



## INTRODUCTION TO SECRETARIAL AUDIT UNDER COMPANIES ACT, 2013

### Commerce

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### ABSTRACT

Secretarial Audit is a mechanism which gives necessary comfort to the management, regulators and the stakeholders, as to the compliance by the company of applicable laws and the existence of proper and adequate systems and processes in the company. Submission of Secretarial Audit Reports for the prescribed companies was mandated with effect from financial year 2014-15 under section 204 of the Companies Act, 2013. This paper endeavours knowledge about secretarial audit and its applications as per companies act, 2013. It also seeks to balance the limited liability of shareholders with the unlimited liability of the company as well as the interests of the present with that of the future. Timely examination of compliance reduces risks as well as potential cost of non-compliance and also builds better corporate image. This papers describes the key points and knowledge regarding the various concepts associated with the important audit i.e., secretarial audit.

### KEYWORDS:

compliances , ministry of corporate affairs, unwarranted legal actions, key managerial personnel

#### Introduction

Companies are the engines of modern economy. They drive the economy and in the process, they are also socially responsible, since they draw resources from the society for their sustenance. Today, in India, the corporate sector is governed by a complex web of laws, rules and regulations. It is essential for a company to abide by plethora of applicable laws, rules, procedures, regulations and the internal regulatory framework. The new laws endeavour to balance the public interests with the private interests – promotes and rewards private initiative while safeguarding the interests of the public, society, economy, environment, etc. Secretarial audit establishes better compliance platform by checking the compliances with the provisions of various statutes, laws, rules and regulations, procedures by a practicing company secretary to make necessary recommendations/remedies. The secretarial audit is a tool to ensure compliance of all applicable laws to the company and thereby ensures certain vital compliances which are relevant from the perspective of corporate governance. Secretarial audit is a process to check compliance with the provisions of various laws and regulations/rules/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 due processes. It is essentially a mechanism to monitor compliance with the requirements of stated laws and processes. The ministry of corporate affairs, government of India released corporate governance voluntary guidelines 2009 on December 21, 2009. The preamble to guidelines states that “these guidelines provide for a set of good practices which may be voluntarily adopted by the public companies. Private companies, particularly the bigger ones, may also like to adopt these guidelines”. The guidelines, amongst other things, recommend the introduction of secretarial audit. Companies, which do not adopt these guidelines, either fully or partially, are expected to inform their shareholders about the reasons for not adopting these guidelines. This is in consonance with the popular doctrine of “Comply Or Explain”. The board should give its comments on the secretarial audit in director’s audit in director’s report as provided in Para V of the guidelines. Further companies bill 2012, states that every listed company and a company belonging to other class of companies as may be prescribed shall annex with its board’s report a secretarial audit report, given by a company secretary in practice.

Companies act, 2013 prescribed four different kinds of audits for companies namely internal audit, statutory audit, cost audit and secretarial audit. Before enactment of companies act,2013 , secretarial audit was not mandatory for the companies. Section 204 of companies act, 2013 has made secretarial audit mandatory for certain companies. In companies act, 2013 requirement of compliance certificate has been withdrawn and a new and wider concept of secretarial audit report has been inserted in section 204 of the said act. 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 there under 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. This also keeps potential fraudsters away from the companies. Secretarial audit postulates verification on a test basis of records, books , papers and documents to check compliance with the provisions of various statutes, laws and rules & regulations by a company secretary in practice to ensure compliance of legal and procedural requirements and processes.

#### Objectives of secretarial audit

1. To protect the interest of the customers, employees, society.
2. To check & report on compliances
3. To point out non-compliances and inadequate compliances.
4. To avoid any unwarranted legal actions by law enforcing agencies and other persons as well.

#### Need for secretarial audit

1. Effective mechanism to ensure that the legal and procedural requirements are duly complied with.
2. Provides a level of confidence to the directors, officers in default, key managerial personnel, etc.
3. Directors can concentrate on important business matters as secretarial audit ensures legal and procedural requirements.
4. Strengthen the image and goodwill of a company in the minds of regulators and stakeholders

#### Secretarial auditor

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. As per section 2 (25) of companies act, 2013 “ company secretary in practice” means a company secretary who is deemed to be in practice under sub-section (2) of section 2 of the company secretaries act, 1980. 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 and resolution for appointment shall be filed with registrar of companies within 30 days of such appointment in E- form MGT- 14.

#### Time of Appointment

It is advisable that the Secretarial Auditor is appointed at beginning of the financial year as secretarial audit entails checking of compliances on a continuous basis. As a good practice, the Secretarial Auditor

should submit a report to the Board at the end of each quarter as to the compliances of the company.

### Companies covered under secretarial audit

As per section 204 of the companies act, 2013 read with companies ( appointment and remuneration of managerial personnel) rules, 2014, following companies are required to appoint secretarial auditor.

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.

Here "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)].

It is also mandatory to a private company which is a subsidiary of a public company ,and which falls under the prescribed class of companies.

### Beneficiaries of secretarial audit

1. *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 risks.
2. *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.
3. *Government authorities/regulators*: It also facilitates reducing the burden of the regulators in ensuring compliances and they can take timely actions against the offenders.
4. *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.
5. *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.

### 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 apply to the Company Secretary in Practice conducting Secretarial Audit under section 204.

Section 143, sub section (12) of the companies act, 2013 specifies that if an auditor of a company , which includes secretarial auditor [ section 143 (15 )] 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/ she shall be immediately but not later than 60 days of his knowledge report the matter to the central government in the form of a statement .Before reporting the frauds to central government auditor shall forward his report to the board or the audit committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within 45 days. But in case the auditor fails to get any reply or observations from the board within period of 45 days, he shall forward his report to the central government alongwith a note containing the details of his report. This report shall be sent to the secretary, ministry of corporate affairs.

### Company to provide all necessary information and assistance for conducting secretarial audit

Section 204(2) of the Companies Act, 2013 provides that it is the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

### Approach to Secretarial Audit

The object of the Secretarial Audit is 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, guidelines about the board processes and existence of compliance management system. This requires knowledge of the corporate laws, economic laws, securities laws, FEMA, and other laws specifically applicable to the company, Corporate governance provisions, Secretarial Standards etc. 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 and the laws which are applicable to the company. He should have understanding of existence of compliance system, Board processes & procedures, secretarial standards etc.

(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 record of documents checked during the course of audit.

(4) **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

(5) **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.

(6) **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.

(7) **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.

(8) **Back up papers to be maintained** : The Secretarial Auditor should maintain Audit Diary and back up papers like working papers, supporting documents, observations, management explanations, basis for his conclusions more particularly for qualifications in the report etc. as these will provide the audit evidence for defending himself in any possible allegation of misconduct so also peer review and help in defending himself in case of any enquiry or questions from regulators.

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### Scope of Secretarial Audit

In terms of Form No.MR-3, the Secretarial auditor needs to examine and report the compliance of the following five specific laws:

- (i) The Companies Act, 2013 (the Act) and the rules made there under;
- (ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made there under;
- (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed there under;
- (iv) Foreign Exchange Management Act, 1999 and the rules and regulations made there under 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.’

It may be noted that the scope of MR- 3 includes ‘The Securities and Exchange Board of India (Listing obligations and Disclosures requirements) Regulations, 2015’.

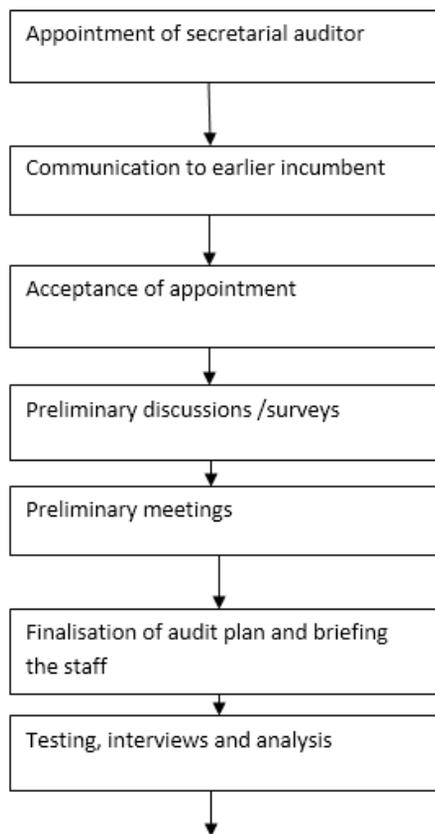
**Reporting of Fraud**

Secretarial Auditor to report fraud where during the course of his audit he has reason to believe that an offence involving fraud is being committed or has been committed against the Company by its officers/employees. [Pursuant to the provision of section 143 (12 & 14) read with section 447].

The Council of the Institute has issued guidelines specifying number of Companies to be audited by a company secretary in practice which will be effective for taking up secretarial audit assignments for the financial year 2015-2016 & onwards.

The Institute has received few suggestions on the number of companies to be audited and based on the suggestions & other inputs, council would deliberate in the forthcoming Meeting.”

**Secretarial audit – Process**



**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 view of this, a company secretary in practice will be attracting the penal provisions of section 448, for any false statement in any material particular or omission of any material fact in the Secretarial Audit Report. However, a person will be penalised under section 448 in case he makes a statement, which is false in any material particular, knowing it to be false, or which omits any material fact knowing it to be material. It is pertinent to note that section 448 applies to “any person”. In view of this, a company secretary in practice, who is an independent professional, will be attracting the penalty, as prescribed in section 448 in case his observations in the secretarial audit report turns out to be false or he omits any material fact, knowing it to be false or 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 up to 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.

**Conclusion**

Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/regulations/procedures; adherence to good governance practices with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for the business and activities of the company, carrying out activities in a lawful manner and the maintenance of minutes and records relating to such approvals or decisions and implementation. The whole conduct of secretarial audit is performed by the well expertise person called secretarial auditor – a only member of the institute of company secretaries of India holding certificate of practice. The secretarial auditor is also expected to express an opinion, after satisfying himself, that 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. The secretarial auditor has also to verify whether diverse requirements under applicable laws have been complied with.

**Journals & books**

“Guidance note on secretarial audit” the institute of company secretaries of India, ISBN978-93-82207-16-0, www.icsi.edu.

“Secretarial audit compliance management and due diligence” ,published by ICSI, www.icsi.edu.

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