MCA:2014

Dear Sh. M.J. Joseph

Sub: Rules under section 204(1) of the Companies Act, 2013

This is in continuation of our letters of even number dated April 2, 2014, April 7, 2014 and April 11, 2014 and several rounds of discussions with the Ministry on the above subject. During the discussion yesterday with you, we were reassured that our representations on the above subject are receiving active and sympathetic attention.

2. We have examined the legal position carefully. We are writing this to share our understanding of the law and the background and legislative intention behind section 204. We are fully convinced that every listed company – big or small - and every other company, which is not a ‘small company’, is required to have a secretarial audit and it is not permissible to exclude private companies which are not ‘small’ from the ambit of secretarial audit.

3. The legislative intention of section 204 is evident from the report of the Standing Committee on Finance (SCF), which had examined the Companies Bill, 2009. Para 10.51 to 10.53 and Para 13.33 (enclosed) deal with secretarial audit. The Ministry had submitted before the SCF as under:

"Secretarial Audit gives a necessary comfort to the investors that the affairs of the company are being conducted in accordance with the legal requirements and also protects the companies from the consequences of noncompliance of the provisions of the Companies Act and other important corporate laws. It is, accordingly, felt and suggested that the Bill may provide for requirement of conduct of secretarial audit by at least bigger companies by a company secretary in practice."

Based on this submission, the SCF recommended that secretariat audit may be required for companies exceeding certain threshold limit of paid up share capital. Based on this recommendation, the Ministry proposed to the SCF that it would include a new clause in the Bill as under:

"Every company having a paid up share capital of rupees five crore or more or such other amount as may be prescribed by Central Government from time to time shall annex with its Board’s Report made in terms of sub-section (3) of section 120 of the Act, a Secretarial Audit Report given by a company secretary in practice in such form as may be prescribed."

The Ministry has, therefore, committed before the legislature that companies above a threshold in terms of capital will have secretarial audit. Based on this understanding, the Companies Act, 2013 has been enacted. The requirement of secretarial audit is, therefore, necessarily linked to size of capital.
4. The legislative intention is also evident from the use of the word ‘bigger companies’ in section 204. It requires every listed company, big or small, and every other company which is not ‘small’, needs secretarial audit. The need for a company to have secretarial audit company can be linked to scale of operations or presence which can be determined in terms of paid up capital, turnover, number of employees, number of shareholders, outstanding borrowings, kind of business, etc. and has no link whether a company is public or private. The law does not envisage any distinction between private companies and public companies. In fact, the Companies Act 2013 has done away with most of the exemptions / relaxations available to private companies under the earlier law and endeavours to provides level playing field to all kinds of market participant. This is based on the profound realization that private companies are not immune to misdemeanors and they are important for the economy and the country. The exclusion of private companies, irrespective of their size, from secretarial audit gives a message that the matters covered under such audit such as compliance with applicable laws is not important from public interest and governance perspective.

5. Secretarial Audit is basically an audit of compliances of applicable laws as is evident from the format of the report notified in the Rules. Its scope extends to compliances under the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996, the Foreign Exchange (Management) Act, 1999 (to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings), the Securities and Exchange Board of India Act, 1992 and rules and regulations made thereunder and all other laws as may be applicable to the company. This gives the necessary comfort to the Government, Regulators, Board and Key Managerial Personnel of companies, the investors and other stakeholders that the affairs of the company are being conducted in accordance with the legal requirements and also protects the companies from the consequences of non-compliance with the provisions of the Companies Act and other important corporate laws. There is no rationale to exclude private companies and big companies from the purview of secretarial audit.

6. Section 204 envisages classification, not grouping of companies. A company chooses to be private company or public company. Whether a company is a private or public reflects its character, and, therefore, grouping, not classification. For example, we do not classify people on the basis of first alphabet of names of the individuals; we classify them based on their level of income, kind of health, etc. Further the subordinate legislation aims to further the objects of legislation. The classification must, therefore, have a nexus with the purpose. There is no nexus in grouping companies as private or public as regards compliance or governance is concerned. The extant rule 9 of the Companies (Appointment and Remuneration) Rules, 2014 which exclude the private companies from the purview of secretarial audit is ultra vires section 204 of the Companies Act, 2013. There is strong view in the member fraternity that it is also violative of Article 14 of the Constitution as the classification is devoid of any rationale.
7. There is a feeling in some circles that the secretarial audit and the financial audit may have possible overlaps. The format of secretarial audit report which is prescribed vide Form No. MR3 and defines scope of secretarial audit is attached. A reference on secretarial audit published by the Institute, which also indicates scope of secretarial audit, is also attached. As is evident from these, secretarial audit is an audit of compliances of applicable laws and no way audit of financial transactions which is the scope of financial audit. For example, the secretarial audit verifies if a company meets the public shareholding requirement under the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder, while the financial audit verifies if the books of account reflect true and fair view of financial position and performance of the company. There is absolutely no overlap. If at all any overlap arises in future, Ministry can address the same by changing the format of report.

8. As indicated to you, the Institute is working on a Guidance Note on Secretarial Audit which will help the company secretaries in carrying out the audit. A copy of the draft Guidance note is attached. This will be finalized in about a week from now. Though many company secretaries have been conducting secretarial audit for over several years, the Institute proposes to hold a series of workshops to prepare a larger number of company secretaries to undertake this work.

9. In view of the above, we urge you to amend the rule 9 immediately to provide for secretarial audit for all listed companies – big or small, and every other company which is not a ‘small company’. At the least, the secretarial audit must be made applicable, to start with, to those companies which are subject to internal audit under the Rules under section 138 of the Companies Act, 2013.

With best regards,

Yours sincerely,

(R. Sridharan)

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Encl: As above.