

# Secretarial Audit: A mechanism for enhancing Corporate Governance

**CS (DR.) S K GUPTA** | MD&CEO IPA OF INSTITUTE OF COST ACCOUNTANTS OF INDIA

**CS BHAGYASHREE BOTHRA** | COMPANY SECRETARY IPA OF INSTITUTE OF COST ACCOUNTANTS OF INDIA

## THE PERSPECTIVE

It is an undisputable fact that the business world is changing rapidly due to VUCA -Vulnerability, Uncertainty, Complexity and Ambiguity which has brought about significant changes in the way the business world has begun to think, work and act. The companies, especially the big transnational corporations have started taking the corporate governance issues seriously with the management boards; and the executives have begun bearing in mind the governance issues in all their activities and actions. The collapse of international giants like Enron, World Com of the US and Xerox of Japan are said to be due to the absence of good corporate governance and corrupt practices adopted by the management of these companies and their financial consulting firms. There is growing realization in the emerging economies including India that a country's business environment must be maintained and operated in a manner that is conducive to investors' confidence so that both domestic and foreign investors are induced to make adequate investment in companies.

## SECRETARIAL AUDIT: WHAT IT IS AND WHY IT IS IMPORTANT

Secretarial Audit is an independent, objective assurance intended to add value and improve an organization's operations. It helps to accomplish the organization's objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of the framework of statutory compliances, risk management, control, and governance processes which can be effectively leveraged to build a compliance credible organization. A comprehensive Secretarial Audit would examine a wide range of issues which may be as mundane as whether or not the company is qualified to do business in various jurisdictions or as complex as an analysis of the company's Board Compliances in order to ensure consistency with current requirement under the Companies Act, 2013 and the all the events/ Corporate action occurred during the year are in compliance with the Companies Act, 2013. The scope and coverage of secretarial audit would include choice and structure of the entity; the decisions of the board of directors and documentation (or lack thereof) relating to those decisions; observance of the Secretarial Standards and Board processes, protection of intellectual property; forms and methods of maintaining records, pending and threatened

litigation, insurance coverage; listing under securities laws and compliance and related trade regulations; labour laws, environmental laws; and a review of compliance of all industry specific laws.

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. It helps to detect non-compliance and to take corrective measures. The multiplicity of laws, rules, regulations, etc. has necessitated the introduction of a compliance management system to ensure compliances of laws applicable to a company.

This has a two-fold objective:

- (a) Firstly, to protect the interests of all the stakeholders;
- (b) Secondly, to avoid any legal action against the company and its management.

The secretarial audit involves a health check up of the company and is not merely an attestation service. Since, the scope of work is vast; it is therefore prudent to spread the audit throughout the period so as to get acquainted with the system of the company and continuously monitor and assess the compliance management system of the company.

Secretarial Audit can be an effective multi-pronged protection to secure the regulator, create trust amongst the shareholders, the creditors and other stakeholders in companies, assure Banks and introduce self-regulation and professional discipline in companies. Secretarial Audit helps to detect the instances of non-compliance and facilitates taking corrective measures. It audits the adherence of good corporate practices by the company.

## APPLICABILITY OF 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 obtain 'Secretarial Audit Report' from independent practicing company secretary;

- (1) Every listed company
- (2) Every public company having a paid-up share capital of Fifty Crore

\*The views expressed are personal views of the author and it should not be taken as views of the NIRC-ICSI.

rupees or more;or

- (3) Every public company having a turnover of Two Hundred Fifty Crore rupees or more.

"Turnover" means the aggregate value of the realization 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)]. Secretarial Audit is also mandatory to a private company which is a subsidiary of a public company, and which falls under the prescribed class of companies

The LODR (Amendment) Regulations, 2018 based on the recommendations of the Kotak Committee brought many changes in corporate governance. These changes included the requirement of annexing a secretarial audit report for both the listed entity and its material subsidiary in a specified format. Regulation 24A was inserted to be effective from the year ended on March 31, 2019.

SEBI vide its circular dated 8<sup>th</sup> February, 2019 specified the format for annual secretarial compliance report which is required to be annexed to the annual report for the financial year 2018-19. While the amendment does not refer to two separate reports i.e. annual secretarial report and annual secretarial compliance report, however, the circular provides for the same. It states that listed entities and their material unlisted subsidiaries can continue to follow the format given under section 204 of the Companies Act, 2013 read with its rules (MR-3), the listed entity in addition, will still be required to annex a separate report, i.e., 'annual secretarial compliance report' for due compliance under Reg. 24A.

Corporate Affairs Secretary Shri Injeti Srinivas has said that mandatory secretarial audit may have to get extended to private companies which have outstanding (debt) beyond a threshold, this might be necessary in cases where companies have borrowed heavily from banks. The move to extend secretarial audit to private limited companies too will improve compliance. Also, it will help to bring to light compliance related issues that the statutory auditor who does financial audit of companies does not flag. The state of corporate governance failures in systemically important entities in the recent past including in Infrastructure Leasing & Financial Services Ltd. has prompted the government to tighten rules and step up oversight of the auditing and rating agencies while addressing the liquidity concerns of businesses.

## CORPORATE GOVERNANCE

At a fundamental level, the word governance comes from the Latin root 'gubernare' meaning to steer or to pilot. Corporate governance, as first defined by the UK Cadbury Committee in 1992, is "the system by which companies are directed and controlled." However, corporate governance is more than the system of specific

checks and balances that contribute to the responsible oversight of a company. "Corporate Governance is concerned with achieving a balance between social and economic objectives, and between the objectives of individuals and the company. The Corporate Governance matrix exists to encourage the efficient use of resources and also to ensure that someone is held to account for the way in which these resources are used. The goal is to align as closely as possible the interests of individuals, corporations and society". (Sir Adrian Cadbury, 'Global Corporate Governance Forum', World Bank, 2000). Good corporate governance means that the processes of disclosure and transparency are followed so as to provide regulators and shareholders as well as the general public with precise and accurate information about the financial, operational and other aspects of the company. Whenever one speaks about corporate governance, it has to be borne in mind that the organizations have duties and responsibilities towards their shareholders and stakeholders and hence they need to be governed in accordance with the law and keeping in mind the interests of the stakeholders and shareholders.

In today's economy, companies are facing intense pressure and scrutiny on their corporate behaviour not only from their own jurisdictions, but also from communities, investors and customers. Now more than ever, companies are being held accountable for their actions, as their size, power and influence expands across borders and has profound impacts on societies and stakeholders. Corporate Governance is a structure that boards and senior managers rely on to help them manage the company responsibly and according to sound ethics and accountability. The principles of corporate governance are based on transparency, accountability, responsibility and fairness.

## THE BENEFITS THAT ACCRUE FROM THE SECRETARIAL AUDIT ARE AS UNDER:

- Secretarial Audit assures the stakeholders of a company that those in-charge of its management are conducting its affairs in accordance with the requirements of applicable laws and regulations
- 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.
- Secretarial Audit being a proactive measure for compliance with a plethora of laws, has a salutary effect of substantially lessening the burden of the law-enforcement authorities.
- 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.

- 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.
- It ensures organization is managed in a manner that fits the best interests of all.
- Secretarial Audit helps in detecting and reporting any non-compliance before it takes seriously alarming shape.
- Secretarial Audit is to be on the principle of "Prevention is better than cure" rather than postmortem exercise and to find faults. It strengthens the image and goodwill of a company in the minds of regulators and stakeholders

## SECRETARIAL AUDIT FACILITATES GOOD CORPORATE GOVERNANCE

Secretarial audit provides an effective mechanism for early detection of the root cause of violations by companies that may be indicative of practices that may eventually result in frauds. If such trends are arrested at an early stage, it can prevent corporate wrongdoings. It audits the adoption and adherence of good corporate practices by the company. Secretarial Audit is a tool of risk mitigation which allows companies to effectively address compliance risk issues. Companies that go the extra mile with their compliance programs lay the foundation for good governance. Companies with an effective compliance management framework within their work culture imbuing business and personal, enjoy employee and customer loyalty and public respect for their brand, which can translate into better market capitalization and shareholder returns.

## HOW SECRETARIAL AUDIT FACILITATES IN EACH OF THE DIMENSIONS OF CORPORATE GOVERNANCE?

**Transparency** : Secretarial audit helps in improving transparency in the structure, process and level of compliances including corporate governance practices followed by companies.

**Accountability** : Secretarial Audit assures that all the compliances are done within the timelines specified by the regulators. If there are any non compliances then the same are duly reported thus bringing in a robust accountability structure within the company.

**Trust and Disclosure** : Secretarial Audit provides an in-built mechanism for enhancing corporate trust generally and help enhance the confidence of investors in the capital market through greater transparency in corporate functioning.

**Interest of Promoters / Stakeholders** : Secretarial Audit assures

the Stakeholders of a company that their interests and stake is not being exposed to unintended risk. It helps the investors in taking informed investment decisions.

**Assurance for prospective investors** : It is an effective due diligence exercise for the prospective investors or joint venture partners. Moreover, Financial Institutions, Banks, Creditors and Consumers can measure the law abiding nature of company's management.

**Fraud and malpractices** : The root cause behind the failure of some of the bluest of the companies is perpetuation of malpractices and fraud. Secretarial audit is a mechanism which helps in bringing frauds to the surface by detecting them through the comprehensive structure and process of review and audit of compliances pertaining to various laws and regulations applicable to the company

**Values and Ethics** : Secretarial Audit offers a framework for functioning of the companies with focus on business and personal work practices based on the tenets of values and ethics, which helps in enhancing the public image of the company including helping in getting recognition as a good corporate citizen.

## Conclusion

Secretarial Audit is an audit to check compliance of various legislations including the Companies Act and other corporate and economic laws applicable to the company. Secretarial Audit helps to detect the instances of non-compliance and facilitates taking corrective measures. It audits the adherence of good corporate practices by the company. It is therefore an independent and objective assurance intended to add value and improve operations of the Company. It helps to accomplish the organization's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes. The extent and complexity of the Secretarial Audit would vary depending on the size of the company in terms of the horizontal and vertical scales i.e. size of business, area of operations, turnover, product line, age of the company and type of businesses, such as trading, services, Manufacturing, the number of shareholders and employees, the extent to which the company does business as a "regulated industry," and a host of other factors.

Secretarial Audit thus provides necessary comfort to the management, regulators and the stakeholders, as to the statutory compliance, good governance and the existence of proper and adequate systems and processes. An organization reflecting tenets of trust, fairness, transparency, accountability and zero tolerance responsiveness to statutory compliances provides a true reflection of Good corporate governance. It is a matter of great pride that India is the first country to have mandated Secretarial Audit.