

FREQUENTLY ASKED QUESTIONS ON SECRETARIAL AUDIT



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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Disclaimer:

The Institute with a view to facilitate the members to conduct Secretarial Audit has compiled Frequently Asked Questions on conducting the Audit.

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FAQs on Secretarial Audit

1. What is Secretarial Audit?

Secretarial Audit is an audit to check compliance of various legislations including the Companies Act and other corporate and economic laws applicable to the company.

The Secretarial Auditor expresses an opinion as to whether there exist adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines. Secretarial Audit helps to detect the instances of non-compliance and facilitates taking corrective measures. It audits the adherence of good corporate practices by the company.

It is therefore an independent and objective assurance intended to add value and improve operations of the Company. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

Secretarial Audit thus provides necessary comfort to the management, regulators and the stakeholders, as to the statutory compliance, good governance and the existence of proper and adequate systems and processes.

2. What are the benefits of Secretarial Audit?

Secretarial Audit can be an effective multi-pronged weapon to assure the regulator, generate confidence amongst the shareholders, the creditors and other stakeholders in companies, assure FIIs/FIs/SFCs/SIDCs/Banks and instill self regulation and professional discipline in companies. It is a tool of risk mitigation and will allow companies to effectively address compliance

risk issues. It helps the companies to build their corporate image.

Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce positive results to the stakeholders of a company:

(a) *Promoters*

Secretarial Audit assures the promoters of a company that those in-charge of its management are conducting its affairs in accordance with the requirements of laws and the owners' stake is not being exposed to unintended risk.

(b) *Non-executive/Independent directors*

Secretarial Audit provides comfort to the Non-executive/Independent Directors that appropriate mechanisms and processes are in place to ensure compliance with laws applicable to the company, thus mitigating any risk from a regulatory or governance perspective.

(c) *Government authorities/regulators*

It also facilitates reducing the burden of the regulators in ensuring compliances and they can take timely actions against the offenders.

(d) *Investors*

Secretarial Audit helps the investors in taking informed investment decision, as it evaluates the company in terms of compliance and governance norms being followed by the company.

(e) *Other Stakeholders*

It is an effective due diligence exercise for the prospective investors or joint venture partners. Further Financial Institutions, Banks, Creditors and Consumers can measure the law abiding nature of company management.

(f) Benefits to the company itself

- Companies that go the extra mile with their compliance programs lay the foundation for good governance.
 - Companies with an effective compliance management programme have lesser chance of receiving penalties, both monetary and by way of imprisonment.
 - Companies that imbibe business and personal ethics and an effective compliance management programme within their work culture often enjoy employee and customer loyalty and public respect for their brand, which can translate into better market capitalization and shareholder returns.
- Recognition for the company as a good corporate citizen.

The Secretarial Audit provides an in-built mechanism for enhancing corporate compliance generally and help restore the confidence of investors in the capital market through greater transparency in corporate functioning.

3. Who can conduct Secretarial Audit?

Only a member of the Institute of Company Secretaries of India holding certificate of practice (company secretary in practice) can conduct Secretarial Audit and furnish the Secretarial Audit Report to the company. [Section 204(1) of Companies Act, 2013]

4. Which companies are required to undergo Secretarial Audit?

As per section 204(1) of Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following companies are required to obtain Secretarial Audit Report:

- Every listed company;
- Every public company having a paid-up share capital of fifty crore rupees or more; or
- Every public company having a turnover of two hundred fifty crore rupees or more.

“Turnover” means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year. [Section 2(91)]

5. Whether the Secretarial Audit is voluntary or mandatory as per the provisions of Companies Act, 2013?

Pursuant to the provisions of section 204 of the Companies Act 2013, every listed company and company belonging to class of companies as prescribed is required to annex with its Board’s report, a Secretarial Audit Report given by a Company Secretary in Practice.

Companies which are not covered under section 204 may obtain Secretarial Audit Report voluntarily as it provides an independent assurance of the compliances in the company.

6. What is periodicity of Secretarial Audit?

Proactive Secretarial Audit on a continuous basis would help the company in initiating corrective measures and strengthening its compliance mechanism and processes. It is therefore, advisable that the Secretarial Audit is carried out periodically (quarterly / half year / annually) and adverse finding if any, is reported on interim basis to the Board immediately.

The Secretarial Audit Report to be annexed with Board’s report is required to be submitted before the preparation of Board’s Report.

7. What is the format of Secretarial Audit Report?

Secretarial Audit Report is required to be provided in the format prescribed in Form MR-3. (Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014).

8. What are the laws specifically mentioned in MR-3 which need to be examined while conducting the Secretarial Audit?

In terms of Form MR-3, the Secretarial Auditor needs to examine and report on the compliance of the following five specific laws:

- (i) The Companies Act, 2013 (the Act) and the rules made thereunder;
- (ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder;
- (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder;
- (iv) Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;
- (v) The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act'):-
 - (a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
 - (b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
 - (c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;

- (e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
- (f) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;
- (g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
- (h) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;

In addition, the form MR-3, point (vi) also refers to 'Other laws as may be applicable specifically to the company.'

9. What is the coverage of 'Point (vi) (other laws as may be applicable specifically to the company)' in Form MR-3 ?

The Council of the ICSI at its 226th meeting held on November 21, 2014 decided on the Scope of Secretarial Audit as regards "point (vi)(other laws as may be applicable specifically to the company)", which is placed as under:

- Reporting on compliance of 'Other laws as may be applicable specifically to the company' which shall include all the laws which are applicable to specific industry for example for Banks- all laws applicable to Banking Industry; for insurance company-all laws applicable to insurance industry; likewise for a company in petroleum sector- all laws applicable to petroleum industry; similarly for companies in pharmaceutical sector, cement industry etc.
- Examining and reporting whether the adequate systems and processes are in place to monitor and ensure compliance with general laws like labour laws, competition law, environmental laws etc.

10. Whether financial laws need to be examined while conducting secretarial audit?

In case of financial laws like tax laws and Customs Act etc., Secretarial Auditor may rely on the Reports given by Statutory Auditors or other designated professionals.

11. What are the 'other areas' which need to be checked?

Secretarial Auditor needs to examine and report on the compliance with the applicable clauses of the following:

- (i) Secretarial Standards issued by The Institute of Company Secretaries of India and approved by the Central Government.
- (ii) The Listing Agreements entered into by the Company with Stock Exchange(s), if applicable;

Format of Secretarial Audit Report also requires reporting on whether-

- The Board of Directors of the Company is duly constituted with proper balance of Executive Directors, Non-Executive Directors and Independent Directors.
- The changes in the composition of the Board of Directors that took place during the period under review were carried out in compliance with the provisions of the Act.
- Adequate notice is given to all directors to schedule the Board Meetings, agenda and detailed notes on agenda were sent at least seven days in advance, and a system exists for seeking and obtaining further information and clarifications on the agenda items before the meeting and for meaningful participation at the meeting.
- Majority decision is carried through while the dissenting members' views are captured and recorded as part of the minutes.

- There are adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines.

12. What are events & actions required to be reported by the Secretarial Auditor in the audit report?

Secretarial Auditor is required to report and provide details of specific events and actions occurred during the reporting period having major bearing on the affairs of the Company in pursuant to above referred laws/ rules & regulations. Few events were also given as example in the format of audit report.

13. What is the minimum fees to be charged with respect to conducting of secretarial audit?

There is no minimum fees prescribed by ICSI for conducting Secretarial Audit by Company Secretary in practice.

However, it would be in the fitness of things that Company Secretary in practice takes proper call about fees considering the nature & size of the company, type of company and the efforts required to be put in while carrying out Secretarial Audit.

It is expected that member should maintain high standard and quality in audit process.

14. Is there any restriction on number of Secretarial Audits?

As of now, ICSI has not placed any restrictions on number of audits that can be conducted by a Company Secretary in Practice in one financial year.

15. Is there a requirement of peer review of Secretarial Auditors?

As of now, there is no requirement of peer review of Secretarial Auditors.

16. What are the ICSI initiatives in this regard?

- The Institute has brought out 'Guidance note on Secretarial Audit' to familiarize its members about the complexities and nuances of Secretarial Audit and the manner of preparing a Secretarial Audit Report and also to prepare them to accomplish the task to the utmost satisfaction of all stakeholders.
- Special issue of Chartered Secretary on Secretarial Audit- January, 2015.
- Capacity building workshops are proposed to be conducted on Secretarial Audit across the country by the Institute and its Regional Councils and Chapters.
- Industry meet proposed with chambers of commerce, CII, FICCI, ASSOCHAM and other local bodies to explain the significance of Secretarial Audit to the Corporate Sector.

17. Who can sign the Secretarial Audit Report?

The Secretarial Audit Report should be signed by the Secretarial Auditor who has been engaged by the company to conduct the Secretarial Audit and in case of a firm of Company Secretaries, by the partner under whose supervision the Secretarial Audit was conducted.

While conducting and signing Secretarial Audit Report, Company Secretary in Practice should ensure that he holds the valid certificate of practice number.

18. How is the Secretarial Auditor appointed?

As per Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, Secretarial Auditor is required to be appointed by means of resolution passed at a duly convened Board meeting.

It is advisable for Secretarial Auditor to get the letter of engagement from the company. Secretarial Auditor should formally accept the letter of engagement.

Further, as a prudent corporate practice, it is advisable that change in the Secretarial Auditor during the year are reported to the members in the Board's Report.

19. Whether communication to earlier incumbent is required ?

Yes, whenever a practicing company secretary is appointed as Secretarial Auditor in place of the existing Secretarial Auditor, he/she should communicate the appointment to the earlier incumbent in writing, in view of the provisions of clause (8) of Part I of the First Schedule to the Company Secretaries Act, 1980 and the relevant pronounced judgments.

20. Is Secretarial Auditor required to get the notice of Annual General Meeting in which his report is to be laid before the members?

Para 1.2.1 of Secretarial Standard on General Meetings requires that the notice in writing of every Meeting shall be given to every Member of the company. Such Notice shall also be given to the Directors and Auditors of the company, to the Secretarial Auditor, to Debenture Trustees, if any, and, wherever applicable or so required, to other specified persons.

21. What are the rights and duties of Secretarial Auditor under the Companies Act, 2013?

Section 143 of the Companies Act, 2013 deals with powers and duties of Auditors. Sub-section (14) of the section provides that the provisions of this section shall *mutatis mutandis* apply to the Company Secretary in Practice conducting Secretarial Audit under section 204.

22. What is the professional responsibility and penalty for incorrect audit report?

Section 448 of Companies Act, 2013 deals with penalty for false statements. The section provides that if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

Section 447 deals with punishment for fraud which provides that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. In case, the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

In terms of Section 448, a Company Secretary in Practice is liable to attract penal provision if, he makes statement in the Secretarial Audit Report which is false in any material particulars, knowing it to be false or omits any material fact knowing it to be material.

Section 204(4) further provides that if Company Secretary in Practice contravenes the provisions of Section 204, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Besides, the Company Secretary in Practice shall be liable for professional or other misconduct mentioned in First or Second Schedule or in both the Schedules to the Company Secretaries Act, 1980 and where held guilty, be liable for the following actions:

- (i) where found guilty of professional or other misconduct mentioned in the First Schedule:

- (a) reprimand;
 - (b) removal of name from the register of members upto a period of three months;
 - (c) fine which may extend to one lakh rupees.
- (ii) where found guilty of professional or other misconduct mentioned in the Second Schedule:
- (a) reprimand;
 - (b) removal of name from the register of members permanently or such period as may be thought fit by the Disciplinary Committee;
 - (c) fine which may extend to five lakh rupees.

23. What are the skills required for conducting Secretarial Audit?

The object of the Secretarial Auditor's Report is to undertake evaluation and form an opinion and to report to the shareholders as to whether, and if so, to what extent, the company has complied with the laws comprising various statutes, rules, regulations, about the board process, existence of compliance management system. This requires knowledge of the corporate laws and economic laws applicable to the company.

Thus, for conducting Secretarial Audit, a Company Secretary in Practice is expected to have expert knowledge of all corporate laws. To be able to give an effective report, a Company Secretary in Practice is expected to have the following:

- 1) Knowledge: While conducting the Audit, the secretarial auditor should have the knowledge of exact nature and activities of the Company, about the laws which are applicable to the Company. He should have understanding of existence of compliance system, Board process & procedures, selection and evaluation process for the Board.
- 2) Team: He is required to ensure that he has a team of appropriately trained staff, who can support the preparation of the report. Most

importantly they should be informed of the basic audit requirements and ethics. Related legislative and administrative updates should be shared and communicated with the team to build and maintain the expertise.

- 3) Documentation & backup: He is expected to develop a manual & checklists which will help in evaluation process. He is required to keep proper records of documents and checklists filed during the course of audit.
- 4) Reliance upon management representations and declaration: He may rely upon the management representation letter or declaration upto a certain extent.
- 5) Third party supporting and evidences: It would always be helpful to check filing made by the company at MCA & other authorities independently. Verification and enquiries can also be made with the other statutory and internal auditors and consultants and Independent Directors of the Company
- 6) Adhering to the timelines: Schedule set to conduct the audit process should be strictly adhered to in order to gain the confidence of the client and boost the expertise level of the team.
- 7) Honesty and impartiality: A Company Secretary in Practice has the professional duty to provide an unbiased and objective view. Company Secretary in Practice should be independent from the company being audited.

The Secretarial Auditor is expected to ensure that activities of the client company are in accordance with the applicable procedure and that supporting evidence maintained by the company is genuine.

- 8) Maintaining Audit Diary: The Audit exercise needs to be planned and executed professionally and verifications done by the team members should be recorded daily. Such maintenance of diary would help in

keeping audit trail that would come in handy to ensure the quality of audit.

24. What is the duty of Secretarial Auditor with respect to reporting on fraud under section 143(12) of the Companies Act, 2013?

A very significant duty has been cast on the Company Secretary in Practice under section 143 (12) of the Companies Act, 2013. It provides that if the Company Secretary in Practice, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government.

The Companies (Amendment) Bill, 2014 passed by Lok Sabha proposes to substitute section 143(12) as under:

“(12) Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.”

Further, as per the Companies (Audit and Auditors) Rules, 2014, in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge.

In case, Company Secretary in Practice does not comply with the provisions of section 143(12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

Sub-section (13) of Section 143 provides that no duty shall be regarded as having been contravened by reason of his reporting the matter (fraud) if it is done in good faith.

25. What is the manner of reporting Qualification in the Secretarial Audit Report?

A qualification, reservation or adverse remarks, if any, should be stated by the Secretarial Auditor at the relevant places in his report in **bold type** or in *italics*.

If the Secretarial Auditor is unable to express an opinion on any matter, he should mention that he is unable to express an opinion on that matter and the reasons therefor. If the scope of work required to be performed is restricted on account of restrictions imposed by the company or on account of circumstantial limitations (like certain books or papers being in the custody of another person who is not available or a Government Authority), the Report should indicate such limitations. If such limitations are so material that the Secretarial Auditor is unable to express any opinion, the Secretarial Auditor should state that in the absence of necessary information and records, he is unable to report on compliance(s) relating to such areas by the Company.

Further, the Board of Directors, in its Board's report, shall explain in full any qualification or observation or other remarks made by the Company Secretary in Practice in the Secretarial Audit Report.

26. Is Secretarial Audit applicable to companies closing their financial year on March 31, 2014?

The requirement of Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 relating to Secretarial Audit Report has come into effect from April 1, 2014.

Section 204(1) of the Companies Act, 2013 provides that the Secretarial Audit Report shall be annexed to the Board's Report made under sub-section(3) of section 134.

As per MCA Circular No.08/2014 dated 4th April, 2014, the financial statement (and documents required to be attached thereto), Auditor's Report and Board's Report in respect of financial years that commenced earlier than 1st April, 2014 shall be governed by the relevant provisions/ Schedules/ Rules of the Companies Act, 1956 and that in respect of financial years commencing on or after 1st April, 2014, the provisions of the new Act shall apply.

Combined reading of Act, The rules and the circular shows that in case of prescribed companies, the financial year of which closed on 31st March, 2014, Secretarial Audit is not applicable for that year.

All the companies to whom the Secretarial Audit becomes mandatory under Companies Act 2013, need to undertake the Secretarial audit for the financial year 2014-2015.

27. Is the Secretarial Auditor required to obtain a Letter of Representation from the Auditee company?

It is strongly advised that the Company Secretary in Practice obtain a management representation letter from the auditee company. The letter may be signed by senior management (Company Secretary/Managing Director/ Senior Management) who would normally have authority to issue

the same. Suggested format of the management representation letter is included in the publication "Guidance Note on Secretarial Audit." The format may be changed, depending on the circumstances and facts governing each audit.

The Secretarial Auditor can use this letter of representation as part of his audit evidence.

28. Is Secretarial Audit applicable to a private company which is a subsidiary of a public company?

Section 2(71) of the Companies Act, 2013 defines a "Public Company as one

- (a) Which is not a private company;
- (b) Has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital as may be prescribed.

The proviso to the definition states that "Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

By this definition, it can be inferred that Secretarial Audit would be applicable to a private company which is a subsidiary of a public company, and which falls under the prescribed class of companies.