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Secretarial Audit: Overview and Regulatory Framework

Introduction to Secretarial Audit

- **Secretarial Audit** is an independent audit focusing on the non-financial aspects of a company.
- It ensures compliance with applicable laws and certifies the existence of adequate systems and processes.
- It plays a key role in strengthening **corporate governance, risk management, and transparency** within companies.

Role of Company Secretary in Practice (PCS)

- A **Company Secretary in practice (PCS)** is responsible for conducting the **Secretarial Audit** of a company.
- The PCS must hold a **Certificate of Practice** and be a member of the Institute of Company Secretaries of India (ICSI).
- **PCS audits** ensure that companies comply with the laws and statutes relevant to their operations.

Regulatory Provisions for Secretarial Audit

1. **Genesis of Secretarial Audit:**
 - Introduced through **Companies (Amendment) Act, 1988**.
 - **Section 161 of Companies Act, 1956** mandated certifying annual returns of listed companies by a practicing Company Secretary.
2. **Companies (Amendment) Act, 2000:**
 - **Section 383A** required companies with a paid-up capital of Rs. 10 lakh or more (and not employing a Whole-time Company Secretary) to obtain an annual certificate from a Practicing Company Secretary.
3. **Secretarial Audit Concept:**
 - Introduced through the **Narsh Chandra Committee Report on Corporate Audit and Governance (2002)**.
 - The **Companies (Amendment) Bill, 2003** introduced the concept of secretarial compliance audits, empowering the **Central Government** to order audits at any time.

4. **Corporate Governance Guidelines (2009):**
 - Emphasized the need for adopting **Secretarial Audits** for both public and private companies, particularly larger ones.
5. **Companies Act, 2013:**
 - **Section 204(1)** mandates secretarial audits for certain companies (listed, those with a paid-up capital of Rs. 50 crore or more, or a turnover of Rs. 250 crore or more).
 - Secretarial audit must be annexed with the **Board's Report in Form No. MR-3**.

Secretarial Audit - Legal Provisions (Section 204)

- **Section 204(1):** Secretarial audit is mandatory for:
 1. **Listed Companies.**
 2. **Public Companies** with:
 - Paid-up share capital of **Rs. 50 crore** or more.
 - Annual turnover of **Rs. 250 crore** or more.
 - Outstanding loans or borrowings exceeding **Rs. 100 crore**.
- **Section 204(2):** Companies must provide all assistance to the secretarial auditor for auditing records.
- **Section 204(3):** The **Board of Directors** must explain in their report any qualification or observation made by the auditor.
- **Section 204(4):** A penalty of **Rs. 2,00,000** for non-compliance by the company or its officers.
- **Secretarial Audit for Subsidiaries:** Even if a private company is a subsidiary of a public company, it must adhere to Section 204 if it meets the specified thresholds.

Need for Secretarial Audit

- **Governance & Compliance Risk Management:**
 - Ensures timely compliance with applicable laws and regulations.
 - Strengthens a company's **image and goodwill** by maintaining proper governance.
- **Legal and Procedural Requirements:**
 - Ensures companies adhere to legal frameworks, mitigating risks from non-compliance.

- **Investor Confidence:**
 - Provides assurance on the compliance level of the company, enhancing trust among investors.

Contribution to Good Corporate Governance

1. **Regulatory Compliance:**
 - Verifies compliance with key laws, including the **Companies Act, SEBI Regulations**, and others like **FEMA**.
2. **Corporate Governance Monitoring:**
 - Evaluates the company's governance structure, board functioning, and adherence to ethical standards.
3. **Risk Identification:**
 - Helps identify internal control weaknesses and external risks, enabling proactive measures.
4. **Enhancing Stakeholder Confidence:**
 - Builds trust with investors, regulators, and other stakeholders by demonstrating compliance and ethical business practices.

Objectives of Secretarial Audit

1. **Verify Compliance:**
 - Ensures adherence to laws, regulations, and statutory guidelines governing the company.
2. **Evaluate Governance:**
 - Assesses the effectiveness of corporate governance practices, including board composition and ethical standards.
3. **Identify Legal and Regulatory Risks:**
 - Identifies risks from non-compliance and assesses the adequacy of internal controls.
4. **Evaluate Board Procedures:**
 - Reviews board decision-making processes and the company's adherence to legal requirements.
5. **Examine Statutory Registers:**
 - Ensures statutory records are maintained accurately and comply with legal requirements.
6. **Review Disclosures:**
 - Ensures transparency in disclosures made by the company to regulators and stakeholders.
7. **Related Party Transactions:**
 - Assesses the compliance of transactions with related parties to avoid conflicts of interest.
8. **Fraud and Mismanagement:**

- Detects instances of fraud, mismanagement, or irregularities within the company.

9. **Remedial Recommendations:**

- Suggests corrective measures for improving compliance and governance practices.

10. **Enhance Stakeholder Confidence:**

- Increases trust in the company's practices by providing an independent assurance of its governance and compliance efforts.

Summary of Key Aspects

- **Secretarial Audit** is crucial for ensuring **legal compliance**, promoting **good corporate governance**, and protecting the interests of **investors and stakeholders**.
- A **Company Secretary in Practice (PCS)** conducts the audit and is legally responsible for certifying the compliance of **listed companies** and **large public companies**.
- The **Companies Act, 2013** mandates secretarial audit for certain companies and provides penalties for non-compliance.
- The **objectives** of secretarial audit are wide-ranging, from verifying compliance to improving governance and enhancing transparency.

This framework and regulatory guidelines ensure that **Secretarial Audit** plays a pivotal role in enhancing corporate integrity and safeguarding stakeholders' interests.

Secretarial Audit and Secretarial Compliance Report under SEBI (LODR) Regulations, 2015

Introduction

- **Secretarial Audit** is mandatory for all listed entities and their material unlisted subsidiaries.
- The **Kotak Committee on Corporate Governance (2017)** recommended compulsory **Secretarial Audits** for all listed entities and material unlisted subsidiaries to strengthen group oversight and ensure compliance.

Regulation 24A of SEBI (LODR) Regulations, 2015

- **Secretarial Audit:** Listed entities and their material unlisted subsidiaries must undertake secretarial audits.

- The audit must be conducted by a **Company Secretary in Practice** and annexed to the annual report.
- **Key Amendments:**
 - **2019 Amendment:** Mandated secretarial audits for material unlisted subsidiaries.
 - **2021 Amendment:** Extended requirements for **Secretarial Compliance Reports**, to be submitted to stock exchanges within 60 days after the financial year ends.
- **Material Subsidiary Definition:** A subsidiary whose income or net worth exceeds **10%** of the consolidated income or net worth of the listed entity in the preceding year.

Annual Secretarial Compliance Report

- **Purpose:** Ensures compliance with all applicable **SEBI regulations, laws, and guidelines.**
- **Submission:** Required from every listed entity, submitted to **stock exchanges** within **60 days** of the end of the financial year.
- **Scope:**
 - Includes verification of **SEBI regulations, stock exchange rules, and other applicable laws.**
 - The report includes independent verification of records, books, and documents by a **Company Secretary in Practice.**

Exemptions to Secretarial Audit (Regulation 15)

- Secretarial audit requirements do **not apply** to:
 1. Listed entities with paid-up capital under **Rs. 10 crore** and net worth under **Rs. 25 crore.**
 2. Companies listed on **SME exchanges.**
- Companies that exceed these limits at a later date must comply within six months.

Auditing Standard on Secretarial Audit (CSAS-4)

- **CSAS-4:** Provides the principles for carrying out **Secretarial Audits** under Section **204** of the **Companies Act, 2013** and **SEBI (LODR) Regulations, 2015.**
- **Mandatory from April 2021:** Specifies audit procedures and standards for secretarial compliance.
- **Applicability:**

- Mandatory for **Secretarial Audit** under regulatory frameworks.
- **Not mandatory** for **voluntary** secretarial audits or the **Annual Secretarial Compliance Report** under SEBI regulations.
- **Standards Compliance:**
 - Auditors must follow **CSAS-1 to CSAS-3** while accepting and conducting the audit.

Concept of Secretarial Audit

- Secretarial Audit ensures that companies follow **compliance management**, reducing risks, frauds, and regulatory violations.
- **Key Benefits:**
 1. **Compliance Verification:** Assures regulatory bodies and stakeholders of legal compliance.
 2. **Corporate Governance:** Improves transparency and accountability within organizations.
 3. **Risk Mitigation:** Identifies risks and addresses potential legal, financial, or reputational damage early.
 4. **Stakeholder Confidence:** Enhances trust among investors, regulators, and the public.

Objectives of Secretarial Audit

1. **Verify Compliance:** Ensures the company adheres to all applicable laws, including the **Companies Act, SEBI regulations, and other statutory requirements.**
 2. **Corporate Governance Assessment:** Reviews the board's procedures and effectiveness, ensuring governance best practices.
 3. **Legal and Regulatory Risk Identification:** Detects potential risks from non-compliance and evaluates internal control systems.
 4. **Evaluation of Statutory Registers and Records:** Ensures statutory documents and filings are accurate and up-to-date.
 5. **Prevention of Fraud and Mismanagement:** Identifies irregularities within the company's governance and operations.
 6. **Enhancing Stakeholder Confidence:** Provides assurance on the company's adherence to legal and governance standards.
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Advantages of Secretarial Audit

1. **Ensures Compliance:** Periodic audits detect instances of non-compliance and help mitigate risks early.
2. **Enhances Corporate Image:** Increases trust among investors and stakeholders by demonstrating transparency.
3. **Acts as a Risk Management Tool:** Helps in reducing the likelihood of fraud, regulatory breaches, and penalties.
4. **Boosts Governance Practices:** Improves overall governance by ensuring compliance with internal processes and laws.

Audit Audience and Benefits

1. **Promoters:** Assures that the company's management is complying with the laws and the owners' interests are protected.
2. **Non-executive/Independent Directors:** Ensures that governance mechanisms are in place to reduce risks.
3. **Government Authorities:** Reduces the burden on regulators by ensuring companies comply with laws.
4. **Investors:** Provides confidence that the company operates lawfully and follows good governance practices.
5. **Other Stakeholders:** Acts as a due diligence mechanism for investors and business partners.

Risks of Non-Compliance

- **Failure of Legal Compliance:** Leads to third-party exploitation of liabilities, fines, and legal complications.
- **Failure to Obtain Approvals:** Could result in penalties, fines, or closure.
- **Regulatory Actions:** Non-compliance can lead to government enforcement actions, jeopardizing operations.
- **Environmental Law Non-Compliance:** Risks associated with civil liability and damage to sustainability.
- **Non-Accurate Records:** Leads to wrongful judgment and liabilities for stakeholders.

Case Law - Penalty for Non-Compliance

- **Sun Pharmaceutical Industries Ltd. Case:**
 - **Issue:** Non-reporting of related party transactions by the secretarial auditor.
 - **Outcome:** The **Secretarial Auditor** was penalized for failing to report compliance with **Section 188** (related party transactions).

- **Lesson:** Secretarial auditors must adhere strictly to guidelines, such as the **ICSI's Secretarial Audit Guidance Note**, and ensure all statutory reporting, including related party transactions, is accurately reported.

Conclusion

Secretarial Audit is an essential tool for ensuring compliance with statutory and regulatory requirements. It not only helps in reducing legal risks but also promotes transparency and enhances corporate governance practices. With mandatory audits for listed entities and their material subsidiaries, it provides stakeholders with confidence that companies are operating within the legal framework and adhering to best governance practices.

Code of Conduct

Overview

A **Code of Conduct** is essential to uphold the professional standards within any field, ensuring accountability, responsibility, and trust. It serves to guide professionals in maintaining ethical behavior in all their dealings, fostering confidence among clients, regulators, and the public. As the corporate environment becomes increasingly complex with regulatory changes, a Code of Conduct ensures self-regulation and discipline within the profession.

Key Principles of Code of Conduct

1. **Integrity:** Upholding honesty and fairness in all professional dealings.
2. **Independence:** Ensuring that decisions are made free from bias or external influence.
3. **Competence:** Continuously enhancing knowledge and expertise.
4. **Objectivity:** Providing unbiased, accurate, and independent professional judgment.
5. **Ethical Behaviour:** Acting in a manner that aligns with ethical standards and values.
6. **Conformance to Standards:** Following prescribed technical and professional standards.
7. **Confidentiality:** Protecting sensitive information obtained during professional duties.

The Institute's Role in Code of Conduct

The **Institute of Company Secretaries of India (ICSI)**, in **1976**, started working on formulating a framework for the **Code of Conduct** through a

National Convention. Over time, it evolved into a statutory requirement under the **Company Secretaries Act, 1980**, with updated provisions and specific guidelines for **professional misconduct**.

The Evolution of the Code

- The **ICSI Council** established rules applicable to all members.
- **Amendments** made to the **Company Secretaries Act** in **2006** provided detailed instances of professional misconduct for both members in **practice** and in **service**.

Importance of Code of Conduct

- Professionals must adhere to the code to maintain **trust** among stakeholders.
- It acts as the **ethical backbone** for the profession, ensuring that practitioners maintain high standards of professional conduct.

Scope of Secretarial Audit

Overview

Secretarial Audit ensures compliance with applicable laws, regulations, and internal governance systems. The audit encompasses a wide range of legal and regulatory requirements, such as the **Companies Act, SEBI Regulations, and Secretarial Standards**.

Key Areas of Examination

- **Compliance with Corporate Laws:** Verification under the **Companies Act, 2013**, and **SEBI (LODR) Regulations**.
- **Specific Industry Regulations:** Applicable laws for **banks, petroleum companies, insurance companies**, etc.
- **Board Composition:** Ensuring that the Board meets the required **regulatory composition** and governance standards.
- **Compliance with Regulatory Requirements:** Evaluation of **Secretarial Standards** and **Listing Agreements**.
- **Adequacy of Systems:** Ensuring the company's systems and processes are sufficient for compliance monitoring.

Scope Breakdown

1. **The Companies Act, 2013:** Secretarial audit involves verifying compliance with annual filings, returns, and company records.

2. **Securities Contracts (Regulation) Act, 1956:** Ensures compliance with stock exchange regulations.
3. **Depositories Act, 1996:** Verifies compliance regarding depository-related matters.
4. **Foreign Exchange Management Act (FEMA), 1999:** Ensures compliance with laws regarding foreign direct investment, overseas investments, etc.
5. **SEBI Regulations:** Verifies compliance with several SEBI regulations like **Takeovers, Insider Trading, Buyback, Delisting**, etc.

Compliance Reporting

- Reports must assess the company's governance, decision-making, and record-keeping.
- Specific events and actions that impact the company's compliance status are highlighted.

Secretarial Audit Process

Key Stages

1. **Appointment of Auditor:** Secretarial auditor is appointed via **board resolution**.
2. **Communication with Previous Auditor:** If a new auditor replaces the previous one, the new auditor must **notify the former** in writing.
3. **Preliminary Discussions:** A meeting with senior management to understand business operations, company processes, and prepare for the audit.
4. **Audit Plan:** A detailed plan covering scope, objectives, resources, and timelines.
5. **Testing and Analysis:** Collection and analysis of information to verify compliance with laws and internal governance procedures.
6. **Fieldwork:** Includes interviewing staff, reviewing procedure manuals, assessing compliance with applicable laws, and evaluating internal controls.
7. **Working Papers:** Detailed records of all findings, discussions, and evidence collected during the audit process.
8. **Audit Summary and Discussions:** Summarizing the findings and discussing with management for feedback and clarification.
9. **Final Report Submission:** The report, including findings, opinions, and qualifications, is prepared and submitted to the board.

Report Details

- The audit report should contain an opinion on the company's compliance status, based on statutory and regulatory requirements.
- The report may contain **qualifications** if any non-compliance or issue is found during the audit.

Secretarial Auditor's Responsibility

The auditor is responsible for verifying compliance with all applicable laws and ensuring the company has adequate processes in place for ongoing compliance. This includes:

- **Assessing Board Composition:** Ensuring a balanced composition of directors.
- **Reviewing Internal Processes:** Ensuring the company follows proper governance procedures for decision-making and record-keeping.

Conclusion

Secretarial Audit plays a crucial role in ensuring that companies comply with laws and regulations. It promotes good corporate governance, instills transparency, and helps mitigate risks. By adhering to a **Code of Conduct** and maintaining high professional standards, Company Secretaries play a significant role in shaping the corporate landscape.

Identification and Segregation of Applicable Laws

Overview

Secretarial Audit ensures compliance with **industry-specific laws** and **general laws**. The **auditor** must verify that the **management** of the company correctly identifies and segregates the applicable laws based on the **business operations, industry, and company specifics**. The auditor's role is to ensure that the **laws identified by management** are sufficient and appropriate for the **auditee's business**.

Key Points:

1. **Responsibility for Identification:**
 - The **management** is responsible for identifying all applicable laws (both **industry-specific** and **general laws**).
 - The **auditor's role** is to verify the correctness and sufficiency of this identification.
2. **Verification Process:**
 - **Professional Judgment:** The auditor must use their **professional judgment** to verify the segregation of laws.

- If the auditor is not satisfied with the identification, they must seek **explanation** from the management.
3. **Specific Guidance:**
 - **ICSI's Clarification:** The **Institute of Company Secretaries of India** has clarified the scope of Secretarial Audit, especially with regard to **industry-specific** laws and their segregation.
 - Example: **Banks** must comply with **banking laws**, **insurance companies** with **insurance laws**, and so on.

Types of Laws to be Identified

1. Industry-Specific Laws:

- Each **industry** has its own set of laws that apply to companies within that sector.
- For example:
 - **Food & Beverages:** **National Food Security Act, 2013, Food Safety and Standards Act, 2006.**
 - **Coal Mining:** **Mines Act, 1952, Indian Explosives Act, 1884,** and other coal mining regulations.

2. General Laws:

- **Labour laws, competition laws, environmental laws, and other regulatory compliance** laws apply to all industries and need to be adhered to by all companies.

Principles for Segregating Applicable Laws

Segregation Factors:

1. **Registration Requirements:** Industry-specific registration with authorities (e.g., **SEZ, Sectoral Regulators**).
2. **Company's Business Classification:** **Manufacturing, Trading, Services, E-commerce, etc.**
3. **Company's Status:** **Listed or Unlisted.**
4. **Geographic Factors:** **Location of the registered office, units, or plants.**
5. **Financial Parameters:** **Turnover, Paid-up Share Capital, Net Worth, Borrowings.**
6. **Company Type:** **Private, Public, Holding, Subsidiary, etc.**
7. **Agreements:** **Joint venture agreements, shareholders' agreements, etc.**
8. **Employee Classification:** Categories like **women employees, contractual employees, etc.**

Verification of Compliance with Industry-Specific Laws

Illustrations for Industry-Specific Laws:

- **Food & Beverages Industry:** Compliance with laws like **Food Safety and Standards Act, 2006**.
- **Coal Mining Industry:** Compliance with laws such as the **Mines Act, 1952**, and **Coal Mines Pension Scheme, 1998**.

Secretarial Audit Process

Key Steps in the Process:

1. **Identification of Laws:**
 - The management identifies the relevant laws.
 - The auditor verifies the sufficiency and correctness of this identification.
2. **Verification of Compliance:**
 - The auditor examines the company's records, website, statutory filings, and regulatory updates to verify that the company complies with **industry-specific** and **general laws**.
 - **Systematic checklists** are used to ensure all compliance points are covered.
3. **Report Preparation:**
 - The **Secretarial Audit Report** is prepared in **Form MR-3**, detailing compliance status and any deficiencies found.

Format of Secretarial Audit Report

- The report is addressed to the members of the company and includes:
 1. **Compliance of Applicable Laws:** Confirmation that the company is complying with all applicable laws.
 2. **Comment on Adequacy of Systems:** Assessment of whether the systems in place are sufficient for compliance monitoring.

General Laws Reporting

- The auditor ensures that there are adequate systems to monitor compliance with general laws such as **labour laws**, **competition laws**, and **environmental laws**.

Corporate Actions & Events

Key Events to Identify:

- Corporate actions like changes in the **charter documents**, **capital structure**, **management changes**, **borrowings**, etc., which can trigger compliance requirements.

Sources for Identifying Events:

1. **Financial Statements.**
2. **Board/Committee Minutes.**
3. **Regulatory Filings:** Annual report, statutory filings, etc.
4. **Third-party Sources:** Including **registrars**, **banks**, and **auditors**.

Board Composition Compliance

Key Considerations for Compliance:

1. **Minimum & Maximum Board Composition:** Ensure the board size complies with the applicable laws.
2. **Independent Directors:** Provisions under the **Companies Act, 2013**, and **SEBI (LODR) Regulations** to ensure a balance between **executive**, **non-executive**, and **independent directors**.
3. **Women Director:** Companies meeting the criteria (e.g., **paid-up capital**, **turnover**) must appoint at least one **woman director**.

Special Requirements for Certain Companies:

- Example: The **State Bank of India (SBI)** is regulated by its own legislation, so the auditor needs to verify compliance with the **State Bank of India Act, 1955**.

Conclusion

- Secretarial Audit ensures that the company complies with **industry-specific** and **general laws**.
- The **auditor's role** is critical in verifying the accuracy of the laws identified by the management and ensuring that the company is adhering to them.
- Regular and thorough **Secretarial Audits** lead to better corporate governance and minimize risks associated with non-compliance.

Board Processes in Corporate Governance

Role of the Board of Directors:

The **Board of Directors** plays a central role in **Corporate Governance**, ensuring that the business is managed in the best interests of stakeholders. Directors have **fiduciary duties** and are required to act in good faith for the benefit of the company's stakeholders, including **shareholders**, **employees**, and the **public**. The board's key functions involve **overseeing** management, setting the company's strategic direction, and ensuring **legal and regulatory compliance**.

Key Aspects of Board Processes:

1. **Meeting Compliance:** The company must ensure that board meetings are held regularly and that they meet the requirements outlined in the **Secretarial Standard – 1 (SS-1)** issued by the Institute of Company Secretaries of India (ICSI).
2. **Board Decision Recording:** The decisions of the board and its committees must be recorded in compliance with applicable laws, **rules, regulations, guidelines**, and any **internal processes**.
3. **Legal Obligations:** The **Companies Act, 2013**, along with the **SEBI (LODR) Regulations**, mandates the establishment of effective **board processes**. These laws govern the structure of the board and the conduct of meetings.

Case Law: RoC Penalty on Non-Compliance of SS-1

- **Case:** M/s Polaris India Private Limited (ROC/D/ADJ Order/118(10)/Polaris/328-333, January 19, 2022)
- **Issue:** Failure to comply with **Secretarial Standard – 1** regarding the mandatory holding of at least four **board meetings** per year.
- **Outcome:** The **Registrar of Companies (RoC)** imposed a penalty of Rs. 1.60 Laacs on the company, its directors, and the company secretary.
- **Reason:** Default in holding board meetings with an interval exceeding **120 days**.

Board Composition Verification by Auditors

The **auditor** plays an important role in verifying the **Board Composition** to ensure compliance with various legal requirements. This includes:

1. **Overall Composition:**
 - The **number of directors** (minimum and maximum) and the **type of directors** (executive, non-executive, independent, and women directors).
 - **SEBI (LODR) Regulations, 2015** and the **Companies Act, 2013** mandate the structure for **board composition**.
2. **Independent Directors:**
 - Ensuring that the company has at least **one-third independent directors** (for listed companies).
 - **Independent women directors** where applicable, depending on company size and type.

3. Directors' Eligibility:

- Verifying compliance with **qualification requirements** and **disqualification conditions** for directors as per **Section 164** of the **Companies Act, 2013**.

4. Committees' Composition:

- Ensuring the establishment and functioning of mandatory committees like:
 - **Audit Committee**
 - **Nomination & Remuneration Committee**
 - **Stakeholders Relationship Committee**

Verification of Board Processes

The **auditor** must verify that board decisions are recorded and compliant with:

1. **Notice of Meetings:** The **auditor** checks whether notices, agendas, and minutes comply with legal requirements.
2. **Board and Committee Meetings:** Ensuring that the meetings are **held** within the prescribed timeframes (i.e., not exceeding **120 days** between two meetings).
3. **Board Performance:** Verifying that the **performance evaluation** of the Board is conducted as per guidelines, including evaluation by **external agencies** where applicable.
4. **Appointment and Resignation:** Reviewing compliance with **appointments** and **resignations** of board members as per the **Companies Act, 2013** and relevant regulations.

Case Study: Board Process Verification

Scenario: Mr. CS appointed as the Company Secretary for **Flowers Pvt Ltd** must verify board processes for the financial year **2022-23**. This includes:

- **Board Composition:**
 1. **Verification of the number** of directors and ensuring **compliance** with minimum and maximum director requirements as per the **Companies Act, 2013, SEBI Regulations**, and **Articles of Association**.
 2. **Optimum Combination:** Ensuring a balance between **executive** and **non-executive directors**, and the required **women directors**.
- **Board Processes:**

- Verifying whether the decisions made in **board meetings** comply with **internal processes, rules, and regulations**.

Systems & Processes for Board Activities

1. **Systems:** Refers to the **framework** in place within the company to ensure compliance with **laws and procedures**. This includes internal control systems, policies, and guidelines.
2. **Processes:** These are the **steps** the company takes to execute the systems effectively and ensure compliance.

Role of Auditor in System and Process Verification

- **Assessment of Systems and Processes:** The **auditor** evaluates whether the company has **adequate systems** in place for ensuring compliance with laws, regulations, and internal policies.
- **Verification through Records:** The **auditor** will review **internal records, reports, and audit findings** to assess the effectiveness of these systems.

Detection of Fraud

Fraud Detection is a critical aspect of secretarial audit. The **auditor** must remain **alert** to signs of potential **fraud**, especially in transactions such as:

1. **Related Party Transactions (RPTs):** Unjustifiable transactions involving related parties, e.g., funds diverted to related companies.
2. **Excessive Managerial Remuneration:** Directors or executives receiving excessive compensation without justification.
3. **Insider Trading:** Directors or management using **confidential information** for personal gain.

Fraud Detection Process:

- **Professional Skepticism:** The auditor should **maintain a questioning attitude** and analyze evidence critically.
- **Collection of Evidence:** The auditor must collect **sufficient evidence** to support any suspicion of fraud, e.g., reviewing **internal controls, whistleblower complaints**, and reports from other auditors.

Examples of Fraud Cases

- **Poly Pack (UK):** Diverting funds through related party transactions.

- **Lehman Brothers:** Manipulating financial statements via related party transactions.
- **Satyam Computer Services:** Fraudulent RPTs to the tune of \$1.6 billion.
- **Kingfisher Airlines:** Unjustifiable loans to related parties.

Conclusion

- **Board Processes** play a crucial role in ensuring that **corporate governance** is maintained effectively.
- **Auditors** verify compliance with **legal and internal standards**, ensuring the board's actions adhere to prescribed guidelines and statutory requirements.
- **Fraud detection** is integral to identifying and mitigating risks, ensuring the company operates within **ethical and legal boundaries**.

Reporting of Fraud in Secretarial Audit

Legal Requirements under Section 143(12) of the Companies Act, 2013

The **Secretarial Auditor** has a legal obligation to report fraud if discovered during the audit. As per **Section 143(12)**, if the auditor has reason to believe that an **offence involving fraud** has been committed by the company's officers or employees, the auditor must report the matter. This must be done in accordance with specific reporting procedures:

1. **Fraud Involving Significant Amount (Rs. 1 Crore or More):**
 - **Report to Central Government:** If the fraud is significant (Rs. 1 crore or more), the **auditor** must report the fraud directly to the **Central Government**.
 - **Timeframe:** The report must be made **within the prescribed time**.
2. **Fraud Involving Lesser Amount (Less than Rs. 1 Crore):**
 - **Report to Audit Committee/Board:** For fraud involving amounts below Rs. 1 crore, the auditor must report to the **Audit Committee** or the **Board** within **two days** of discovering the fraud.
 - **Details to Include:**
 - Nature and description of the fraud.
 - Approximate amount involved.
 - Parties involved.
3. **Disclosures in the Board's Report:**

- If fraud is reported to the Audit Committee or Board, the **Board's Report** must disclose the following:
 - Description of the fraud.
 - Amount involved.
 - Parties involved.
 - Actions taken (if no action is taken, it must be stated).

Consequences of Non-Compliance with Reporting

- **Penalty for Failure to Report:**
 - If the **Secretarial Auditor** does not report fraud in accordance with Section 143(12), the following penalties apply:
 - **Listed Company: ₹5 Lakh** penalty.
 - **Other Companies: ₹1 Lakh** penalty.
 - **Section 143(13):** Provides protection for auditors if the fraud is reported in **good faith**.

Who is an Auditor for Fraud Reporting?

- The term "**auditor**" includes:
 - **Statutory auditors** appointed under Section 139 of the **Companies Act, 2013**.
 - **Company Secretary in Practice** conducting **Secretarial Audit** under Section 204 of the **Companies Act, 2013**.
 - **Cost Accountant in Practice** conducting **Cost Audit** under Section 148 of the **Companies Act, 2013**.
- **Exclusion: Internal auditors, tax auditors, and other professionals not acting as statutory auditors are not covered** under Section 143.

Case Study: Reporting Fraud by Secretarial Auditor

Scenario: M/s ABC & Co., Practicing Company Secretaries, were secretarial auditors for Opoco Ltd. During the audit, they discovered **fraud of ₹3.5 crore** committed by company officers.

Actions Taken:

1. **Report to Board & Audit Committee:** The **Secretarial Auditor** immediately reported the fraud to the **Audit Committee** and the **Board**.
2. **Report to Central Government:** Since the fraud exceeded ₹1 crore, the **auditor** forwarded the report to the **Central**

Government after receiving no response from the Board within **45 days**.

3. **Penalty:** The **auditor** faced a penalty of **₹5 lakh** for failure to report the fraud correctly within the prescribed time.

Difficulties in Estimating the Quantum of Fraud

- **Challenges:** Determining the exact **amount** of fraud can be difficult, especially in complex cases.
- **Impact of Incorrect Estimation:** Incorrectly estimating fraud below ₹1 crore may result in **failure to report** to the Central Government, leading to **legal consequences**.
- **Subsequent Reporting:** If the fraud amount is later determined to exceed ₹1 crore, the auditor must report it within **45 days** of re-evaluating the fraud.

Fraud vs. Non-Compliance

- **Fraud:** Intentional **deception** or **concealment** of information for unfair gain or to harm others. Fraud is a **criminal offence** and can result in severe **penalties**.
- **Non-Compliance:** Refers to the **failure** to adhere to applicable **laws, regulations, or internal procedures**, which may lead to regulatory actions but **not necessarily criminal charges**.

Identification and Reporting of Events/Actions with Major Bearing on the Company

The **Secretarial Auditor** must also identify and report any **events/actions** that have a **major bearing** on the company's affairs, including:

1. **Mergers/Acquisitions:** Corporate actions such as mergers, demergers, or acquisitions must be reported.
2. **Fraud/Defaults:** Fraud or defaults by promoters, key management personnel (KMPs), or the company itself.
3. **Changes in Business Strategy:** Any major change in business operations or strategy, e.g., **corporate debt restructuring**.
4. **Significant Events:** For example, **default in payment** of debt, major **corporate restructuring**, or **changes in board composition**.

Examples of Events with Major Bearing:

- **Failure to pay interest or dividends** on non-convertible securities.
- **Change in control** or significant shift in board composition.

- **Regulatory defaults** or actions affecting business operations (e.g., strikes, lockouts).

Conclusion

Secretarial Auditors must uphold stringent duties to **detect, report, and mitigate fraud** in accordance with the **Companies Act, 2013**. Ensuring **timely reporting** and **adequate disclosures** is crucial in maintaining corporate integrity and compliance with **legal standards**. Failure to do so can result in significant penalties and damage to the company's reputation.

Impact of Secretarial Audit

Overview of Secretarial Audit:

- **Objective:** To evaluate a company's compliance with statutory provisions and adherence to corporate governance norms.
- **Investor Confidence:** Provides investors with essential information for making informed investment decisions.
- **Due Diligence:** Serves as an effective due diligence tool for potential investors or joint venture partners.

Key Benefits of Secretarial Audit:

1. **Compliance Monitoring:**
 - Ensures the company's adherence to legal requirements and good governance practices.
 - Establishes a formal **compliance management program** for continuous monitoring.
2. **Confidence for Stakeholders:**
 - Instills **confidence in directors, KMPs, and stakeholders** regarding compliance and governance.
 - Directors can focus on key business matters without worrying about regulatory compliance.
3. **Strengthening Goodwill:**
 - Helps enhance the company's **goodwill** among regulators and stakeholders.
 - Establishes the company as a trustworthy entity for investors and the public.
4. **Governance and Risk Management:**
 - Acts as an **effective risk management tool** for governance and compliance risks.
 - Assures investors about the company's **compliance levels**, thus increasing the company's **reputation**.

Audit Reporting:

- **Audit Standards:** The **Secretarial Audit Report** should be prepared following the **ICSI's Auditing Standards** and signed by the **Secretarial Auditor** or, in case of a firm, by the partner overseeing the audit.
- **Effective Mechanism:** Ensures an effective mechanism to meet legal and procedural requirements and strengthen internal governance.

Form No. MR-3: Secretarial Audit Report

Key Sections of the MR-3 Format:

1. **Introduction:**
 - **To:** Members of the company.
 - **Statement:** Audit of compliance with statutory provisions and corporate governance practices for the financial year.
2. **Statutory Provisions Covered:**
 - **Companies Act, 2013** and related rules.
 - **Securities Contracts (Regulation) Act, 1956.**
 - **Depositories Act, 1996.**
 - **Foreign Exchange Management Act, 1999 (FEMA)** for FDI and ECB.
 - Various **SEBI Regulations**, such as:
 - SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
 - SEBI (Prohibition of Insider Trading) Regulations, 2015.
 - SEBI (Buyback of Securities) Regulations, 2018.
3. **Compliance Review:**
 - **Examine Books:** The auditor examines the company's books, forms, returns, and other records.
 - **Observations:** Any non-compliance or audit qualifications are reported.
4. **Board Composition:**
 - Ensures proper balance of **Executive and Non-Executive Directors**, including **Independent Directors**.
5. **Board Processes:**
 - Verifies **notice of meetings, agenda, minutes**, and compliance with internal processes.
 - Ensures timely participation in board meetings and adherence to procedures.

6. **Other Specific Events:**
 - Reporting on major events such as **mergers, acquisitions, or shareholder agreements.**

Annexure-B: Annual Secretarial Audit Compliance Report (ICSI)

Purpose:

- To **review compliance** with statutory provisions under the **SEBI Act** and other regulations.

Key Sections in the Report:

1. **Verification of Compliance:**
 - Ensures the company's compliance with the **SEBI (LODR) Regulations** and other relevant SEBI guidelines.
2. **Audit Review:**
 - Based on the **examination** of the company's documents, filings with stock exchanges, and internal records.
3. **Non-Compliance Reporting:**
 - **Deviations:** Specifies any **violations**, actions taken by the company, and related fines or penalties.
4. **Resignation of Statutory Auditor:**
 - Examines **compliance with SEBI Circulars** related to auditor resignation, including reporting concerns and compliance with deadlines.
5. **Prohibition of Insider Trading:**
 - Confirms whether the company complies with **SEBI (Prohibition of Insider Trading) Regulations, 2015.**
6. **Action by SEBI or Stock Exchanges:**
 - Reports if any **action** has been taken by SEBI or stock exchanges concerning the company's compliance.

Limitations and Assumptions:

1. **Responsibility:**
 - The **management of the company** is responsible for ensuring compliance and authenticity of documents and information.
2. **Scope of the Review:**
 - The report is not an **audit** of financial records or an opinion on the company's future viability.

- This report focuses solely on compliance with **SEBI regulations** and **corporate governance practices.**
3. **No Guarantee of Accuracy:**
 - The auditor does not guarantee the **accuracy** of the company's financial records or books.
 4. **No Assurance on Viability:**
 - The report is **not an assurance** regarding the future viability or performance of the company.

Conclusion:

- The **Secretarial Audit Report** plays a crucial role in ensuring that companies follow **legal compliance** and **good governance practices.** It boosts confidence among investors and stakeholders, and helps in detecting any potential issues that could affect the company's reputation or operations.

Regulatory Framework for Internal Audit
