

e-mail :

deepali@indiacp.com

Secretarial Audit – An Unconventional Overview

Deepali A. Mendiratta, ACS, Manager, Corporate Professionals (India) Private Limited, New Delhi.

The rationale behind inculcation of Secretarial audit as a part of Management Practices is not only to provide the organization with an assurance that all essential laws, rules, regulations and provisions of law as applicable on the company and any particular event or action thereto have been duly complied with but also to impart necessary confidence in its stakeholders that their interest is being taken care of.

Secretarial Audit is an indispensable tool in the hands of corporates, which enables them to identify how robust the legal and corporate law compliance system of the organization is. It is a means which instills professional discipline and signifies the law abiding nature of the management of the company. Historically what was limited to audit for providing Compliance Certificate as required by section 383A of the Companies Act 1956, is not the very same with reference to the modern concept of Secretarial Audit. The contemporary scope of Secretarial Audit extends itself to the assessment of all Corporate Laws except that related to Finance and Taxation which fall within the scope of a Statutory and Tax Auditor. Such desirable and somewhat prevalent scope of Secretarial Audit is a tool which fills up the blank spaces left by Financial Audit as it does not only acts as pre-emptive check to monitor compliance with the requirements of the Companies Act but also extends itself to various other laws such as foreign transactions regulatory provisions, Securities Laws covering the compliances of Listing Agreements, Insider Trading Regulations, Takeover Regulations, regulations relating to further issue of capital and other related provisions thereto and various Industrial, Labour and Business Specific Laws. Since Secretarial Audit along with Financial Audit completes the health check process of an organization, the inclusion of Secretarial Audit, as a mandatory part of Director's Report will go a long way in re-assuring the investors about the quality of corporate governance in the company.

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company and any particular event or action thereto have been duly complied with but also to impart necessary confidence in its stakeholders that their interest is being taken care of. A corporate entity besides serving to the interest of its promoters carries a fiduciary duty of abiding by the well being of its other stakeholders as well as the Employees, Creditors, Bankers, Suppliers, and also the society at large. One who instills trust in an entity needs an assurance that their interest is vesting in the right hands and Secretarial Audit as a tool extends its assurance in this direction. It gives necessary confidence to the investors and other stakeholders that the affairs of the company are being conducted in accordance with the legal requirements and also relieves the independent directors from the consequences of non-compliance of the provisions of the Companies Act and other important corporate laws, besides extending miscellaneous other benefits.

Governance and Audit – Interrelated tools for Stakeholders Value Enhancement

The Satyam fiasco acted as an eye-opener for India Inc. and gave new dimensions to the functioning of the corporate sector. Even the Regulators of the country, be it the Ministry of Corporate Affairs (MCA) or the Securities and Exchange Board of India (SEBI) strengthened their control and vigilance on the companies in more focused manner. Various issues which are by and large fundamentally important for the growth and elevation of India Inc. got fresh recognition. One amongst such was the buzz word on 'Corporate Governance' which paved its way to this devise of 'Secretarial Audit'.

Good corporate governance is nothing but managing or targeting the actions and decisions of a corporate in the directions they should righteously move. It is just about taking



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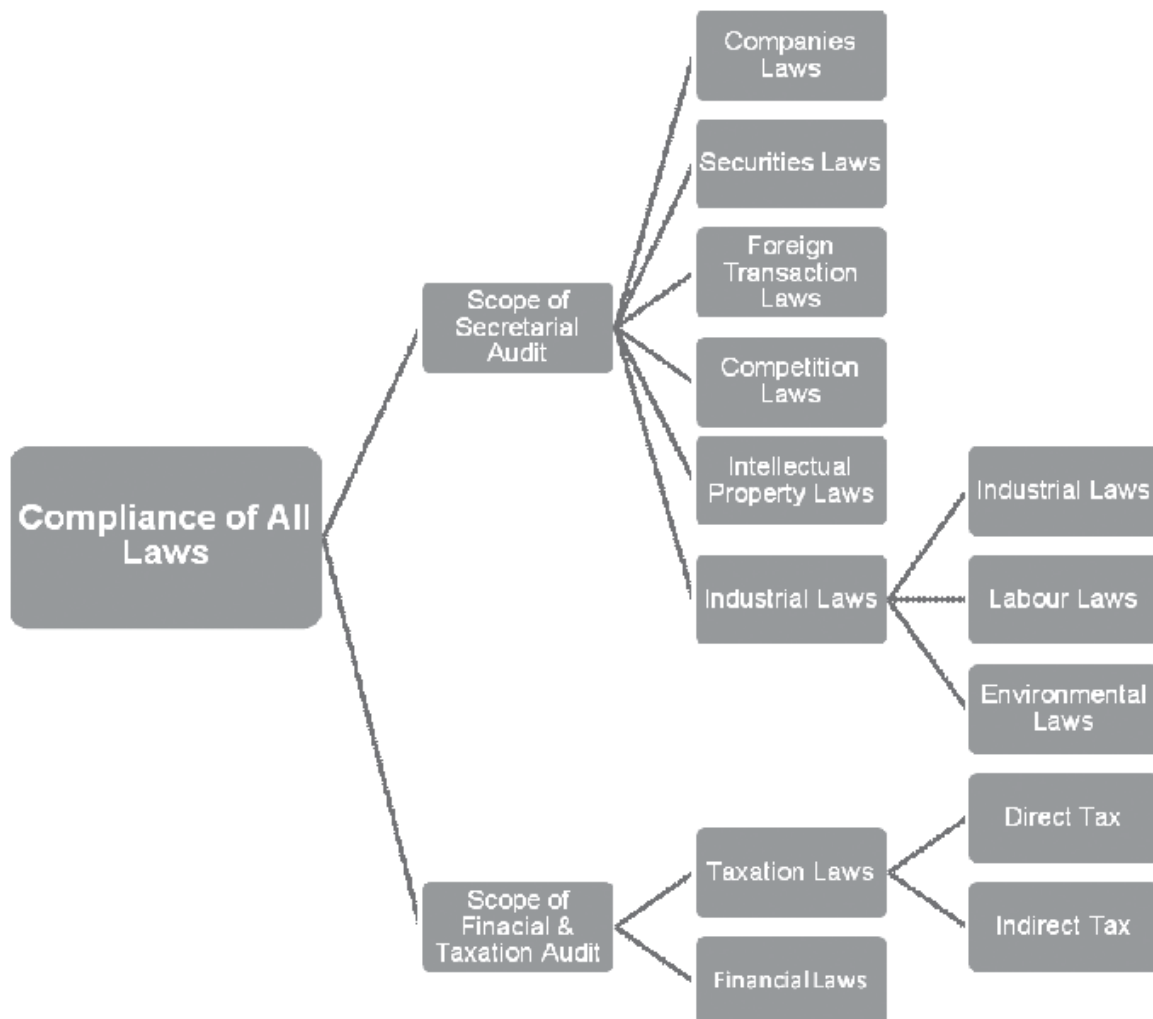
appropriate and most desirable business decisions so that a sustainable growth is achieved and the benefit derived from such decisions is justifiably shared amongst all the stakeholders involved. Some of the criterions forming components of good corporate governance are:-

- (a) Stakeholders benefit which include
 - (i) Investors
 - (ii) Employees
 - (iii) Customers
 - (iv) Suppliers
 - (v) Creditor/Lender
 - (vi) Society
- (b) Board constitution and value enhancement
- (c) Transparency and disclosures compliances
- (d) Internal audit and control systems

- (e) Corporate social responsibility

The focal point of all aspects of good corporate governance is ensuring protection of the interest of all the stakeholders involved in the entity, along with achieving a sustainable distribution of benefits amongst them. An attribute which largely relates to ensuring protection of interest of such stakeholders is compliance of all applicable Laws. One of the essential ingredients of achieving confidence on compliance of all laws is the tool of Secretarial Audit. The redefined and elevated scope of audit includes within its preview the following.

Secretarial audit, as we say now, is a tool which goes deep into the veins of the company to identify the mal-functioning relating to the legal provisions as referred hereto. It is an indispensable tool which relates to value-enhancement for the stakeholders of the company particularly relating to the one mentioned below:-



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- (a) **Investors** – The investor category can broadly be divided into three basic heads.



Though there is difference in the risk and return perspectives of the said investors' categories, all of them *per se* are concerned with higher profitability of the company to ensure maximum return. One of the requisites of ensuring such return is that the procedural activities and compliances of all laws relating to the company are essentially taken care of and that there is no legal or procedural hurdle in the growth of the company. Secretarial audit as a tool, not only, plucks any such default or legal mal-functioning in the company but also can be extended to provide to the management, solutions of making such defaults good, keeping in mind the best interest of the stakeholders.

- (b) **Employees** – Employees and workers form the backbone of any good organization. An organization grows as much as its employees and team leads it to. Employees of the company also expect maximum return from the company and if the company commits any legal default, the confidence level of such employees goes down. Hence in order to retain talented personnel in the company and to explore more and more output from such persons, there should not be any legal or procedural hindrance in the progress of the Company. Secretarial Audit provides an effective solution to that.
- (c) **Customers, Suppliers and Lenders**- Any adverse news on any non-compliance also adversely affects the confidence of the customers, suppliers and lenders of the company. In order to achieve steady growth it is essential that such hindrance are adequately taken care of by the company, through proper and timely audit of the compliances of all laws.
- (d) **Society** – The growth and development of the company is proportionately related to the growth and development of the Society. In other words, as much as the Society progress so will be the growth of corporate and *vice versa*. Since the benefits of both the sectors are likely to spread to each other and create synergies for each other's growth a focused and professionally managed company is more likely to share its benefits to the society than a non-complied one.

Besides serving to the aforesaid stakeholders, Secretarial Audit is also a fundamental tool in the hands of the Directors including Independent Directors of the company who provide their know-how and skills for the working of the company. An audit provides an assurance to such Director that the legal and procedural requirements are being taken care of by the company management and that they are investing their efforts in a right venture.

The need of the hour - A redefined perspective

The internal audit and control systems play a very important role in the functioning of the company. The need of the hour is not just to limit the utilization of Secretarial Audit as a tool to assure compliance of related laws but also to focus on verification of process implementation system of the organization including the assurance on identifying whether the base level execution is being exerted in the right direction. Effective result of the audit can be derived if together with the compliances of laws relating thereto, the working of the company is understood and the processes followed by the company for implementation of any activity in the company are analyzed. Once the focus of an audit is on the processes and its implementation procedure then besides ensuring compliance of law, the spiritual adherence of the same would also be identified and recognized. A small illustration of the same will clarify the same which we may call *Analysis of Process Implementation Model*:

Various listed companies encourage the process of Whistle Blower Policy. One approach of a Secretarial auditor could be to recognize the fact and make it known to its stakeholders by mentioning the same in his report. Another approach could be besides making himself acquainted with the fact that the company has laid down a Whistle Blower Policy, he would make an effort to go through such policy and identify short-comings if any, in the said policy and provide suggestions for its value addition and effective working. If a company has incorporated a Whistle Blower Policy but has not specified way-outs or taken adequate steps towards protection of interest of the employee or personnel who acts as a 'Whistle Blower', then, the whole exercise of formulating such policy would be rendered futile. In the Analysis of Process Implementation procedure, an auditor would ensure that the processes and system of the company are transparent and well defined so that the stakeholders interest is ensured in true sense.

Mentioned below is a brief comparative analysis of the conventional and the unconventional Secretarial Audit Models:-



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| The Attributes | Conventional Secretarial Audit | Un-conventional Secretarial Audit |
|-----------------------|---|--|
| Default Laws | Companies Act, 1956 | Corporate Laws including Companies Act 1956, Securities Laws, Foreign Transaction Laws, Industrial and Labor Laws and other Industry and Location specific laws. |
| Mode of Audit | Audit of compliance level on the basis of Documentation of the Company | Audit of compliance level on the basis of Documentation and process adopted by the Company. |
| Focus Area | Conducted with a focus on the interest of the Board and Senior Management of the Company. | Conducted with a focus on the interest of all the Stakeholders of the company. |
| Scope of Audit | Restricted to the Secretarial Department of the Company | Unrestricted exploration of the related wings of the organization from which document or information could be sought for. |

The basis of conducting such unconventional secretarial audit is based on systematic compilation of the information which could enable the auditor to reach up to desirable conclusion. The intent here is that the Secretarial Auditor should come out of the default model of conducting audit with what is statutorily required to be complied with. The purpose and aim of audit would be effectively achieved if the focus of audit goes beyond what is statutorily provided to reach up to audit of processes which are essentially desirable for the true implementation of the compliances. As a matter of illustration, the various attributes which should be taken into consideration while conducting an audit of the compliances of Insider Trading Regulations which restricts the usage of unpublished price sensitive information by Director or officer of other person having privileged access of the same, is provided underneath. The format covers a detailed overview of the requirement and compliances in true spirits.

1. Whether the company has framed the Code of Conduct for Insider Trading near to the Model Code of Conduct as provided in the guidelines?
2. Whether the company has framed the Code of Conduct for corporate disclosures?
3. Whether the company has appointed a Compliance Officer?

4. Whether the company maintains a record (list) of designated officers and their dependents?
5. Whether the compliance officer has framed procedures for Pre intimation of closure of trading window and thereafter opening of trading window on periodic rests?
6. Whether the procedure of pre-clearance of trade properly followed in the company?
7. Whether any of the designated person had entered into opposite transaction within six months of transaction relating to buy/sell of company securities?
8. Whether there has been any waiver of holding period, if so, how many times and to whom?
9. Whether the company is regular in receiving joining/quarterly and annual disclosures from the designated persons?
10. Whether the compliance officer maintains the records of the said disclosures by the said persons?
11. Whether the compliance officer makes presentation before the Managing Director/Chief Executive Officer or the Corporate Governance Committee (in case of Company) on a monthly basis of all the details of the dealing in the securities by employees/director/officer of the company and the accompanying documents that such persons had executed under the pre-dealing procedure as envisaged in this code?
12. Whether intimations regarding sale/purchase of transactions by such persons have timely been made to the Company/Stock Exchanges by such persons?
13. Whether any action taken against any employee upon non-adherence to the said code of conduct?
14. Any other prevention mode with respect to Insider Trading as adopted by the Company.

To ensure that the growth and credentials of the entity are adequately recognized in the economy it is indispensable that the compliance model of the corporate is highly strengthened. To enable the same being done the scope and horizon of Secretarial Audit should get further dimensions, wherein it is not specifically limited to Company Law but includes various other Corporate Laws in its purview. Apart from Securities Laws, Labor Laws, Foreign Exchange Laws, Taxation Laws other laws relating to Intellectual Property Laws, Sector Specific or Location Specific Laws and other complex legal structure and related process implementation should also be covered for the audit.

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Statutory Audit v. Secretarial audit

These days Indian corporates are competing at the global arena in a highly commendable manner and the requirement here is to provide confidence and assurance to its stakeholders. An effective mode of delivering such trust is the Audit of laws and processes applicable on the company and providing such report to the present as well as prospective stakeholders of the entity. The report of the statutory auditor of the company, as attached to the Annual Report, is considered as an authentic and full-proof document of extracting information and ascertaining the compliance level in an organization. Statutory Audit however, has a limited legal coverage in its report and the compliances with reference to various laws including various activities and

assignments are left unanswered. There is no Statutory report on other compliances related to the functioning of the company which remains unanswered in a Statutory report such as the issues related to rotation of money *vis-a-vis* formation of web of group companies or subsidiaries, transactions with such parties etc. The apparatus of Secretarial audit can thus be acknowledged as an information dissemination mode of the remaining compliances of the organization. A list of illustrative events and actions which are indispensable to be known as Stakeholders of the company and which would enhance the stakeholders confidence in the entity, for which the secretarial audit report can be ascertained as an authentic information are as under:-

Companies Act

- Whether the company is in receipt of any Show Cause from Statutory Authority? If yes, reason & its repercussions?
- Whether the company has adequately maintained the documents relevant to the stakeholders at the registered office of the company?

Listing Agreement

- Whether the company has made the compliances of the Listing Agreement within due dates?
- Whether the company has received any default notice or notice for delisting or suspension of trade from the Stock Exchanges during its term span?

Corporate Governance

- Whether the independent directors of the company possess adequate qualifications for being the public representative on the Board of the Company?
- Whether the process and working of the committees are being effectively carried on?

Insider Trading

- Whether the Directors/Promoter are taking any undue benefit from the company?
- Whether the information flow in the company is adequate to protect the interest of general public?

Foreign Transactions

- Whether the company is complying with the prescribed level of sectoral caps in the industry?
- Whether any money laundering activity is going on in the company or the processes of the company are transparently carried on?



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The need today is to define the precise criteria based on which the Secretarial auditor would give his report to the company. Just as the Statutory auditor is held accountable for the financial disclosures and management of the company, the Secretarial auditor should be held accountable for the Secretarial compliance management. This would not only provide a centralized platform as an answer to many unanswered queries of the stakeholders but also move a long way in enhancing the confidence level in the Company.

Secretarial Audit – Whether should be made mandatory?

The upcoming Companies Bill has provided for mandatory compliance of Secretarial Standards which would be prescribed with respect to Board Meetings and General Meetings. Unlike Statutory Audit of the financial records of the Company the Secretarial Audit of the company has still not been proposed to be made mandatory for the Companies. Secretarial Audit would serve as a tool to encounter following issues and render further benefits

1. At present there are several instances where a Company Secretary in practice is required to give various certificates under the provisions of various laws such as
 - (a) conducting due diligence audit for banks as per the requirement of Specific statute;
 - (b) providing compliance certificate under the provisions of Section 383A of the Companies Act 1956;
 - (c) providing other certificates at the time of preferential allotment or other times as per the provisions of the Companies Act 1956 and related provisions thereto;
 - (d) providing half-yearly certificates under Clause 47C of the listing agreement;
 - (e) providing quarterly certificates under Regulation 55A of SEBI (Depositories & Participants) Regulations, 1996;
 - (f) providing various certification under The Foreign Exchange Management Act with reference to allotment/transfer of shares to non-residents, or otherwise.

Various Regulators are reposing their confidence on the Company Secretaries profession and providing them with different responsibilities.

In case, like Statutory audit, Secretarial audit is also made compulsory and various attributes to be taken into account while conducting the same are pre-defined, it

would be easier for the regulatory to repose confidence on the companies. Just as the Regulators at present seek the Audited financial results to gain confidence on the financials submitted by the companies, the secretarial audit report could be prepared to serve the purpose of all the regulators for different reasons as per their requirements.

2. Even with reference to the Investors and other stakeholders, the Secretarial audit would be a great boost to their confidence level in the Company. Their confidence on the compliance level would enable brighter chances for the growth of the company.
3. The Directors and most importantly Independent Directors who are always worried of any unforeseen liability which may fall upon them at any point of time would be much benefitted from secretarial audit. This would not only result in enhancing their confidence level but also lead to imparting enhanced value addition to the Company.
4. The prospective investor, who otherwise calls for a due-diligence of the company before investing would be assured of the compliance level of the company and the inflow of investment in the Company could be smoothened.

To make the Secretarial Audit procedure more systematic and result oriented it would be most desirable for a Secretarial Auditor to provide the companies with a compliance dashboard related to provisions governing the regular event which may fall due on them from time to time during the year. Any event based dashboard may be provided from time to time. Such pro active attitude on the part of the company and the secretarial auditor would ensure that the compliances are duly undertaken within time. Just like financial audit, secretarial audit on a quarterly basis may be conducted by listed companies which would in turn enhance the corporate governance level in the company. The pre-determined attributes such as turnover, net worth, profitability or public shareholding in the company could be identified as criteria for making the Secretarial Audit mandatory for such companies.

The way ahead for the profession lies not just in limiting the foot steps to specified areas of concern but in exploring the work horizon to the vast unexplored areas and reaching the untargeted heights of professional expertise. The growth of economy as a whole as well as the growth of the profession lies in identifying new avenues and new methodology of such traditional processes which could be a benefit for the professionals and serve the benefit of the Stakeholders as well. The focus should be one on **Value Creation** for all stakeholders. □