*: Which are very hard to come by and may not be a reality in the strict sense, are those reports wherein the diligence team have not been able to come across any violations, leading them to submit what is called a ‘clean report’.

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

(iii) Post Diligence

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

TECHNIQUES OF DUE DILIGENCE AND RISK ASSESSMENT

Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement and throughout the duration of a commercial agreement respectively.

The Due diligence and risk assessment and control processes are central to good business practice. These processes are particularly important in taking leadership in the market and charge premium rate services. Where services are delivered to clients through Associates, which can, on occasion, include many different parties, the professional should prior to contracting with such party write down the expectation from such party in the process of due diligence.

All parties in the Due diligence team should be confident that the established team is for good positive business and industry-wide growth. Such processes are built on the following cornerstones:

Evaluation of the objective of the plan: The first step is to determine the main objective of the project which helps in ascertaining the exact information required that align with organisation's strategy.

Know your client - All businesses have risks, and these can vary significantly dependent on the nature of the company and the services being operated. It is important to know your client so you can properly identify the risks involved and assess how to manage them. This is not to limit or prevent commercial relationships forming but to ensure they are properly managed whether an issue ultimately arises or not.

Examination of Financials of the organisation: It examines the financial records of the organisation that helps in assessing the financial performance, asset health and stability of the organisation. Some of the Items inspected here include:

- Balance sheets and income statements
- Inventory schedules
- Future forecasts and projections
- Revenue, profit, and growth trends
- Stock history and options
- Short and long-term debts

- Tax forms and documents
- Valuation multiples and ratios in comparison to competitors and industry benchmarks.

Inspection of documents: The next step is to review all the documents/information records made available to get a better understanding of the organisation and it help to determine the growth and value of the business of the organisation.

Actions taken to control any risk: once risks are identified, industry members must make a proper assessment of the issues that would arise if incidents occur and take proportionate steps to minimise the likelihood of such issues resulting in consumer harm. Good process planning and/or staff training may have a positive impact on a company's ability to respond effectively when incidents do occur.

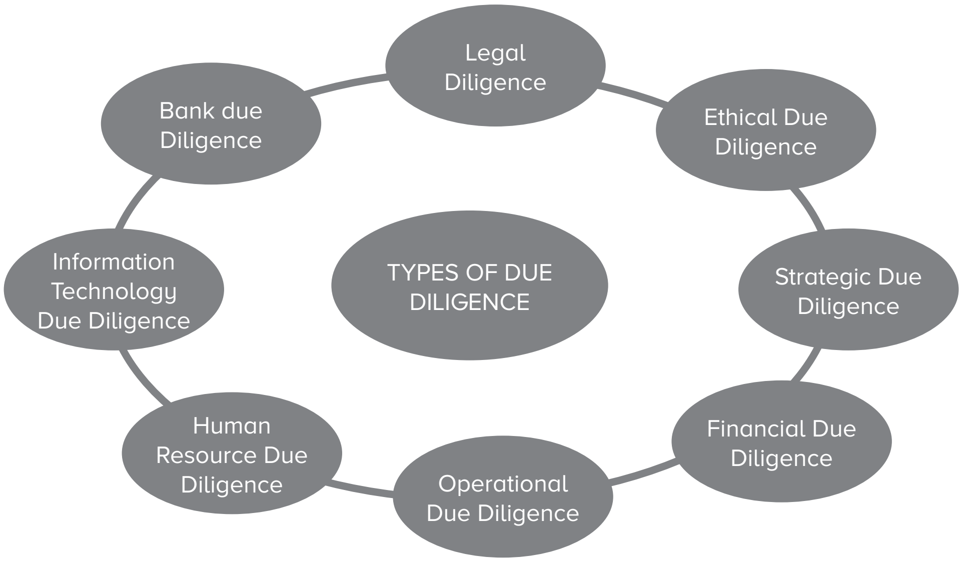
The formulation of an action plan could be based on the following:

- To periodically test and/or monitor certain 'risks' that would normally be associated to a particular service category (e.g. for a subscription service, it may be prudent to test the clarity of promotions, whether reminder messages have been sent, with delivery confirmation noted, and that 'STOP' commands have been properly processed);
- The frequency of such testing should reflect the risk posed by both the client and the service type. For example, a client with no breach history, or where none of the directors are linked to other companies with breaches, and low- risk service types (such as football score updates), would require far less monitoring than a client with an extensive breach history that provides a high- risk category of service (e.g. a subscription-based lottery alerts system with a joining fee);
- 'Mystery shopper' testing could be used as and when appropriate;
- Internal mechanisms to enable 'whistle-blowing' by staff, where appropriate;
- Putting in place internal checks that correlate with unusual patterns of activity which may indicate consumer harm (e.g. spikes in traffic and/or consumer complaints made directly to the provider about one specific service);
- Having a procedure to alter and address instances of non-compliant behaviour;
- Monitoring of the client's service to ensure that any directions given by the Phone-paid Services Authority have been complied with;
- Producing a compliance file, comprising of a written record of the assessment, the subsequent action plan and evidence of any monitoring and/or testing required by the plan having taken place. This record does not necessarily need to be lengthy (although this will depend on the client and the actions taken under the plan) but should be made available to the Phone-paid Services Authority upon request.

Responding to incidents - even where a business makes significant effort to comply with regulations and legal requirements, they may not be immune to problems arising. Providers ought to be prepared to respond calmly and proactively to incidents, working closely with the regulator and other parties in the value chain to identify, mitigate and correct any fallout, providing support to consumers. Breaches ought to be identified and acknowledged quickly when they arise so that they can be remedied and services are therefore delivered to a high standard to consumers.

TYPES OF DUE DILIGENCE

In business transactions, the due diligence process varies for different types of companies. The relevant areas of concern may include the financial, legal, bank, labour, tax, environment and market/commercial situation of the company. Other areas include intellectual property, real and personal property, insurance and liability coverage, debt instrument review, employee benefits and labour matters, immigration, and international transactions. The Business due diligence involves looking at quality of parties to a transaction, business prospects and quality of investment. The most important types of Due Diligence are :



LEGAL DUE DILIGENCE

A legal Due Diligence is a process of assessing all legal risks associated with organisation structure, its assets, contracts, securities, contracts, intellectual property, etc. of the target company. It is a safeguarding process to understand the strength and weakness of the organisation with maximum information available. It ensures safe execution of transaction with minimum issues in future.

> A legal due diligence covers the legal aspects of a business transaction, liabilities of the target company, potential legal pitfalls and other related issues. Legal due diligence covers intra-corporate and inter-corporate transactions.
>
> NCLT Chennai Bench, CP/ 75/ CHE/ 2021 dated 01.07.2022 in *Technology Frontiers (India) Private Limited* v. *Global Sports Commerce Pte Ltd & Ors.* took an alternative stance and held that a company secretary is a *'Watchdog of protecting the Principles of Corporate Governance as well as the collective interest of all the stakeholders so also the Company'.* the NCLT emphasized that a company secretary is required to act not only with '*adequate*' diligence but with '*proper*' and '*necessary*' diligence while discharging duties, '*by sounding the knell*' to bring to the attention of the Board and all concerned, instances wherein there is any apprehension of deviations from sound corporate principles and prudent governance practices In the best interest of the company and its stockholders.

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

- Copy of Memorandum and Articles of Association; Minutes of Board Meeting for the last three years; Minutes of all meetings or actions of shareholders;
- Register of Members, charges, etc.
- Share transfer deeds;
- Copy of share certificates issued to Key Management Personnel; Copy of all guarantees to which company is a party;
- All material contracts;

- Copies of all loan agreements, bank financing agreements, line of credit to which company is a Status of the order, awards issued by the various regulators and courts;
- Status of Pending litigations; Organisational chart; Returns filed with ROC; Search/status report if any;
- Details of branches and subsidiaries; Registrations documents under various laws; Documents/reports filed with stock exchanges; Related party transactions;
- Contracts and loans with directors; Borrowings and investment of the company;
- Matters like IPO, FPO, Prospectus, etc. in compliance with SEBI regulations; Maintenance of statutory registers, minute books, etc.;
- Various compliances, under applicable laws.

TRANSACTIONS COVERED UNDER LEGAL DUE DILIGENCE

Initial Public Offer/ FPOs/ QIPs	Private Equity	Joint Ventures
Mergers & Acquisitions	Corporate Restructuring	Corporate Governance Related Matters
Commercial Agreements	Leveraged Buy Outs	General Compliance Requirement

SCOPE OF LEGAL DUE DILIGENCE

Legal Due Diligence assesses the regulatory compliances applicable to the company under various laws such as:

- Company Law
- Income Tax Law
- Labour Law
- RERA Act
- SEBI Act, its rules and regulations
- Insurance Act
- RBI Act
- FEMA Act
- Intellectual Property Law etc.

DUE DILIGENCE FOR MERGER & AMALGAMATION

In case of the mergers and amalgamation of the companies, due diligence is a critical process which cannot be overlooked by the management as well as by the shareholders of the company while giving consent for the amalgamation. Due diligence in mergers not only requires the assessment of the financial, legal, and regulatory exposures but also requires insights into the target company's structure, operations, culture, human resources, supplier and customer relationships, competitive positioning and future outlook. The due diligence provides an assurance in taking decisions considering the factors which may be a potential deal-killers/shapers and provide assurances that the acquisition is the right decision at the right price. Due diligence also provides management an insight, holistic view of the target company that which helps in the easy integration of the target's people and business.

Merger with an existing company will, generally, have the same features as an acquisition of an existing company. However, identifying the right candidate for a merger or acquisition is an art, which requires sufficient care and calibre.

Once an organization has identified the various strategic possibilities, it has to make a selection amongst them. There are several factors financial/ non-financial/ open/ hidden factors that influence the ultimate choice of strategy. The process of analysis of strategic choices on various aspects for merger is done through due diligence process.

Due Diligence Process in the M&A Strategy

Stages	For Buyer	For Seller
Preparation Stage	● M&A strategy formulation ● Preparation of list of potential Targets ● Appoint external advisor for evaluation of targets ● Short list targets ● Create due diligence team	● Structure a business plan ● Preparation of list of potential buyers ● Appoint external advisor ● Shortlist buyers
Pre Diligence	● Approach targets ● Negotiation of initial terms ● Execute non-disclosure agreement ● Compliation of list of data required	● Approach buyers ● Negotiate initial terms ● Execution of non disclosure agreement ● Creation of data room
Due Diligence	● Inspection of data room ● Analysis of private documents ● Evaluation of risk and return ● Structure the terms and conditions	● Assistance in data room ● Setting deadlines for offer
Negotiations	● Make final offer ● Negotiate and agree on terms	● Compile final offers ● Select best offer ● Negotiations

Stages	For Buyer	For Seller
Documentation	● Execution of merger agreement, acquisition agreement, or purchase agreement	● Execution of merger agreement, acquisition agreement, or purchase agreement
Regulatory approvals	● Depending on the nature of the transaction and the industries involved, both companies may need to obtain regulatory approvals from board of directors, shareholders and various other stakeholders including regulatory agencies and government agencies.	● The company need to obtain regulatory approvals from board of directors, shareholders and various other stakeholders including regulatory agencies and government agencies.
Integration	● After the transaction is complete, the companies should begin the process of integrating their operations, systems, and cultures to realize the benefits of the transaction.	
Post Diligence	● Post merger integration and cultural adjustments	● Termination of data room and ownership exchange

DUE DILIGENCE FOR TAKEOVERS

For any business, doing takeover of a business company is not an easy task. Moreover, it is an important financial investment that implies a number of risks, some of which can run the entire process around. Which make the takeover due diligence as one of the prerequisites for takeover of a business.

The Takeover Due diligence is generally conducted in different domains; Financial, Legal, Taxation, social life, environment, etc. The Takeover Due diligence covers the history of the company, past performance, the present, and the future of a company. In effect, it must respond to certain requirements of the buyer, i.e., maximize financial or non-financial benefits, and negotiate the risks of failure. Therefore, takeover due diligence is useful in allowing the buyer to confirm his or her decision of the sale, or in negotiating the conditions of the sale.

The takeover due diligence is having a great importance for a business as it synthetically expresses the overall value of the target enterprise. According to which the buyer will be able to analyze the potential of the target company while understanding the risks related in taking it over.

Thus, taking over a company brings inevitable risk, some of which can cause great detriment to the company. Due diligence allows the company to avoid a tragic end after being taken over. This being said, the acquisition audit is a complex process. Because of this, it is necessary to find people experienced in due diligence, so that the audit acquisition will be effective and useful.

The takeover due diligence allows the buyer to better discern the risks and opportunities linked to the target company. This due diligence will be performed once an agreement is signed or after the letter of intent. It will allow verification of the elements being negotiated between the parties, producing an accurate reflection of the current state of the target company.

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of the Listing Agreements with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The compliances under the regulations include event based/continual disclosures, open offer requirements including public announcement, escrow account, obligations of acquirer/target company/merchant banker, undertaking/ authorization, offer price etc.

CASE STUDIES

1. In the case of *Nirma Industries and Anr. v. Securities Exchange Board of India, Nirma* Industries sought withdrawal of an open offer under Regulation 27(d) of the Takeover Regulations on the ground that the promoters of the target company had committed a fraud and had embezzled funds. Nirma Industries applied to SEBI to allow the withdrawal of the open offer. The Supreme Court however rejected all the contentions of Nirma Industries and held that an investing company is responsible for its own decision to invest and should carry out appropriate diligence. The Court stated that Nirma Industries were aware of various litigations, the plea of ignorance of litigation and dangers of investment was thereby denied.

2. Total Energies said its $3.1 Billion Exposure In Adani Group taken after Due Diligence, Full Compliance

   TotalEnergies SE states its exposure of $3.1 billion, or about 2.4% of the company's employed capital, in Adani Group was taken in full compliance and with due diligence.

   Since 2018, the French energy major has invested in four Adani entities: 50% each in unlisted Adani Total and AGEL23, 37.4% in listed Adani Total Gas Ltd., and 19.75% in Adani Green Energy Ltd.

   All investments in Adani's entities were undertaken in full compliance and with due diligence, which "were consistent with best practices", the company said in a statement on February 03, 2023. "All relevant material in the public domain was reviewed, including the detailed disclosures to regulators required under applicable laws."

   (Source: *https://www.bqprime.com/business/totalenergies-says-its-31-billion-exposure-in-adani-group-taken-after-due-diligence-full-compliance*)

DUE DILIGENCE FOR ISSUE OF SECURITIES

A public company may issue securities to public through prospectus - Public offer by complying with the provisions of Companies Act 2013 Part I of chapter III - Prospectus and Allotment of Securities; or through private placement by complying with the provisions of Part II of chapter III - Prospectus and Allotment of Securities; or through a rights issue or a bonus issue in accordance with the provisions of the Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder, the key regulation governing the issue of securities and preparation of financial information are:

- The SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018
- The SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015

A private company may issue securities by way of rights issue or bonus issue in accordance with the provisions of the Act; or through private placement by complying with the provisions of Part II of chapter III - Prospectus and Allotment of Securities & Chapter IV -Share Capital & Debentures of Companies Act, 2013.

The scope and comprehensiveness of the Issue of Securities due diligence is important not only from a legal standpoint to avoid liability but also from a reputational perspective as the reputation of the company and its promoters and other participants may be significantly vanished, if on a later date it appears that the company and other participants are failed to uncover and disclose to prospective investors critical issues relating to the issuer or the Securities.

While the specific requirements in connection with issue of securities are different under the Companies Act, 2013 and SEBI Laws & Regulations made thereunder, any non-compliance in these regulations are generally impose liability if the offering memorandum or prospectus contains a materially incorrect or misleading statement or omits a material fact, however in certain conditions the complete issue of securities stand cancelled. The violation of any applicable liability provisions may result in liability for offering participants, in particular the issuer and the underwriters. These liability provisions emphasize the need for careful preparation of all materials to be used in issue of securities offerings, in particular the offering memorandum or prospectus.

INTELLECTUAL PROPERTY LAW

The company which owns Intellectual Property (IPs) use there IPs to monetize their business. These IPs are something that differentiates their product and service from their competitors. However, the concept of valuation of intangible assets related to Intellectual Property like Patents, Copyrights, Design, Trademarks, Brands etc., also getting greater importance as these Intellectual Properties of the business are now often sold and purchased in the market by itself like any other tangible asset. Many Indian companies and corporate entities do not give much importance to the portfolio management of their Intellectual Property Rights (IPR). The main objective of intellectual property due diligence is to ascertain the nature and scope of target company's right over the intellectual property to evaluate the validity of the same and to ensure whether there are no infringement claims. Few of the items that need to be seen while conducting due diligence is:

- A schedule and copies of all consulting agreements, agreements regarding inventions, licenses, or assignments of intellectual property.
- Schedule of patents and its application.
- Schedule of copyrights, trademarks and brand names.
- Pending patents clearance documents.
- Any pending claims case by or against the company in violation of intellectual property.
- Details of Indian and international patents with the company.
- Details of threatened claims if any.

ENVIRONMENT LAW

List of important statutes for environment protection in India:

- The National Green Tribunal Act, 2010
- The Air (Prevention and Control of Pollution) Act, 1981
- The Water (Prevention and Control of Pollution) Act, 1974
- The Environment Protection Act, 1986
- The Wildlife Protection Act, 1972
- The Forest Conservation Act, 1980
- Public Liability Insurance Act, 1991
- The Biological Diversity Act, 2002.

Environmental due diligence analyses environmental risks and liabilities associated with an organisation. This investigation is usually undertaken before a merger, acquisition, management buy-out, corporate restructure etc. Environmental due diligence provides the acquirer with a detailed assessment of the historic, current and potential future environmental risks associated with the target organisation's sites and operations. It involves risk identification and assessment with respect to:

- Details of environmental permits and licenses.
- Hazardous substances used in the Company's operations.
- Copies of all correspondence with environment authorities.
- Litigation or investigations if any on environmental issues.
- Contingent environmental liabilities or continuing indemnification obligations, if any.
- Review of the environmental setting and history of the site.
- Assessment of the site conditions.

- Operations and management of sites.
- Confirm legal compliance and pollution checks from regulatory authorities etc.

Things to be reviewed by the management

- List of environmental permits and licenses and validities of the same.
- All correspondence and notices with EPA, state, or local regulatory agencies.
- Whether the company's disposal methods of various by products are in sync with the regulated guidelines.
- Whether there are any contingent environmental liabilities or continuing indemnification obligations.

LABOUR LAWS

List of major labour laws in India:

- Employees Compensation Act, 1923
- Payment of Wages Act, 1936 Employment Standing order Act, 1946
- Minimum Wages Act, 1948
- Factories Act, 1948
- Maternity Benefits Act, 1961
- Payment of Bonus Act, 1965
- The Payments of Gratuity Act, 1972
- Employees State Insurance Act, 1948
- Industrial Disputes Act, 1947
- Trade Unions Act, 1926
- The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013

The purpose of a labour due diligence to conduct a comprehensive review. The compliance from a labour law perspective in order to identify gaps before an authority audit, any non-compliances relating to the inappropriate application of labour law regulations and to allow company to correct errors and deficiencies. The labour law due diligence is identify gaps and minimize labour law and payroll deficiencies before any regulatory action.

However, the Labour Law due diligence is important in case of the merger and acquisitions, takeovers, IPOs, joint ventures and winding up / liquidation of the companies. The scope of the labour law due diligence extends to all the labour & employment related central, state and local laws, rules and regulations applicable to the company. During the payroll and labour due diligence the auditor should examine and review the following areas:

- Labour law regulations and agreements;
- Employment contracts, amendments to employment contracts; Information, job descriptions;
- Legal declarations/agreements regarding termination of employment; Maintenance of records
- Labour law regulations and agreements;
- Employment contracts, amendments to employment contracts; Information, job descriptions;
- Legal declarations/agreements regarding termination of employment;
- Maintenance of records.
- Employment Standing Order

Note : The Government has formulated four Labour Codes Namely, the Code on Wages, 2019, the Industrial Relations Code, 2020, the code on Social Security, 2020 and the Occupational Safety, Health and Working Conditions Code, 2020, which are yet to be notified.

COMPETITION LAW

Due diligence on competition law aspects is an examination of the actual operations and practices of an enterprise to determine the extent of its compliance with the competition law and to identify potential risks and liabilities and assess the adherence to and effectiveness of the company's competition law compliance policy and training program.

Primary components of Competition Law due diligence are:

- An examination of selected company documents.
- Interviews with selected company personnel.
- Identify specific business activities that potentially could create antitrust exposure for the company.
- The results of the due diligence may suggest an enterprise to have an effective competition law compliance programme.
- The results of the due diligence may result in variation of deal value, withdrawal of deal and also make suggestions to structure a compliance program.
- How to go about the process of due diligence of competition law.

Due diligence of competition law may be made under the following heads:

1. Due diligence of various agreements (both existing and proposed)
2. Due diligence on dominance and its likely abuse if any, (existing)
3. Due diligence on combinations (i.e. effect of proposed Mergers & Acquisition).

Due Diligence of various agreements includes:

- 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 Areas. Cases of abuse if any

Due diligence on regulation of combinations :

- Nature of combination.
- 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

FEMA DUE DILIGENCE

Foreign Exchange Management Act (FEMA) is the legislation which governs the foreign currency in India. The main aim of FEMA is to facilitate external trade, balance the payments, promote the orderly development, and maintain the foreign exchange market in India. Doing Compliance for cross border transactions in India is a big challenge for most of the companies covered in the FEMA. Further, an increased flow of funds, inbound as well as outbound has increased the level of check on compliances in context of foreign exchange. This requires companies to keep a regular eye on foreign exchange transactions, in context of sectoral caps, investment caps, to circumvent from the huge penalties. The FEMA Due diligence helps to avoid damaging circumstances and is helpful in ensuring compliance of Foreign Exchange laws. The FEMA Due diligence covers all types of cross border transactions - import, export, debt funding, equity capital infusion, transfer of shares etc.

The following are covered under the FEMA Due diligence:

- Capital Accounts transactions
- Current account transaction
- Currency Transactions
- Regulations, Master Directions and Circulars issued by RBI
- FDI Policy, approvals
- Setting up of Business through Liaison office, Branch office, project office, wholly owned subsidiaries, joint ventures, foreign institutional investors, and foreign venture capital investor, Non-Resident of India/ person of Indian origin.

FCRA DUE DILIGENCE

The Foreign Currency (Regulations) Act, 2010, the FCRA Rules, 2011, and FCRA Amendment Rules, there under were respectively enacted to regulate the inflow of foreign funds received by NGOs. The FCRA, 2010 replaces the erstwhile Foreign Contribution (Regulation) Act of 1976.

The FCRA legislation state that an organization cannot receive funding from a foreign source, unless it is registered under the Foreign Currency (Regulations) Act, 2010 or has obtained special government approval for a specific project. Also, the registered NGOs need to comply with various post-registration requirements, as detailed in the provisions of the Act and its rules of enforcement.

NGOs in India are categorized under three legal categories: society, trust, and a limited company. These may be founded for a specific cultural, economic, educational, religious, or social purpose. These organizations are heavily regulated by respective state and government agencies.

The Income Tax Department (IT Department) and Ministry of Home Affairs regulate registration and require all NGOs to file annual tax returns and submit audited account statements to their respective agencies. All types of NGOs are treated equally under the Income Tax Act of 1961.

The most important reporting requirement under the FCRA is the submission of annual returns. All NGOs are required to submit their annual returns to the central government (MHA) within nine months from the closure of the previous financial year.

OTHER BUSINESS LAWS

The business in India is regulated through various laws and regulations that secures sustainable development of the business and society as well. Apart from corporate and taxation laws there are other laws and regulations that keep a check on the business organisation.

- Registrations and approvals from various statutory authorities.
- Compliance under pollution control laws.
- Issues relating to immovable properties, title deeds, etc.
- Compliance under FEMA and Insurance Laws etc.
- Real estate and construction law.
- Labour and employment law.
- International business law.

FINANCIAL DUE DILIGENCE

One of the most important types of due diligence, is financial due diligence as it seeks to check whether the financials showcased in the Information Memorandum is correct or not. It also provides a deep understanding of all the :

- Company's financials, including but not restricted to audited financial statements for last three years, recent unaudited financial statements with comparable statements of last year,
- review of accounting policies,
- review of internal audit procedures, quality and sustainability of earnings and cash flow, condition and value of assets, potential liabilities, tax implications of deal structures,
- examination of information systems to establish the reliability of financial information, internal control systems etc.

Financial Due Diligence is the process of analysing requiring inquiry, analysis and interpretation of financial and operational data to assist a buyer in assessing certain risks and opportunities involved in a potential transaction.

The Financial Due diligence also review the company's projection and basis of such projections, capital expenditure plan, schedule of inventory, debtors and creditors, etc. Also, the process involves analysis of major top customer accounts, fixed and variable cost analysis, analysis on gross margins, customers with high profit margins and their contract period, internal control procedures etc. It will also involve the type of the company's order book and sales pipeline to better build projections.

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

The Financial Due Diligence can further extended to tax due diligence which covers the Diligence on various taxes the company is required to pay and which ensure that the proper calculation with no intention of under-reporting of taxes. Status of any tax related case running with the tax authorities. The tax due diligence comprises an analysis of:

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

COMPONENTS OF FINANCIAL DUE DILIGENCE

- Sustainable / normalised earnings
- Sales trends – by segment product geographies diligence Sales trends – by segment, product, geographies
- Customer / product profitability
- Overheads – fixed vs. variable
- Balance sheet – fixed assets, borrowings, working capital Unrecorded liabilities
- Commitments, contingencies
- Accounting policies
- Management BOD control environment Corp Governance Relationship between profit and operating cash flows Reliance on debt funds and usage of debt

- Debt repayment and potential debt trap
- Working capital lock up.

Illustration

ABC Ltd. negotiated a transaction with purchase consideration values at 5 times of normalized EBIT for the year ended 31.03.2022.

Purchase consideration was Rs. 2,860 million (5 *572 million)

It was revealed in the Due Diligence that reported EBIT of Rs. 572 million includes profits from sale of land amounting to Rs. 84 million. With this ABC Ltd. successfully negotiated purchase consideration with reduction of 380 million.

FOCUS AREAS OF FINANCIAL DUE DILIGENCE

Quality of earnings, gross margin & cash flows

Quality of assets- Working Capital

Net Debt

Potential liabilities & commitments

Separation/ Structuring/ Integration Issues

Related Party Transactions

Quality of earnings, gross margin & cash flows

- Identification of seasonable sales
- Growth rate in gross margins
- Change in margins with cost variances
- Impact of standalone costs
- Impact of foreign exchange rate fluctuations
- GAAP Applications
- Revenue Recognitions
- Recurring /non-recurring expenses
- Cash flows from operations - stability, timing and certainty
- Capitalisation of assets/ WIP
- Assets on lease/used but not owned /owned but not used.

Quality of assets - working capital

- Inventory Turnover ratio,

- Current Ratio,
- Debtors outstanding for more than and less than six months
- Cheques issues but not cleared
- Valuation of WIP
- Seasonal impact on working capital

Net Debt

- Transactions on cash/credit basis
- Debt-like items (pension underfunding, severance and other non-operating liabilities)
- Loan Agreements
- Complying with Debt Restructuring schemes.

Potential liabilities & commitments

- Contingent liabilities and off balance sheet items
- Pension and related obligations
- Conservative Policy
- Aggressive Policy
- Off Balance sheet items

Separation/ Structuring/ Integration Issues

- Changes in supply chain management
- MIS and accounting systems
- Standalone considerations (impact of economies of scale, support functions)
- Synergies
- Transition services agreement

Related Party Transactions

- Transaction at arm length basis
- Resources and cost sharing with related parties
- Financing arrangements with related parties

BANK DUE DILIGENCE

The Bank conduct due diligence whenever the company intends to borrow the money from the bank. The main objective of conducting due diligence by the bank are:

- Verification of details of directors/promoters.
- Statutory and procedural compliances by the company
- Examining the existing or previous charges created by the company in respect of loans and their satisfaction.
- Knowing the defaulting status of the directors,etc.

The Practising Company Secretary (PCS) is required to certify compliance in respect of matters specified in the RBI Circular No. DBOD NO. BP. BC. 46/08.12.001/2008-09 dated September 19, 2008. Para (2)(iii) of the RBI Circular specifies that the Diligence Report shall be in the format given in Annex III thereto.

Period of Reporting

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

Right to Access Records and Methodology for Diligence Reporting

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

(i) show cause notices received;

(ii) persons and concerns in which directors are interested, etc.

Reporting with Qualification

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

If the PCS is unable to form any opinion with regard to any specific matter, the PCS shall state clearly the fact that he is unable to form an opinion with regard to that matter and the reasons thereof.If the scope of work required to be performed, is restricted on account of limitations imposed by the company or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the Report shall indicate such limitation. If such limitations are so material as to render the PCS incapable of expressing any opinion, the PCS should state that:

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

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

Professional Responsibility and Penalty for False Diligence Report

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

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

Disqualifications of Secretary in Whole-Time Practice

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

(a) a body corporate;

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;

(e) a person holding any security of that company which carries voting rights.

However, any securities held by such person as nominee or trustee for any third person and in which the holder has no beneficial interest shall be excluded from such disqualification. Further, if a person is not qualified for appointment as PCS of a company for reasons stated above, then he is also disqualified for appointment as PCS of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company. If a PCS becomes subject, after his appointment, to any of the disqualifications specified above, he should vacate his office as such.

Format of Diligence Report (ANNEXURE III to RBI Circular)*

DILIGENCE REPORT*

To,

The Manager,

____________________ (Name of the Bank)

I/We have examined the registers, records, books and papers of _____________ Limited (the Company) as required to be maintained under the Companies Act, 2013 and the rules made thereunder , the provisions of various statutes, wherever applicable, the provisions contained in the Memorandum and Articles of Association of the Company as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s, as may be applicable for the half year ended on _____________ . In my/our opinion and to the best of my/our information and according to the examination carried out by me/us and explanations furnished to me/us by the Company, its officers and agents. I/We report that in respect of the aforesaid period:

1. the management of the Company is carried out by the Board of Directors comprising the following persons :

During the period under review the following changes took place :

2. the shareholding pattern of the company is as under :

During the period under review the following changes took place :

3. the company has altered the following provisions of
   (i) the Memorandum of Association during the period under review and has complied with the provisions of the Act.
   (ii) the following Articles of Association during the period under review and has complied with the provisions of the Act.
4. the company has during the period under review, entered into the following transactions with business entities in which directors are interested.
5. the company has during the period under review, advanced loans, given guarantees and provided securities amounting to Rs. _____________ to its directors and/or persons or firms or companies in which directors are interested.

6. the Company has during the period under review, made loans and investments; or given guarantees or provided securities to other business entities as under:

7. the amount borrowed by the Company from directors, members, public, financial institutions, banks and others during the period under review is/are within the borrowing limits of the Company. The break up of the company's borrowings are as under:

8. the Company has during the period under review, not defaulted in the repayment of any public deposits or unsecured loans and the Company or its Directors are not under the Defaulter's list of Reserve Bank of India or in the Specific Approval List of ECGC.

9. the Company has during the period under review, created, modified or satisfied charges on the assets of the company as under:

10. the Forex exposure and Overseas Borrowings of the company are as under"

11. the Company has issued, offered and allotted all the securities to the persons entitled thereto and has also issued letters, coupons, warrants and certificates thereof to the concerned persons and also redeemed its preference shares/debentures and bought back its shares (wherever applicable) in compliance with the specified procedures and within the stipulated time.

12. The Company has insured all its secured assets.

13. The Company has complied with the terms and conditions, set forth by the lending institution at the time of availing the facility and also during the currency of the loan and has utilized the funds for the purposes for which these were borrowed.

14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 2013.

15. The Company has insured fully all its assets

16. The Company / Directors are not in the willful defaulters' list of RBI

17. The Company / Directors are not in the Specific Approval List of ECGC.

18. The Company has paid all its Statutory dues and that there are no arrears

19. The Company has complied with the terms and conditions, set forth by the lending institution at the time of availing any facility and also during the currency of the loan.

20. The Company has used the funds for the purpose for which it borrowed.

21. The Company has declared and paid dividends to its shareholders, as per the provisions of the Companies Act.

22. The Company has complied with the provisions stipulated in Section 186 of the Companies Act in respect of its Inter Corporate loans and Investments.

23. The Company has complied with the applicable and mandatory Accounting Standards issued by the Institute of Chartered Accountants of India.

24. The Company has credited and paid to the Investor Education and Protection Fund all the unpaid dividends and other amounts required to be so credited.

25. A list of prosecutions initiated against or show cause notices received by the Company for alleged offences under the Act and also the fines and penalties or any other punishment imposed on the Company in such cases is attached.

26. The Company has (being a listed) complied with the SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015.

27. The Company has deposited both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

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

Signature:

Name of Company Secretary:

C.P. No.:

Place:

Date:

Footnote Link:

*https://rbidocs.rbi.org.in/rdocs/notification/PDFs/287063.pdf

CERTAIN OTHER TYPES OF DUE DILIGENCE

Ethical Due Diligence

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

Ethical due diligence of management of a company involves assessing employees in terms of their fit with the ethical culture and values of the organization. Ethical performance assessment is also used as one of the parameter of the career development and promotion within the organization.

Carrying out the assessment of a company's ethics as part of a due diligence can add considerably to the depth of insight into the target company. For an ethics assessment to add this value, it is crucial that it is an accurate and reliable assessment.

Strategic Due Diligence

Strategic due diligence tests the strategic rationale behind a proposed transaction and analyses whether the deal is commercially viable, whether the targeted value would be realized. It considers factors such as value creation opportunities, competitive position, and critical capabilities. Strategic due diligence focuses on determining how much adequate, realistic, and attainable is a deal's value. Strategic due diligence is broader and considers micro and macro-environmental factors of a business, connecting the legal and financial consideration with a long-term focus. Essentially strategic due diligence determines the question, "Whether a business plan can hold up to the market realities?"

Operational Due Diligence

Operational Due Diligence diagnoses of the organization's historical and current operational performance, cost structure, map of potential synergies. It aims at the assessment of the functional operations of the target company, connectivity between operations, technological up gradation in operational process, financial impact on operational efficiency etc. Operation due diligence involves verifying operational matters such as the various facilities, office layout, sitting capacity etc. Further in operational due diligence the detailed index of the fixed assets and its locations, age of the assets including all lease agreements relating to various equipment, schedule of sales and purchases of major capital equipment during previous years/ last three years, real estate deeds, mortgages, title policies and other permits also need to be verified in operation due diligence.

Benefits of Operational Due Diligence:

- It also uncovers aspects on operational weakness, inadequacy of control mechanisms etc.
- It also gives a better picture of the kind of cost the buyer is going to incur in case they plan to go for expansion.
- It verifies the various facilities owned by the target company and whether all costs are captured in the financials or not.

Human Resource Due Diligence

Human Resource Due Diligence evaluates the company's organizational structure, HR practices and policies, collective agreements, compensation programs, ratios of labour turnover and demographic analysis of the Company. It aims at people or related issues. Key managers and scarce talent leave unexpectedly. Valuable operating synergies get disturbed when cultural differences between companies are not understood or are simply ignored. It is crucial to consider cultural and employees' issues upfront, for success of any venture.

CASE STUDY

A manufacturing firm that builds components for lithium batteries wants to develop and manufacture entire battery systems autonomously. They are looking at merging with a mid-sized firm that is into manufacturing battery cases and would be interested in conducting strategic diligence to identify firms that align with the vision of the company, and who can enable their manufacturing objectives. They find the best fit for the company and observe that a proper diligence on the human resources of the firm is crucially fundamental, as the operations of the manufacturer are labour intensive.

To understand if the work culture can align with their objectives, the executives from the former firm conduct diligence on the HR policies in place. The results were favourable, as the policies in place were conducive to the merger. They further conduct thorough diligence on the employee demographics for a better understanding of the salaries, tenure, specific skill sets, work hours put in, the average age and the bonuses drawn. There is a thorough assessment of any pending litigations or claims regarding breach of contracts, pensions, and employee's compensation to ensure everything is in order before proceeding with the merger documentation.

Elements of Human Resource Due Diligence

- List of employees, their positions and salaries.
- All employment contracts with non-disclosure, non-solicitation and non-competition agreements between the company and its employees. In case there are few irregularities regarding the general contracts, focus must be given.
- Analysis of total employees, including current positions, vacancy, due for retirement and serving notice period.
- Analysis of employee problems for alleged wrongful termination, harassment, discrimination and any legal case pending about the same.
- Analysis of current salaries, bonuses paid during last three years and years of service.
- A list and description of all employee health benefits and welfare insurance policies or self-funded arrangements.
- HR policies regarding annual leave, sick leave and other forms of leave.

- In case there are labor disputes, requests for arbitration, or grievance procedures currently pending and its financial impact needs to be seen.
- Employee Benefit Schemes and schedule of grants of such scheme.
- Details of options given/vested under ESOP scheme.
- Employee harassment reports if any.
- Cultural issues in case of cross border transactions.

CASE STUDY

Microsoft was running into serious internal problems with its organizational structure and human resources. It wasn't until the new CEO Satya Nadella took charge and started to undertake some major restructuring for this massive company. At a very high level, we can see some of the fruits of Nadella's ideas by looking at Microsoft's stock price.

Even after the phenomenal and long-lived success of Windows and Office products, Microsoft was struggling to keep up with other companies — specifically, with Google becoming dominant in the search and software market and Apple owning the phone market. The tech giant was stagnant and rife with internal wars between major departments that often viewed each other more as competitors than partners within the same company. As a result, innovation was being thwarted by a toxic environment that kept the company increasingly dependent on Windows and Office. While both products are very successful, the stagnation put the company in a dangerous "comfort" zone.

How Microsoft optimized its processes and unified its teams:

After being named CEO in February 2014, Satya Nadella undertook a major restructuring of the tech giant to eliminate its destructive internal competition. Microsoft products and platforms would no longer exist as separate groups. Instead, all employees would start focusing on a limited set of common goals — and bringing them all together. Their new common functions include:

- Reinventing productivity and business processes
- Building an intelligent cloud platform
- Creating more personal computing.

In September 2016, Nadella created a new AI and Research Group by merging their original research group with the Bing, Cortana, and Information Platform teams. This move brought roughly 5,000 engineers and computer scientists together to focus on artificial innovation across all Microsoft product lines.

A new, meaningful mission.

Right at the beginning, Nadella shared a new sense of mission with his employees: "To empower every person and every organization on the planet to achieve more." Prior to the restructuring, employees had been lacking a positive sense of purpose, with the result being low morale and weakened employee engagement.

Impact:

The appointment of Mr. Nadella as Microsoft CEO has brought a positive change in the working culture of Microsoft. Before his appointment, though the company's revenue was increasing, the stock price stagnated for almost a decade but as soon as he took the charge the stock price starts climbing up. Microsoft's cloud service Azure became profitable and it reached a $1 trillion valuation in 2019.

INFORMATION TECHNOLOGY DUE DILIGENCE

Today in era of Technology, it is utmost require to examine all system, policy, process, procedure and policy related to information technology. It provides with the following benefits:

- A clear understanding of technological capability of the organisation.
- Identification and assessment of the risks associated with technology adapted by the organisation.
- Impact of the information technology on the particular business transaction.

Information security due diligence is often undertaken during the information technology procurement process to ensure that risks are uncovered. However, the regular review internal information security system helps to identify security gaps, as well as ensure that the company is acting with an acceptable standard of care elevate existing information security management system.

Information security due diligence apprises the acquirers with the target company's existing security network, it is risk level, and ways to mitigate the risks. The information security due diligence covers the following:

- Information Security Measure
- Data Protection/ sharing policy
- Network and System design
- Wireless and Remote Access facility
- Incident management

Essentials of Information Technology Due Diligence

- Analysing IT processes and systems of the organisation
- Determining the current cost and investment in IT
- Assessing the infrastructure of the company establishes IT Security
- Analysing the efficiency of Business systems and softwares

> Information Technology due diligence is important because it protects organizations from risks — risks that can become incredibly costly if left unchecked. A report from IBM and the Ponemon Institute found that the average cost of a data breach reached $4.35 million in 2022, which marks a 2.6% increase from 2021."

NON DISCLOSURE AGREEMENT

A non-disclosure agreement is defined as a legally enforceable contract that creates a confidential relationship between a person who holds some kind of trade secret and a person to whom the secret will be disclosed.

The Confidentiality agreements typically serve three key functions:

- To protect sensitive information. By signing an NDA, participants promise to not divulge or release information shared with them by the other people involved. If the information is leaked, the injured person can claim breach of contract.

- In the case of new product or concept development, a confidentiality agreement can help the inventor keep patent rights. In many cases, public disclosure of a new invention can void patent rights. A properly drafted NDA can help the original creator hold onto the rights to a product or idea.
- Confidentiality agreements and NDAs expressly outline what information is private and what's fair game. In many cases, the agreement serves as a document that classifies exclusive and confidential information.

Content of the Non-Disclosure Agreements

1. *Definitions and exclusions of confidential information;*

   Definitions of confidential information spell out the categories or types of information covered by the agreement. This specific element serves to establish the rules-or subject/consideration-of the contract without actually releasing the precise information.

2. *Obligations from all involved people or parties; and time periods.*

   At the same time, nondisclosure agreements often exclude some information from protection. Exclusions might comprise information already considered common knowledge or data collected before the agreement was signed. Additionally, Time periods are also commonly addressed in NDAs and usually require that the party receiving the information stays mum for a number of years. This specific information is usually up for negotiation.

Sample Non-Disclosure agreement is placed below:

XYZ Limited

Non-Disclosure Agreement

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

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

IT IS HEREBY AGREED AS FOLLOWS.

1. Definitions

In this Agreement:

1.1 Confidential Information:

(a) means any information disclosed by one Party (the "Disclosing Party") to any other Party (the "Receiving Party") or which is otherwise communicated to or comes to the attention of the Receiving Party whether such information is in writing, oral or in any other form or media and whether such disclosure, communication or coming to the attention of the Receiving Party occurs prior to or during this Agreement; and

(b) includes without limit:

(i) any information which can be obtained by examination, testing or analysis of any hardware, any component part thereof, software or material samples provided by the Disclosing Party under the terms of this Agreement;

(ii) all information disclosed by one Party to any of the other Parties relating directly or indirectly to the Purpose;

(iii) the fact that the Parties are interested in or assessing the Purpose and/or are discussing the Purpose with each other; and

(iv) the terms of any agreement reached by the Parties or proposed by any of the Parties (whether or not agreed) in connection with the Purpose;

(v) all knowledge, information or materials (whether provided in hardcopy or electronic or other form or media) whether of a technical or financial nature or otherwise relating in any manner to the business affairs of the Disclosing Party (or any parent, subsidiary or associated company of that party) software, samples, devices, demonstrations, know-how or other materials of whatever description, whether subject to or protected by copyright, patent, trademark, registered or unregistered design.

2. Undertakings

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

(i) to keep confidential and not disclose to any third party, copy, reproduce, adapt, divulge, publish or circulate any part of or the whole of any Confidential Information without the prior written consent of the Disclosing Party; and

(ii) to restrict access to the Confidential Information disclosed to it under this Agreement to those of its employees and officers who need to know the same strictly for the Purpose; and

(iii) not to use Confidential Information disclosed to it under this Agreement for any purpose other than the Purpose; and

(iv) not to combine any part of or the whole of the Confidential Information with any other information; and

(v) not to disclose the whole or any part of the Confidential Information to any third party without (a) the prior written consent of the Disclosing Party and (b) prior to disclosure to such third party procuring that the third party is bound by obligations which are no less onerous than those contained in this Agreement; and

(vi) to procure that each employee and officer to whom Confidential Information is disclosed under this Agreement is, prior to such disclosure, informed of the terms of this Agreement and agrees to be bound by them; and

(vii) to procure that the Confidential Information in its possession is stored securely and that physical access to it is controlled.

3. Exceptions

3.1 The protections and restrictions in this Agreement as to the use and disclosure of Confidential Information shall not apply to any information which the Receiving Party can show:-

(a) is, at the time of disclosure hereunder, already published or otherwise publicly available; or

(b) is, after disclosure hereunder published or becomes available to the public other than by breach of this Agreement; or

(c) is rightfully in the Receiving Party's possession with rights to use and disclose, prior to receipt from the Disclosing Party; or

(d) is rightfully disclosed to the Receiving Party by a third party with rights to use and disclose; or

(e) is independently developed by or for the Receiving Party without reference or access to Confidential Information disclosed hereunder.

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

4. No title of Use

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

(i)

(ii)

5. No Obligation to Disclose, No Representations

Nothing in this Agreement shall be construed as?

(i) creating an obligation on any of the Parties to disclose particular information; or

(ii) creating an obligation on the parties to negotiate; or

(iii) as a representation as to the accuracy, completeness, quality or reliability of the information.

6. Term & Termination

6.1 Subject to clause 3, the obligations contained in clause 2 shall continue to apply for so long as the Receiving Party has in its possession or has procured that any third party authorized under this Agreement has in its possession any Confidential Information.

6.2 The Receiving Party shall, on the request of the Disclosing Party, return to the Disclosing Party (whose property they shall remain) all documents and things containing Confidential Information, together with all relevant samples and models which it has in its possession pursuant to this Agreement.

7. Miscellaneous

7.1 No Party shall assign its rights and/or obligations pursuant to this Agreement without the prior written consent of the other Party.

7.2 No failure or delay by either party in exercising any rights, power or legal remedy available to it hereunder shall operate as a waiver thereof.

7.3 In the event any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement but this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been set forth herein, and the Agreement shall be carried out as nearly as possible according to its original terms and intent.

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

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

Signed for and on behalf "XYZ Limited"	Signed for and on behalf "ABC Limited"
By its duly authorized representative	By its duly authorized representative

(Signature) ______________________ (Signature) ______________________

(Name) ______________________ (Name) ______________________

(Title/position) ______________________ (Title/position) ______________________

(Date) ______________________ (Date) ______________________

LESSON ROUND-UP

- The objective of due diligence is to Collection of material of information, Identification of strength and threats and weaknesses, to improving the bargaining position, Identification of areas where representations and warranties are required.
- A due diligence process can be divided into three stages i.e. (i) Pre diligence, (ii) Diligence, and (iii) Post Diligence.
- Operational due diligence aims at the assessment of the functional operations of the target company, connectivity between operations, technological up gradation in operational process, financial impact on operational efficiency etc.
- Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement, and throughout the duration, of a commercial agreement respectively.
- The objective of due diligence is to verify the strategic identification or attractiveness of the target company, valuation, risk associated etc.
- Scope of due diligence is transaction based and is depending on the needs of the people who are involved in the potential investments, in addressing key uncovered issues, areas of concern/ threat and in identifying additional opportunities.
- The first and foremost step for the management of the target company, is that the investor is to sign a Letter of Intent (LOI) or a term sheet which underlines the various terms on which the proposed deal is going to be concluded.
- As regards the process of diligence, as a professional care should be taken to scrutinize every document that is made available and ask for details and clarifications, since the Due diligence is a time bound activity and is needed to be wrapped up at the earliest.
- After the diligence is conducted, the professionals submit a report which in common parlance which is called as Due Diligence report.
- Post diligence sometimes result in rectification of non-compliances found during the course of due diligence. There can be interesting assignments arising out of the diligence made by the team of professionals.
- Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement and throughout the duration of a commercial agreement respectively.
- In business transactions, the due diligence process varies for different types of companies. The relevant areas of concern may include the financial, legal, bank, labour, tax, environment and market/commercial situation of the company.

- A legal Due Diligence is a process of assessing all legal risks associated with organisation structure, its assets, contracts, securities, contracts, intellectual property, etc. of the target company.
- Financial Due Diligence is the process of analysing requiring inquiry, analysis and interpretation of financial and operational data to assist a buyer in assessing certain risks and opportunities involved in a potential transaction.

GLOSSARY

Acquisition : Acquisition means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company.

Business Transaction : Business Transaction includes any corporate action relating to the merger, de-merger, amalgamation, take over, joint venture etc.

Exaggerated credentials : Exaggerated Credentials means overstating and misleading the documents, reports, valuations, company's profile etc to describe it as more impressive than it really is.

Intellectual Property : Intellectual Property is a category of intangible asset and includes trademark, copyright, patent, design and geographical indication.

Joint Venture : A joint venture means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

SWOT Analysis : A SWOT Analysis is a technique used to determine and define one's Strengths, Weaknesses, Opportunities, and Threats – SWOT.

Target Company : A target company includes a company chosen as an attractive capital restructuring option by a potential acquirer.

Term sheet : A term sheet is a document containing the material terms and conditions of a potential business agreement, establishing the basis for future negotiations between a seller and buyer.

TEST YOURSELF

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

1. What are the stages of M&A due diligence?

2. Whether Intellectual Property Due Diligence can be considered as Technical Due Diligence? Prepare a brief note.

4. Draft the confidentiality clause of the non-disclosure agreement?

5. What do you mean by the term Non-Disclosure Agreement (NDA)? Explain its functions and content.

6. Describe various heads of Due Diligence of Competition Law?

7. Prepare a brief note on Right to Access Records and Methodology for Diligence Reporting.

8. Mega Ltd. has identified Helping Hands, a reputed NGO for executing its CSR activities as an implementation agency. However, one of the directors suggested it would be better if the company considers to go for a FCRA due diligence before finalizing and appointing the NGO. Explain in brief about the FCRA due diligence.

LIST OF FURTHER READINGS

- ICSI Publication: Guidance Note Guidance Note On Diligence Report For Banks Diligence Report For Banks
- Background Material on Due Diligence by the Institute of Chartered Accountants of India

OTHER REFERENCES (Including Websites / Video Links)

- https://fcraonline.nic.in/home/index.aspx
- https://www.sebi.gov.in/
- https://www.rbi.org.in/
- https://ipindia.gov.in/
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- https://in.indeed.com/career-advice/career-development/due-diligence
- https://www.tinypulse.com/blog/3-examples-of-organizational-change-and-why-they-got-it-right
- https://tradebrains.in/biggest-mergers-acquisition-india/
- https://businesscloud.co.uk/

WARNING

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PROFESSIONAL PROGRAMME
COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE
GROUP 1 • PAPER 3

(This test paper is for practice and self-study only and not to be sent to the Institute)

Time Allowed: 3 Hours *Maximum Marks: 100*

Answer ALL questions

PART I:

Question No. 1

M/s. ABC Limited was incorporated on 29.11.2018 under the provisions of Companies Act, 2013 and having its registered office at Business Enclave, C-58/14, Basant Kunj, New Delhi as per records maintained in the Registrar of Companies. Whereas a complaint has been received from Mr. "X", who is the owner of premises, where the company is having its registered office w.e.f.01.08.2019; wherein the complainant Mr. "X" has complained about the illegal running of company and involved in unlawful activities at his above-mentioned premises.

After inquiry and examination of records by the Investigating Officer it has been observed that the company has not filed Annual Return for the F.Y. 2019-20, 2020-21, 2021-22. Thus, company and its directors has violated the of provisions of Section 92(4) and liable for action u/s 92(5) of the Companies Act, 2013. During the Inquiry it was pointed out by the Investigating Officer that the turnover of the company exceeds the Rs.1000 Crore. Hence, in compliance of the Section 138 of the Companies Act, 2013, the company shall appoint internal auditor & shall conduct audit in the company. However, the company neither appointed internal auditor and nor conducted audit in the company and failed to comply with requirements of section 138 of the Companies Act, 2013. Mr. "Z" is the Company Secretary of M/s. ABC Limited and was not discharge his professional responsibility as a Key Managerial Person towards the Board or to the company.

Whereas adjudication of penalty for violation of Sections 12, 92, 138 of Companies Act, 2013 was initiated by the Adjudicating Officer against the company and its Key Managerial Personnel and the orders passed by the Adjudicating Officer were served upon them through registered post. The copy of were duly served/ delivered upon the M/s. ABC limited and Ms. Moon, Director; while the same notice addressed to other directors returned undelivered on 01.08.2023 from the address of the directors namely Mr. Jupiter and Mr. Mars. It is transpired that the directors namely Mr. Jupiter and Mr. Mars are not present at their declared address as per particulars filled in DIN application form and that they have failed to intimate their change of address with the MCA in the prescribed form DIR-6 as required under Rule 12 of the Companies (Appointments and Qualifications of Directors) Rules, 2014.

Based on the above facts, answer the following questions:

(a) Whether violation of Sections 12, 92, 138 of Companies Act, 2013 by M/s. ABC Limited is Compoundable Offences? Whether joint application by Company and Key Managerial Personnel in default are allowed?

(b) Whether Mr. Jupiter and Mr. Mars are liable under Section 447 of Companies Act, 2013 for the act of concealment/suppression of material fact to the Registrar of Companies for not disclosing the change of address?

(c) "Though a Company Secretary is entitled to enjoy some rights and powers as laid down in the Companies Act, yet his position is not free from liabilities". Comment.

(d) According to the Companies Act, 2013 read with the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the Company Secretary must perform the certain functions and duties. Elucidate.

(5 Marks each)

Attempt all parts of either Q. No. 2 or Q. No. 2A

Question No. 2.

Luke Graves (Luke) is the long-serving Chief Executive Officer (CEO) of Hornbill Ltd., a listed company. He had a meeting with the newly-appointed Chairman of the company, Ross Plank (Ross). A number of different items were on the agenda for discussion. Luke said that he has decided to insert a Compliance framework as a system designed to assist an Organisation to meet its obligations and to Reduce the risk of non- compliance. He further added that a systematic compliance framework establishes better compliance platform by timely compliances with the provisions of various statutes including, laws, rules & regulations, procedures therein. He had also discussed the company's performance over the past few months. Luke added that he had also discussed the company's main business strategies with executives and had informed them that he intended to establish a strategy committee within the company, consisting of the executive directors and other senior executives for implementing the decision. Luke and Ross later on discussed on Compliance monitoring which is the most essential mechanism of corporate compliance framework because it enables companies to recognize whether their compliance framework has been implemented in practice and whether it is practicable, responsive, and suitable for the characteristics of the company. Deliberation also took place for arranging a strong compliance training and education program which reinforces company compliance culture.

Based on the Luke and Ross meeting and discussions, answer the following questions:

(a) Elucidate the components of corporate compliance framework.

(b) At the time of discussion on corporate compliance framework of the company, Mr. Ross commented that the Compliance Chart is a vital part of the framework and the company must at present first focus on preparation of the Compliance Chart. Explain the activities in preparation of a compliance chart and its contents.

(c) "Compliance monitoring is the most essential mechanism of corporate compliance framework because it enables companies to recognize whether their compliance framework has been implemented in practice and whether it is practicable, responsive, and suitable for the characteristics of the company". Explain.

(d) "A strong compliance training and education program reinforces company compliance culture" Comment.

(5 Marks each)

OR (Alternate Question to Q. No. 2)

Question No. 2A

(i) A complaint of professional misconduct is filed with ICSI against Ravi, a Practicing Company Secretary. The Disciplinary Committee of ICSI is of the opinion that Ravi is guilty of professional misconduct mentioned in the Second Schedule to the Company Secretaries Act, 1980. The Committee, after affording Ravi an opportunity of being heard, ordered for removal of his name from Register permanently and also imposed penalty of Rs.10 lakh. Is the action of the Committee valid? What actions can the Board of Discipline (a separate authority) take if it is of the opinion that a member is guilty of professional misconduct mentioned in the First Schedule to the Act, 1980?

(ii) ABC Ltd. had a paid-up share capital of Rs. 275 crores in the previous year 2022-23. Explain how a Practicing Company Secretary can prepare himself for such a big assignment before undertaking the work relating to pre-certification so that the chances of incorrect certification will not be there.

(iii) 'S' was appointed as Managing Director of VPR Mart Limited recently. During the meeting of the Board, he desires that all agenda files should be sent by email encrypted by password. He also desires that to protect the file from hacking, there should be some special name to the file. As a company secretary, kindly highlight any eight best practices for file naming.

(iv) Thinking Star Limited, a Public Limited Company was into manufacturing of steel and steel products. The Company wanted to expand its operations and to fund the same, it evaluated various options including bank loan, private placement, etc. However, due to a paucity of time the Company went ahead and funded its operations by issuing shares to a friend of Mr. XY, the Managing Director of the Company on private placement basis. The Company failed to comply with the provisions of the Companies Act, 2013. Mr. XY was not willing to act, unless there was any notice from the regulators. Mr. S, the Corporate Advisor to the Company suggested Mr. XY to compound the offence as it would be in the best interest of the Company.

Under the Companies Act, 2013, where a Company seeks compounding before institution of any prosecution, whether any prosecution shall be instituted in relation to such offences either by Registrar of Companies or any person authorised by the Central Government'?

(5 Marks each)

PART – II

Question No. 3

Managing Director, Chief Financial Officer and Company Secretary of the ABC Limited were having a meeting on angles of independence of audit and conducted research on top hundred companies for their adaptation of criteria of internal audit.

The Company secretary of the company has conducted detailed research and shown below facts:

Independence of audit refers to the independence of the auditor including statutory auditor, internal auditor, secretarial auditor, cost auditor or any other external auditor from parties that may have a financial interest in the business being audited. The auditor plays a critical role in lending independent credibility to published financial statements

used by investors, creditors and other stakeholders. The company should ensure that the annual audit is conducted by an independent, qualified and competent auditor in accordance with high-quality auditing standards in order to provide an external and objective assurance to the Board and Shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

Observation:

Out of the total companies evaluated, in 62% of the company's Internal Audit is conducted by an External Agency and in 38% of the companies it is conducted by the Internal Team.

Independence of audit is the foundation of the auditing profession. An independent, reliable, and ethically sound audit enhance the credibility of a company and allows the public to trust the accuracy of the results and the integrity if the accounting profession.

Based on the above discussion, answer the following questions:

(a) The concept of the internal audit has been recognized as a statutory exercise under Section 138 of the Companies Act, 2013, and has been made mandatory. As per Rule 13 of Companies (Accounts) Rule, 2014, the certain class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate. Explain.

(b) Discuss the factors impairing the independence of internal auditors. Elucidate.

(c) "Internal Audit effects the efficiency of internal control, operations, the reliability of financial reporting, deterring and detecting fraud and compliance with laws and regulations". Comment.

(5 Marks each)

Question No. 4.

You are a Company Secretary of a manufacturing company; the company has enrolled your name for attending a 2 days residential workshop on the topic “risk management’. You have attended the workshop and prepared below mentioned notes:

In the corporate context, ‘Risk’ may be defined as the possibility of an occurrence of event that can adversely affect the achievement of a company’s objectives and goals. Risk is inherent in every business, whether it is of financial nature or non-financial nature. Thus, management of the risk is very important.

Risk management is a structured, consistent and continues process, applied across the Organisation for the identification and assessment of risks. Control assessment and exposure monitoring.

Risk management begins with the risk identification, analyzing the risk factors, making an assessment of the risk and mitigation of the risk. Better risk management techniques provide early warning signals so that the same may be addressed in time. In a traditional concept, the natural calamities like fire, earthquake, flood etc. were only treated as risk and keeping the safeguard equipment, etc. were assumed to have mitigated the risk.

But now, in the era of fast-changing global economy, the management of various types of risks (for example-industry and service risks, management and operational risks, market risks, political risks, disaster risks, sustainability risks, cyber security risks etc.) has gained utmost importance. The International Organisation for Standardization (ISO) has also identifies principles of risk management.

Based on the above-mentioned notes, answer the following questions:

(a) Risk profiling of a Company may include the certain types of risks. Explain.

(b) Elucidate Risk Assessment considering the existing Internal Control Mechanism.

(c) Risk management begins with the risk identification, analyzing the risk factors, making an assessment of the risk and mitigation of the risk. Analyze.

(5 Marks each)

Question No. 5

(i) M/s S. Core Advisory Services Pvt. Ltd. has submitted its bid invited through International Bidding Process by RE Textiles & Yarns Ltd. Being a lowest bid, the letter of award was issued in favour of M/s S.Core Advisory Services Pvt. Ltd. for providing consultancy services to set up a Knitting Fabric Plant at Maharashtra. M/s S.Core Advisory Services Pvt. Ltd. is already providing consultancy services to various organizations in India and outside India. RE Textiles & Yarns Ltd. asks M/s S.Core Advisory Services Pvt. Ltd. to enter into a Non-Disclosure Agreement. The Agreement is proposed to be signed at Mumbai. The Management of RE Textiles & Yarns Ltd. wants to include the following clauses in the Agreement:

  (1) No Title to Use

  (2) No Obligation to Disclose, No Representations

Prepare a brief note on above two clauses required to be included in the Non-Disclosure Agreement.

(ii) Z Ltd. is a listed Company, in pharma sector. During the Covid-19, for expansion, it acquired M Ltd., which is an unlisted Company. The medicine in Highly demand named ‘ROLO’ was produced by M Ltd. in large quantity. During the investigation, it was found that there was big scam, where the merged entity has given huge incentives amounting Rs. 2000 Crore approximately to medical professionals for recommending the ROLO. The government has also constituted a special committee to report on the same. A Company Secretary firm was engaged to report on fraud. In view of this type of cases, what other types of transactions to be noticed under the term of ‘Fraud’. Who is considered as an Auditor for fraud reporting?

(iii) Discuss the types of information with respect to ‘Maintenance of Professional Skills and Standards’ are sought by Quality Review Board during the peer review of Practicing Company Secretary/Firm.

(5 Marks each)

Attempt all parts of either Q. No. 6 or 6A

Question No. 6.

(a) X, Y and Z are three partners in JK LLP, a firm of Practicing Company Secretaries. X holds 1% paid-up share capital in ABC Ltd. Y holds shares of nominal value of Rs. 70,000/- in ABC Ltd. Referring the provisions relating to ICSI Auditing Standards, advise whether JK LLP can be engaged for the Secretarial Audit of ABC Ltd.

(5 Marks)

(b) ABC Pvt. Ltd. is a subsidiary company of a XYZ Ltd. having a paid-up capital of Rs. 60 Crore and Turnover of Rs. 180 crores as per the audited balance sheet as on 31st March, 2021. Referring to the provisions of the Companies Act, 2013, answer the following:

(i) Whether the ABC Pvt. Ltd. is obliged for conducting of secretarial audit?

(ii) Whether the Cost Accountant in Practice who is also a Company Secretary can be a competent professional for the appointing as a 'Secretarial Auditor'?

(iii) To whom the secretarial audit report is required to be addressed?

(iv) In which prescribed form secretarial audit report is required to be submitted by the auditor?

(v) What are the penal provisions, if Secretarial Auditor doesn't comply with the provisions of section 143 (12) of the Companies Act, 2013?

(5 Marks)

(c) You as a practicing Company Secretary has been approached by Popular Bank to carry out due diligence regarding the loan of Rs. 50 crores to be given to Weak Ltd. How would you find that the company has misused borrowed funds from banks/ financial institutions from the purpose for which they were borrowed and there has been Siphoning of Fund?

(5 Marks)

OR (Alternate questions to Q. No. 6)

Question No. 6A

Since the last ten years, Vijaya Ltd. has been misreporting its financial accounting accounts, which have been duly audited by the Practicing Chartered Accountants (PCA) Partnership business. Vijaya Ltd. had no choice but to declare itself as bankrupt when the company's financial situation deteriorated to the point that it was unable to pay any current liabilities as well. During the discussion and under pressure from stakeholders, Vijaya Ltd. published a press release claiming that there is a discrepancy between actual and reported earnings over the last decade due to accounting irregularities.

During the course of the forensic audit, it was discovered that the auditing firm's independence had been compromised by a huge audit fee and hefty consultant income. Because Vijaya Ltd. was such a significant client for PCA, it had intentionally signed off on incorrect statements to protect the company's management. The examination also discovered a number of serious internal control flaws, including a lack of effective management oversight of the external reporting process and a disregard for applicable accounting standards.

Assuming the above-mentioned circumstances for the secretarial audit done by Mr. X (PCS) for Vijaya Limited, answer the following questions:

(i) Briefly explain the Procedure of Forensic Auditing Investigation.

(ii) Audit fee which is to be charge by the auditor depends on several factors, Elucidate.

(iii) How Internal Audit effects the efficiency of internal control, operations, the reliability of financial reporting, deterring and detecting fraud and compliance with laws and regulations?

(5 Marks each)