

## ***Corporate Compliance and "Due Diligence"*** – Value addition

Corporate Compliance is the latest buzzword in the corporate world after the much publicised Corporate Governance. If we believe that corporate governance is here to stay, then corporate compliance has to start performing. Today corporate India has realised the importance of compliance as the only tool for achieving greater accountability in Governance issues and in being compliant will achieve *excellence through business value addition*. To ensure that there is sufficient compliance; corporates are putting in sufficient efforts to maintain records in-house and elsewhere diligently.

Being "diligent" has a price and its share of emotions, sentiments, tragedy, comedy and of course when finally things turn out favourable, a very happy ending.

My first brush with diligence was in 1996, while working for a large telecom group when we were informed that the company was to come out with the first ADR issue in the country. One great thing about "being first", I sometimes used to wonder, of course on a light note since no one knows what is to be done, what you do may be the right one.

A pre diligence meeting was called for comprising the head of the company and various other departmental heads. A leading banker was appointed to manage the ADR issue and a smart business school graduate informed the team that he would lead manage and he will be the "censor board" for the proposed diligence and that the members of the team are supposed to check with him before committing on "numbers", if it is the finance team or on the "facts" if it was the legal and Company Secretary's team. Not knowing what to say being the first time all of us nodded our head left to right.

It all began with a grand kick off meeting and it reminded me of the opening scene in a bond movie. I think even after 11 years the "kick off" meetings are of great significance which makes the diligence interesting.

The dictionary meaning of the word "***Due Diligence***" as a measure of prudence, activity or assiduity as is properly to be expected from, and ordinarily exercised by a reasonable and prudent man under particular circumstances, not measured by any absolute standard, but depending on the relevant facts of the special case.

Expression due diligence in commercial transactions include investigating into the matters of a company and assessing the risks in a commercial context.

**What is in a name, diligence also can have many names which include -**

**A Compliance Certificate** – this form of diligence is a requirement under section 383A of the Companies Act, 1956 which makes it mandatory for all companies with a paid up share capital of not less than rupees ten lakhs and not more than rupees two crores to attach along with the Directors' report a certificate from a practising company secretary for every financial year.

**A Secretarial audit** – Though this form of diligence is not mandatory many state government companies/ companies in private sector have adopted this form of reporting and have attached to their annual report as a matter of good governance.

**Legal Compliance** – on an annual basis some of the corporate conduct this diligence in house to check on the various processes that the company has internally and whether compliances are in place.

**Annual Compliance Review** – another interesting form of diligence which can be an in house affair by leading corporate house to ensure that the house is in order.

**Quarterly statutory compliance reporting** – A popular form of health check that is in vogue in many corporate to protect the interest of the top management. A certification is provided by the CEO to the Board and in turn a back to back certification is obtained by various departmental heads.

**Health Check Audit** – this form of diligence is popular among venture capital funds who conduct this exercise on an annual basis to check if the compliance parameters in the company are under control

**CEO / CFO certification under clause 49** – this is another form of diligence which is mandatory for all listed company in India to attach to its Directors' report a certificate to be certified by the CFO/ CEO of the company that the company has complied with all the requirements in law.

All this in today's parlance is termed as corporate compliance and as Company Secretaries, we are the torch bearers of the legal and corporate law diligence either representing the company or in practice.

It is fun to be on either side of the table the only difference being in practice you play an offensive role and in employment a defensive role. Any diligence can be divided into three parts i) a pre diligence ii) the diligence and iii) post diligence

A **pre DD diligence** would include the following which primarily deals in management of paper, files and people.

1. Signing of on a Letter of Intent (LoI) and the Non Disclosure Agreement (NDA).
2. Receive and review the checklist
2. Identifying the issues
3. Organising the papers required for a diligence
4. Creating a data room

The first and foremost in a deal is for the management of the target company and the investor to sign off a Letter of Intent or a term sheet which underlines the various terms on which the proposed deal is to be concluded. Immediately on receipt of the LoI the investors sign off on a NDA with the various agencies doing a diligence which may be finance, accounting, legal and secretarial.

Being corporate Lawyers let us review the details that go into a legal diligence, on receipt of the checklist by the company which is very exhaustive in nature the company can either get into the task in-house or outsource this to an external agency to organise the data. While the data is being collated care should be taken to close all open ended issues that may arise out a pre diligence that the company can conduct.

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

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

**During the diligence** care should be taken to adhere to the hospitality issues:

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

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

After the diligence is conducted the professionals would submit a report in common parlance which is called the DD report. These reports can be of various kinds a summary report; a detailed report; and the findings mentioned in the report can be very significant in as much as the deal is concerned and the terms used to define the outcome of these reports are:

***Deal breakers***, in this report the findings can be very glaring and may expose the various non-compliance that may arise – any criminal proceeding or known liabilities

***Deal diluters***; the findings arising out a diligence may contain violations which may have an impact in the form of penalties which may be quantified and in turn may result in diminishing the value of company.

**Deal cautioners;** are those findings in a diligence which may not impact the financials but may be certain non compliances which are rectifiable but the company is required to be cautious.

**Deal makers,** which is 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 are would submit what is called a clean report.

Interestingly, once the reporting formalities are over and the various rectifications are carried out, the most important documentation is the Shareholders agreement which will include some of the Standard clauses like the tag along and drag along rights; representations and warranties; Condition precedents, that have an impact on the deal and others.

**Post 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.

Hence arising out of this diligence can be various opportunities for a professional in practice which may include interalia compounding application to the statutory bodies, amending the various shortcomings and so on. In fact filing of these applications becomes a pre condition to close a transaction and where the expertise of professionals is sought after.

Diligence is one tool in compliance which can add excellence in compliance and is a business value addition as far as a professional is concerned, who is employed and in practice.

Thus one can sum up to say that "Compliance is not the beginning in a well governed company, but is a statement by the management on the attitude of one and all in an organisation practiced in letter and in spirit". A due diligence exercise proves the level of compliance in a corporate and acts as a health check to ensure that the standards are maintained.