

SECRETARIAL AUDIT - Makes a way for Enhanced Governance*

Secretarial Audit: An Introduction

The Corporate sector in India is governed by various Acts and the rules, regulations made thereunder and every mode of business has to abide by plethora of applicable laws, rules, procedures, regulations and the internal regulatory framework. Secretarial Audit is a process to check compliance with the provisions of various laws and rules/ regulations/procedures, maintenance of books, records, etc. by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due process.

Secretarial Audit is a proactive governance measure that will have a positive effect on corporate entity. Secretarial Audit is a form of Compliance Auditing that is used in carrying out auditing of compliances with the applicable laws, rules and regulatory requirements applicable to the company. It looks into all the events, compliance and records created during the audit period to check whether the Company really complies with the applicable laws and secretarial standards as issued by the ICSI.

It is pertinent to note that the Secretarial Audit is not just concerned with the Company Law compliances but its scope is much beyond Company Law. The words used are ***“Compliance with the applicable laws”***.

Company Law and Secretarial Audit

The Companies Act, 1956 did not contain any provision with respect to Secretarial Audit. However, MCA had released Corporate Governance Voluntary Guidelines 2009 (“MCA Guidelines”) in December, 2009, according to which voluntary Secretarial Audit was introduced to ensure that the effective compliance system is in place.

The MCA Guidelines read as under:

“Since the Board has the overarching responsibility of ensuring transparent, ethical and responsible governance of the company, it is important that the Board processes and compliance mechanisms of the company are robust. To ensure this, the companies may get the Secretarial Audit conducted by a competent professional. The Board should give its comments on the Secretarial Audit in its report to the shareholders.”

However, the above stated guidelines did not mandatorily provide for conducting of Secretarial Audit, rather such guidelines gave an option to the Companies to get the Audit done by a Practicing Professional.

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Views expressed in the Article may not express the views of the Institute.

Recommendation by Parliamentary Standing Committee on Finance (Year 2009)

21st report of Standing Committee on Finance on the Companies Bill, 2009 in the year 2009-10, had recommended the conduct of Secretarial Audit in listed and bigger companies. It provides that, *“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 non compliance of the provisions of the Companies Act and other important corporate laws.*

Accordingly, it is suggested that the Bill may provide for requirement of conduct of secretarial audit by at least bigger companies by a company secretary in practice”.

The Companies Act, 2013

The Companies Act, 2013 introduced the concept of “Secretarial Audit” as a new class of audit in addition to statutory audit, internal audit, cost audit etc., as prescribed in the Act.

Legal Framework governing Secretarial Audit under the Companies Act, 2013

As per the provision of section 204(1) of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:

1. Every listed company;
2. Every public company having a paid-up share capital of 50 crore rupees or more; or
3. Every public company having a turnover of 250 crore rupees or more; or
4. Every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more. *[Inserted by the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2020 dated January 03, 2020, effective from April 01, 2020.]*

require to annex with its Board’s Report made in terms of Section 134(3) of the Companies Act, 2013, a Secretarial Audit Report, given by a Company Secretary in practice, in **Form MR- 3**

MCA has clarified that the paid up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

Thus, this amendment has widened the scope of Secretarial Audit by extending its applicability to overall bigger companies including Private Companies having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more. Thus, aiming at enhanced levels of compliance and transparency. By this move, MCA has tried to assure as well as ensure that borrowed funds will not be misappropriated and not diverted to other related entities.

Applicability of Secretarial Audit to a Private company which is a subsidiary of a Public company

According to the provisions of section 2(71) of the Companies Act, 2013 “public company” means a company which is not a private company and has a minimum paid-up share capital as may be prescribed.

However, the proviso to the aforesaid definition provides 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 the Companies Act, 2013 even where such subsidiary company continues to be a private company in its articles”.

Hence, it is clear from above proviso that Secretarial Audit is also applicable to a private company which is a subsidiary of a public company and which falls under the aforesaid prescribed class of companies.

Secretarial Audit under SEBI Regulations

The Committee on Corporate Governance, constituted under the Chairmanship of Shri Uday Kotak, in its report dated October 05, 2017, recommended the following in view of the criticality of secretarial functions to efficient board functioning:

- a) Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”), in line with the provisions of the Companies Act, 2013.
- b) Secretarial Audit to be extended to all material unlisted Indian subsidiaries. This is in line with the theme of strengthening group oversight and improving compliance at a group level for listed entities.

The aforesaid recommendations were accepted by SEBI and in order to implement the same, the SEBI (LODR) Regulations, 2015 have been amended *vide* Notification dated May 09, 2018 to include Regulation 24A.

Accordingly, as per Regulation 24A, every listed entity and its material unlisted subsidiaries incorporated in India is require to undertake Secretarial Audit and annex with its annual report, a secretarial audit report, given by a Company Secretary in practice, in such form as specified with effect from the year ended March 31, 2019.

Thereafter, SEBI *vide* its Circular dated February 08, 2019 notified the formats for Annual Secretarial Audit Report and Annual Secretarial Compliance Report for listed entities and their material subsidiaries, effective from the financial year ended March 31, 2019.

SEBI *vide* its abovementioned circular has clarified the following key points regarding the same:

- **Annual Secretarial Audit Report:** The listed entity and its unlisted material subsidiaries shall continue to use the same Form No. MR-3 for (secretarial audit report) as required under the Companies Act, 2013 and the rules made thereunder for the purpose of compliance with Regulation 24A of SEBI (LODR) Regulations, 2015 as well.
- **Annual Secretarial Compliance Report:** While the annual secretarial audit cover a broad check on compliance with all laws applicable to the entity, listed entities additionally, on an annual basis, require a check by the PCS on compliance of all applicable SEBI Regulations and circulars/ guidelines issued thereunder, consequent to which, the PCS need to submit annual secretarial compliance report to the listed entity in the format prescribed under said SEBI circular.

The Annual Secretarial Compliance Report is required to be submitted by the listed entity to the stock exchanges in specified format within 60 days of the end of the financial year.

Scope of Secretarial Audit

Secretarial Audit provides an effective mechanism to ensure that compliance of various legislations and regulations including the Companies Act, 2013, SEBI Laws, Secretarial Standards and other Corporate and Economic Laws applicable to the company has been diligently done. This would give necessary comfort to the Management, Regulators, and the Stakeholders. The periodical Secretarial Audit helps to detect the instances of non-compliances and facilitates taking corrective-measures well in time to avoid any further risk.

The Secretarial auditor needs to examine and report the compliance of the following specific laws:

- i. The Companies Act, 2013 and the rules made thereunder;
- ii. The Securities Contracts (Regulation) Act, 1956 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 Borrowing;
- v. The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 (SEBI ACT):
 - (a) The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
 - (b) The SEBI (Prohibition of Insider Trading) Regulations, 2015;
 - (c) The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
 - (d) The SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999/ SEBI (Share Based Employee Benefits) Regulations, 2014;
 - (e) The SEBI (Issue and Listing of Debt Securities) Regulations, 2008;
 - (f) The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015;
 - (g) The SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;
 - (h) The SEBI (Delisting of Equity Shares) Regulations, 2009;
 - (i) The SEBI (Buyback of Securities) Regulations, 2018;
- vi. Other laws as may be applicable specifically to a company

'Other laws as may be applicable specifically to a company'

The Scope of Secretarial Audit as regards other laws as may be applicable specifically to the company' is produced here as under:

Reporting on compliance of "*Other laws as may be applicable specifically to the company*" which shall include the laws which are applicable to specific company for example for Banks- laws applicable to Banking Industry; for insurance company- laws applicable to insurance industry; likewise for a company in petroleum sector- 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.

Therefore, the scope of Secretarial Audit is not limited to verification of compliance arising out of Company Law Obligations but also akin to the laws that are applicable to the company.

Other areas' which need to be checked

In addition, the Secretarial Auditor is also required to conduct detailed examination and report on the compliances with the applicable clauses of the following:

- i. Secretarial Standards as issued by ICSI;
- ii. Listing Agreements entered into by the company with the Stock Exchange(s), if applicable.

Apart from the key areas which are required to be monitored by PCS while conducting the Audit, there are certain other important areas too which require great consideration in order to ensure

that a company's internal reporting and internal controlling checks are in place or not. These include:

- Reporting on Composition of a valid board with proper balance of Executive, Non-Executive Directors, Independent Directors and Women Directors and any changes thereof.
- Reporting on Board processes such as issuance of notice to all directors to schedule the Board Meetings along with timely issue of agenda and detailed notes on agenda in advance.
- Reporting on process followed by the company with regard to capturing of views of dissenting members while drafting minutes of the respective meetings.
- Reporting and providing details of specific events and actions that have occurred during the reporting period, which may have major bearing on the affairs of the company in pursuance of above referred laws/ rules & regulations.

Thus, if we look into entirety, the inherent idea behind the Secretarial Audit is not just to from the perspective of Company Law but to have a thorough check done by an expert from the angle of applicable laws on the company and especially reporting on non-compliances, if any, found during the process.

Importance of Secretarial Audit

- The Secretarial Audit conducted by the PCS generates a confidence in the management as it provides a peace of mind to the directors and KMPs that the legal and secretarial compliances are being taken care of by a Professional.
- Audit is performed by a member of the recognized Body, which ensures that high levels of Professional Standards and Ethics are being followed, which further adds up to the responsibility of the Professional who issues such report under his hand.
- The Secretarial Audit helps to identify risk areas that require serious attention of the management, which could have been overlooked or not looked at all, had the Audit been not undertaken.
- The Audit exercise helps the companies to stand out in the market as it gears up the reputation/ brand value of the company. Regulators do keep a watch on such compliant companies.
- 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 risks.
- It 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.
- It 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.
- 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.

Recent Initiatives

Recently, Reserve Bank of India has come out with a discussion paper on Governance in Commercial Banks in India in the month of June, 2020 with the proposal to introduce Secretarial Audit in all commercial banks both listed and unlisted.

ICSI's Auditing Standard on Secretarial Audit : A step towards standardizing diverse audit practices

The Institute of Company Secretaries of India (ICSI) has issued four Auditing Standards out of which Auditing Standard on Secretarial Audit i.e. CSAS-4 has been issued with respect to Secretarial Audits, which shall be mandatorily required to be observed by the Company Secretary in Practice accepting Secretarial Audit Engagements on or after April 01, 2021.

Conclusion

Secretarial Audit has proved to be a tool for ensuring effective compliance management by the companies. Company Secretaries, as a corporate savior, are being looked at as an expert when it comes to compliance with the laws. Therefore, be it CS in employment or Practice, both are concerned with adherence to the words of statute in true letters and spirit.

References

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