

# Secretarial Audit for Better Corporate Governance

*Long streams from little fountains flow  
Great Oaks from little acorns grow*



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Corporate Governance is a means to an end, the end being long-term shareholder value, and more importantly, stakeholder value. It is a process, not a state and the field is continually evolving. Corporate governance mainly involves the establishment of structures and processes, with appropriate checks and balances that enable the Board, as collegian, to discharge

their legal responsibilities in a manner which is beneficial to all stakeholders.

Good corporate governance practices are *sine qua non* for sustainable business that aims at generating long term value to all its stakeholders.

Good Corporate Governance practices are essential to ensure inclusive growth, wherein every section of society enjoys the fruits of the corporate growth. Sound and efficient corporate governance practices are the basis for stimulating the performance of companies, maximizing their operational efficiency, achieving sustained productivity as well as ensuring protection of shareholders' interests. It ensures the health of the economies and their stability.

The key aspects of good corporate governance includes disclosures & transparency; accountability & responsibility of senior management and the boards; corporate social responsibility, enhancement of shareholders' value and protection of interest of all stakeholders' value. Protection of interests of Investors and other stakeholders is the recognised principle of good corporate governance the world over.

*According to OECD Corporate Governance Principles the corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.*

*A key aspect of corporate governance is concerned with ensuring the flow of external capital to companies both in the form of equity and credit. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of different resource providers including investors,*

*employees, creditors, and suppliers.*

*The governance framework should recognise that the interests of the corporation are served by recognising the interests of stakeholders and their contribution to the long-term success of the corporation.*

## Secretarial Audit and its Genesis

The corporate sector is governed by a complex web of laws, rules and regulations viz. Companies Law, Competition Law, Economic Laws, Securities and Capital Market Laws, Consumer Protection Laws, Industrial and Labour Laws, Pollution Control Laws, Foreign Exchange Legislation, etc. However, the experience shows that enactment of various laws is not enough and the desired results cannot be achieved unless their implementation is made in true letter and spirit.

The frauds and scams in recent years in India like Satyam fraud, the Harshad Mehta Scam, Sarada Chit fund Scam, the Sahara Scam, the Satyam scam have rekindled the thought on the need for high standards of corporate governance and stringent provisions to tackle fraud, which needs to be above the tick the box approach.

This prompted our lawmakers to statutorily address the growing problem of corporate frauds by audit of compliances by companies with various laws. The audit is one of the cornerstones of corporate governance. Given the separation of ownership from management, the directors are required to report on their stewardship, to the stakeholders this includes how the company has performed within the periphery of laws, rules, procedures. The audit of compliances provides an external and objective check on the compliance management and various checks and balances required.

In 2002, the **Naresh Chandra Committee Report on Corporate Audit and Governance** recommended introduction of Compliance audit.

Later in the year 2003, the Ministry introduced the **Companies (Amendment) Bill, 2003**, containing important provisions in the arena of independence of auditors, relationship of auditors with the management of the company, independent directors with a view to improve the corporate governance practices in the corporate sector. The Bill introduced the concept of Secretarial Audit; powers were given to Central Government to order, at any time, the secretarial compliance audit of the company for any period. Similarly, **Concept Paper published by MCA in 2004**, contemplating to enact a new Company Law included the concept of the Secretarial Compliance Audit.

**ICSI Recommendations to Strengthen Corporate Governance Framework (Dec 2009):** The Satyam fiasco

in January 2009 led to a re-look at the corporate governance provisions. Considering the revelations the Institute analysed the issues arising out of Satyam Episode and inter alia made suitable recommendations for policy and regulatory changes in the legal framework. After detailed study of the best corporate governance practices the recommendations included Secretarial Audit as a measure to enhance investor protection. The recommendation is reproduced as under:

#### **ICSI Recommendation 14**

*Secretarial Audit should be made mandatory in respect of listed companies and certain other companies.*

*The Secretarial Audit be conducted by a Company Secretary in Practice.*

*The report on the audit of secretarial records shall be submitted by the secretarial auditor to the Corporate Compliance Committee of the Board of Directors of the Company.*

*The Secretarial Audit Report should form part of Board's Report.*

**Corporate Governance Voluntary Guidelines, 2009** released in December 21, 2009, insisted on adoption of Secretarial Audit for public companies and private companies, particularly the bigger ones.

*Para V of the Guidelines states that :*

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

**The Parliamentary Standing Committee on Finance in its 21st Report on Companies Bill, 2009** has recommended the Ministry to suitably incorporate the **new sub-clause 178A in the Companies Bill relating to Secretarial Audit**. The draft clause provided for secretarial audit for bigger companies, it provided that *every company having a paid up share capital of rupees five crore or more or such other amount as may be prescribed by Central Government from time to time shall annex with its Board's Report made in terms of sub-section (3) of section 120 of the Act, a Secretarial Audit Report given by a company secretary in Practice.*

Further the relevant extracts of the debates/discussions on secretarial audit at the committee are as under:

*7.8 Secretarial Audit may also be mandated for bigger companies, including all listed companies; as it inter-alia provides necessary assurance to the investors that the affairs of the Company are being conducted in accordance with the legal requirements. The Board of Directors shall, in their Report to shareholders, explain in full any qualification or observation or other remarks made by company secretary in practice in his secretarial audit report.*

#### **Companies Act, 2013**

The Companies Act, 2013, incorporates various revolutionary provisions on good corporate governance. The Act boosts investor confidence and market sentiments and codifies disclosure of not just financial but also the non-financial aspect.

The Act has placed immense responsibility on the Directors for stakeholders protection. Section 166 of the Act defines the duties of the directors, one of the duties emphatically profess the stakeholders protection. It states that a director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

The **Directors Responsibility Statement** as required under Sec 134(5) states that the *directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.* Moreover the **Listing Agreement** provides that the *Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.*

The Act relies on the pillars of good corporate governance, hence emphasis has been placed on the relevance of robust compliance management system in an organisation. It is the responsibility of the Company secretary under section 205 of the Act to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company.

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.

Secretarial Audit is, therefore, an independent and objective assurance intended to add value and improve operations of a company. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

**Section 204 of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides for mandatory secretarial audit for:**

- every listed company
- every public company having a paid-up share capital of fifty crore rupees or more; or
- every public company having a turnover of two hundred fifty crore rupees or more.

The term 'Turnover' has been defined in section 2(91) as 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. Such company is required to annex a secretarial audit report with its Board's report.

The companies which are not covered under section 204 may obtain Secretarial Audit Report voluntarily as it provides an independent assurance of the compliances of applicable laws of the company.

*The Board of Directors, in their report made in terms of section 134, shall explain in full, any qualification or observation or other remarks made by the Company Secretary in Practice in the Secretarial Audit Report.*

The Report has to be annexed in Form MR-3 prescribed under Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014. The Secretarial Auditor as a tool for good governance measure has to report to the stakeholders compliance of the company with respect to the Board Processes, adequate systems and processes that are in place to monitor and ensure compliances, reporting on compliance of Secretarial Standards issued by The Institute of Company Secretaries of India, the Listing Agreement wherever applicable. The auditor has to report on compliance of various laws such as Companies Act, 2013, Securities Contracts (Regulation) Act, 1956 ('SCRA'), Depositories Act, 1996, Foreign Exchange Management Act, Regulations and Guidelines prescribed by Securities and Exchange Board of India Act, 1992 and on any other law specifically applicable to the company.

#### **Secretarial Audit and Company Secretary in Practice**

Company secretary in practice has been exclusively recognised for conducting secretarial audit. In terms of section 204(1), 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 rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting of the company.

It is advisable that the Secretarial Auditor is appointed at beginning of the 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.

#### **A Tool for good Corporate Governance**

Secretarial Audit provides an effective mechanism to ensure that compliance of various legislations and regulations including the Companies Act and other corporate and economic laws applicable to the company has been diligently done. This would give necessary comfort to the Management, Regulator, and the stakeholders. It is essentially a pre-emptive check to monitor compliance with the requirements of stated laws.

The major purpose of Secretarial Audit is to help to create a culture of periodic assessment of risk from non-compliance and take appropriate steps to implement modified process of work and reduce the risk element from non-compliance. The reporting serves as a bridge between the external assurer i.e. the secretarial auditor and the stakeholders.

The benefits that accrue from the Secretarial Audit are as under:

- (a) 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.
- (b) 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.
- (c) Secretarial Audit being proactive measure for compliance with a plethora of laws, will have a salutary effect of substantially lessening the burden of the law-enforcement authorities.
- (d) 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.
- (e) 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.

#### **Conclusion**

It is a matter of great pride that India is the first country to have mandated Secretarial Audit Good corporate governance is the norm and the Indian companies cannot ignore it any more. The Companies Act, 2013 has carved out a significant new role for the Company Secretaries. The Regulators has reposed tremendous trust and confidence on the profession and has cast huge responsibility on the Secretarial auditor and the corporate management to set a benchmark on good corporate administration and governance, acceptable not only to the Indian investors but also acceptable to the international business community. The new yet effective implementation of this audit will certainly lead to reduction in corporate frauds and malpractices.

As Governance professionals Company secretaries should profess the compliances of law in letter and spirit, ethical conduct of business, sensitivity to environment/society etc. A true professional should convey the message to the management on correcting the processes and system wherever required to imbibe the essentials of good corporate governance.

The Act has cast a very significant duty on the Governance professional under Section 143 it is provided

that where an secretarial auditor of a company in the course of the performance of his duties, has reason to believe that an offence involving fraud is being or has been committed in the company by officers or employees of the company, he shall immediately report the matter to the Central Government or as under the Companies Amendment Act to the Board as per the thresholds.

As a governance tool Secretarial Audit is a system of audit which will ensure sustained growth of corporate and reaffirm the adequate systems and procedures established within the company's corporate governance framework.

There was a question which was asked in one of the forums with regard to the mandatory appointment of women directors in select class of companies and

somebody mentioned that is the Government resorting to quota system and is it that law is contemplating that better governance will be achieved by women being on the Board of companies. Their contention was that it should come from within and not enforced. I just asked a question that if stringent environmental laws are not enforced, will any corporation seek for clearance of the same or would it even think once before making the rampant and careless use of the precious natural resources?? No answer was received to this. It has been seen that the judicious use by the law makers of the carrot and stick policy is what probably works. The enforcement of secretarial audit is a bold step in the right direction.

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*"A small body of determined spirit, fired by an unquenchable faith in their mission can alter the course of History".*

-Mahatma Gandhi