

DUE DILIGENCE - A KEY SUCCESS FACTOR FOR MAJOR BUSINESS TRANSACTIONS & MCA UPDATES RELATING TO LLP



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INTRODUCTION

Due Diligence (DD) is a word which has gained more popularity in the recent past, due to various legal and regulatory requirements. It has opened up a lot of opportunities for professionals.

Due diligence is an inspection and risk assessment of an upcoming business transaction; it is a background check to make sure that the parties to the transaction have the required information they need, to proceed with the transaction. A proper due diligence is required to reveal misrepresentation and fraudulent dealings in a major business transaction.

Thus, it may be stated that Due diligence is a process of:

- i) Analysing various aspects to estimate potential company.
- ii) Assessing the financial viability of the entity in terms of its assets and liabilities at a comprehensive level.
- iii) Examining the operations and verifying the material facts related to the entity.

At times, the scope of a diligence and audit appears to be same, but the expected outcome of both are quite different. Statutory Audit is limited to Financial Analysis and is a recurring event based on the historical data whereas the due diligence does not only cover the financial aspect but also includes business plan, legal issues, sustainability of business, management prospects etc. Due Diligence is conducted occasionally and covers the future prospect in addition to the historical data.

It is important to understand the right approach to do a diligence since now we professionals have been empowered with the responsibility of conducting due diligence for various purposes and the report is relied on by various authorities therefore it is essential to understand the significance of DD and the principles to be followed while conducting the DD.

Objective of Due Diligence

- Collect the material information from the target Company
- Conducting SWOT analysis to identify its strength and weakness
- To take correct decision about an investment
- To disclose the correct and complete information
- To make Accurate and Smooth decision

If the DD is based on a regulatory requirement, it establishes compliance of provisions or exhibits the position of the entity and is expected to bring out all the relevant information, which is required to be divulged to the regulatory or statutory authority. DD is a concise summary of facts happened over a period of time, which is collated and analysed with the perspective of the Scope of the DD and gives the correct position at any given point of time which helps the parties in taking a decision on the issue for which the DD is conducted.

SIGNIFICANCE AND IMPORTANCE OF DUE DILIGENCE

DD is a useful tool for review of areas in which there is prima facie concern. It provides an opportunity to look at contingent liabilities standing firmly in the present.

Misrepresentations and fraudulent dealings are not always obvious or straight. These are to be uncovered, especially in a major business transaction, as it would create a major impact on the business. Proper due diligence services explore and assess the details behind the same and inform about the financials, business, internal systems, profitability, key operational aspects, management team, promoters and other material factors which will help in making an accurate decision about an investment. Due diligence is designed to protect the interests of the Company by providing objective and reliable information before making any commitments. Due diligence is necessary to allow the investigating party to find out everything that one needs to know about the subject of the diligence.

Due Diligence is understood to be an investigation or exercise of care that a reasonable business or person is normally expected to take before entering into an agreement with another party or an act with certain standard of care. The theory behind DD holds that performing this type of investigation contributes significantly to informed decision making by enhancing the amount and quality of information available to decision makers and by ensuring that this information is systematically used to deliberate on the decision on hand and all its costs, benefits and risks.

It takes the decision makers to the past, the present and the future of an enterprise.

DIFFERENT FORMS AND TYPES OF DD AND BUSINESS TRANSACTIONS

Different forms and types of DD depending upon on the purpose.

- examination of potential target for merger, acquisition, privatization, partnership
- an investigation focussing on material future business;
- Public offer
- Joint Venture and Collaborations
- Financial Due Diligence
- Legal Due Diligence
- Tax Due Diligence

SCOPE AND REQUIREMENT

It is very essential to understand the scope and requirement of a DD, since this will help identify the areas to be covered and the pertinent questions to be asked. DD is an investigation into the required aspects and the outcome in the form of report should bring out the necessary information to the recipient. The due diligence framework gives you a structured approach to research and to achieve this end result, certain points and factors one should keep in mind :-

- a) Evaluate the Objectives and Purpose in Mind.
- b) Areas of Due Diligence
- c) Analysis of Business Financials
- d) Complete Review on finance, legal, secretarial etc aspect
- e) Review of various Policies
- f) Filings with ROC/ SEBI/ Stock exchanges / tax authorities;
- g) Internal reports like MIS reports, Internal Audit report to be checked.
- h) Thorough Inspection of Documents, Minutes, Agreements
- i) an examination being conducted by asking certain key questions and preparing the detail checklist
- j) an investigation into the current practices of process and policies

The above is by no means an exhaustive list and more items could be added on the basis of the scope, specific subject of DD and the extent of the DD to be conducted.

DD is a process and a procedure to look at from a close angle the business transactions conducted by the company over a period of years. This does not mean that the transactions have to be considered in a doubtful manner but with an open mind. This requires a peep into future effect of past transactions from the point of view of finding out hidden losses, if any, which will have the effect of increasing liability of the company.

DUE DILIGENCE: IT'S IMPACT

Due Diligence ensures that regulatory decision-makers have sufficient information to decide if it should be allowed to proceed. It involves elements of both risk assessment and risk management.

India presents a varied economic, regulatory, and legal landscape for doing business. India nowadays has been set as a lucrative destination for foreign investment. Its large untapped resources, labour force, are lead source of attraction in the Indian economy. Ever since India opened its doors to the global market, many foreign-based firms have been aggressively looking to invest in the Indian market, and even vice versa. Due diligence in India is generally performed by a company before any merger & acquisition, private equity investment, raising funds through IPO, FPO, right issue, bonds bank loan funding, etc. Indian companies have recognized that in order to confirm with international standards of due diligence, the practice must be incorporated in their framework. That due diligence becomes a powerful tool for companies to ensure that it is able to manage the risk prior to entering into a business transaction. Due Diligence is now finding deserved place in Indian Statutes. Mandatory provisions have been introduced for the conduct of due diligence under various statutory laws.

CONCLUSION

Diligence is an indispensable element of any form of business organization. Right from the setting up of business, managing organic and inorganic growth of business, dealing with legal issues and so on and so forth. It is heartening to note that Due Diligence has gained substantial footprints in India and DD provides with an excellent business opportunity to the professional and should be conducted meticulously with a professional approach. The task is multi-dimensional in nature and has a company-wide effect. It requires a sound knowledge of the relevant laws and the degree of care required is of utmost importance and it is what a reasonable person is expected to exhibit.

We professionals act as a catalyst in due-diligence. We are known as “Governance Professionals” and are called upon to guide the corporate board on various strategic, governance-related and compliance issues.

With this scope, at every step there is a need for professionals to alter their roles while undertaking any compliance and to perform utmost due-diligence with respect to same.

MCA UPDATES RELATING TO LLP

- **WEB BASED LLP FILLING**

The Ministry of Corporate Affairs has launched a new way of e-filing for LLP on MCA21 portal. All LLP filings going forward will be web based.

- **LLP (AMENDMENT) ACT 2021**

LLP Amendment Act 2021 is meant to support the 'ease of doing business' initiative, by extending a helping hand for the Start-up India community, as the amendments provide for decriminalizing certain offences, introducing the concept of small LLPs, appointment of adjudicating officers/ special courts, etc. This will help the small business houses to do their business by incorporating LLPs without fear of prosecution, reduced compliances and their costs etc.

Section 1 to 29 of LLP (Amendment) Act 2021 shall be applicable from 01.04.2022

Key Amendments

Introduction of Small Limited Liability Partnership

“Small Limited Liability Partnership” means a Limited Liability Partnership the contribution of which does not exceed twenty-five lakh rupees or such higher amount, not exceeding five crore rupees, as may be prescribed; AND

the turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed; OR

OR which meets such other requirements as may be prescribed and fulfills such terms and conditions as may be prescribed.

RESIDENT OF INDIA:

The LLP (Amendment) Act, 2021 amended the Section 7(1) of the LLP Act, 2008 by substituting the words “eighty-two days during the immediately preceding one year” by “twenty days during the financial year”. Therefore, a person who is resident in India for just 20 days in financial year can be appointed as Designated Partner.

ACCOUNTING STANDARDS FOR CLASSES OF LLPs:

The Central Government may, in consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013, –

- a. prescribe the standards of accounting; and
- b. prescribe the standards of auditing

as recommended by the Institute of Chartered Accountants of India constituted under section 3 of the Chartered Accountants Act, 1949, for a class or classes of limited liability partnerships.

CHANGE OF NAME OF LIMITED LIABILITY PARTNERSHIP:

A limited liability partnership, is registered by a name which is identical with or too nearly resembles to that of any other limited liability partnership or a company; or a registered trade mark of such proprietor the Central Government may direct that such limited liability partnership to change its name or new name within a period of three months from the date of issue of such direction:

If the limited liability partnership is in default the Central Government shall allot a new name to the limited liability partnership which the limited liability partnership shall use thereafter:

COMPOUNDING OF OFFENCE:

The Regional Director or any other officer not below the rank of Regional Director authorised by the Central Government may compound any offence under this Act which is punishable with fine only.

A sum which may extend to the amount of the maximum fine provided for the offence but shall not be lower than the minimum amount provided for the offence

It is hereby clarified that any second or subsequent offence committed after the expiry of the period of three years from the date on which the offence was previously compounded, shall be deemed to be the first offence.

Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Regional Director Etc.

ESTABLISHMENT OF SPECIAL COURT FOR SPEEDY TRIAL OF OFFENCES:

The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts etc.

PAYMENT OF ADDITIONAL FEES:

It shall be noted that different fees or additional fees may be prescribed for different classes of Limited Liability Partnerships or for different documents or returns required to be filed under the LLP Act, 2008 or Rules made there under.

GENERAL PENALTIES:

If a Limited Liability Partnership or any Partner or any Designated Partner or any other person contravenes any of the provisions of the LLP Act, 2008 or the Rules made there under for which no penalty or punishment is provided elsewhere in this Act, the person, who is in the default, shall be liable to a penalty of five thousand rupees and in case of a continuing contravention with a further penalty of one hundred rupees for each day after the first during which such contravention continues, subject to a maximum of one lakh rupees.

ADJUDICATION OF PENALTIES.:

The Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government, not below the rank of Registrar, as adjudicating officers

The Central Government shall, while appointing adjudicating officers, specify their jurisdiction in the order ETC

POWER TO REMOVE DIFFICULTIES:

If any difficulty arises in giving effect to the provisions of this Act as amended by the Limited Liability Partnership (Amendment) Act, 2021, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act, as may appear to it to be necessary for removing the difficulty, within three years from the date of commencement of the Limited Liability Partnership (Amendment) Act, 2021.”.

JURISDICTION OF COURTS:

The Special Court referred to in clause (a) of sub-section (2) of section 67A shall have jurisdiction and power to impose punishment. The criminal cases pending before the court of Judicial Magistrate of the first class or Metropolitan Magistrate, as the case may be, shall be transferred to the Special Court

COGNIZANCE OF OFFENCES

No court, other than the Special Courts referred to in section 67A, shall take cognizance of any offence punishable under this Act or the rules made there under save on a complaint in writing made by the Registrar or by any officer not below the rank of Registrar duly authorised by the Central Government for this purpose.

DE-CRIMINALIZATION OF MONETARY PENALTIES:

The overall number of criminal provisions under the LLP Act, 2008 will be reduced and number of offences are decriminalized under LLP Act, 2008

