



Role of Secretarial Audit in enhancing Corporate Governance

by CS Gaurav Pingle

Introduction

Secretarial Audit is the process of review and verification of corporate secretarial records of a company by Practising Company Secretary to ensure compliances of the provisions of Companies Act, 2013 or other applicable laws. The Secretarial Audit aims at introducing and developing an effective corporate compliance mechanism w.r.t. compliance of company law and other applicable laws. The Secretarial Audit also aims for flawless compliance and at same time taking necessary corrective steps for non-compliance. From the perspective of the company, there is a requirement of preparing an internal check-list of the compliances (including updation, depending upon the changes in laws), action-oriented compliance of the relevant provisions of the law, ensuring that the documents and information are maintained and easily accessible.

In India, every entity (not just companies) has to ensure compliances of many laws and regulations generally, which includes - laws relating to registration, laws relating to taxation and accounting, laws relating to maintenance of book and records, laws for a particular entity or sector in which it operates. Corporate entities are incorporated for several reasons, which includes limited liability, separate legal entity, structuring of certain transactions, taxation perspectives, etc. To ensure proper compliance of the basic law (i.e. law applicable at the time of registration) i.e. Company Law - Secretarial Audit plays a very important role. In fact, Secretarial Audit adds value in the entire Corporate Governance process as the audit ensures compliance of the relevant provisions of the Companies Act, 2013, Rules made thereunder, Notifications/Circulars issued thereunder, Secretarial Standards issued by ICSI, etc. The compliance of the said provisions are verified from the perspective of compliance in letter and compliance in spirit.

Need for Secretarial Audit

The need for Secretarial Audit arises from the fact the company shall have effective legal compliance system for ensuring multiplicity and complexity of laws. Primarily, the Secretarial Audit has two objectives: (i) Protection of the

interest of directors, promoters, investors and stakeholders like lenders, regulators, customer, employees, (ii) Avoidance of any unwarranted legal actions by Regulators / law enforcing agencies. The Secretarial Audit is the one of the very few or probably the only 'non-financial audit' that focuses on review of corporate secretarial documents and legal compliance management system in the company - which ultimately improves the corporate governance in the company.

It is important that primary responsibility of ensuring compliance of company law and all applicable laws lies with the directors of the company (all companies, no further classification about its applicability). As provided in section 134(5)(f) of the Companies Act, 2013, the directors are required to state in the Directors Responsibility Statement that they have devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively. This is a very important and onerous declaration that directors are required to give in the Directors Report. Considering the scope of Secretarial Audit and the directors' declaration in the Directors Report, it can be said that both stakeholders strive for better compliance, effective legal management systems and better corporate governance. Secretarial Audit will also serve as an assurance to prospective directors to render their expertise to the companies.

Secretarial Audit & Related Party Transactions

One of the important pillars of Corporate Governance is 'Related Party Transactions'. In quite a group-companies (in the form of promoter's holding entity, joint venture



companies, subsidiary companies, fellow subsidiary companies, etc.), almost all these companies and directors are 'related parties' under the Company Law. Any transaction between such companies or entities would fall under the provisions of 'related party transactions' either under the Company Law or Securities Laws or Accounting Standards or Income Tax Laws. The provisions under Company Law or Securities Laws are very strict and ensure compliance in the form of board approval, shareholders approval, compliance of conditions like - arm's length basis and determination of a transaction in ordinary course of business or not, etc. In certain cases, it may happen that a company within the group would be 'related party' under Income Tax Law or Accounting provisions but not a 'related party' under Company Law (exempted by a notification) or vice-versa. Therefore, determining that a particular entity is a related party or not, is a very important aspect of compliance. Therefore, secretarial audit verifies such important issues and provides a value addition at this stage as well. Related Party Transaction being a very important and essential provision, no group-company can ignore the conditions of the compliance. Therefore, secretarial audit of group companies with an emphasis on related party transactions will not only improve the compliance level but also enhance the corporate governance standards in the company. There would appropriate check-points and compliance requirements for each related party transaction.

Secretarial Audit also assists the company in reviewing and ensuring that the board of directors has optimum combination of directors i.e. executive directors and non-executive directors (including independent directors).

Secretarial Audit - a weapon against suspected shell companies

Secretarial Audit also acts a weapon against the suspected shell companies. In fact, the company undergoing secretarial audit would never be a shell company or a dormant company. It may happen that the company is an inactive company or undergoing the process of acquisition or insolvency, but such company would not be shell company.

Because, adequate information and documents are required to be kept, checked and verified in the audit process that the possibility of shell company is ruled out. Just like any other audit, there would be visits to the registered office of the company or the place where the statutory records of the company are maintained. In fact, in quite of few cases of listed companies, SEBI has relied upon the Secretarial Audit Report issued by a Practising Company Secretary for the purpose of identifying misrepresentation in company's financials statements, misreporting of related party transactions and loans from companies in which directors are common. The dependency of Securities Market Regulator itself is an indication that Secretarial Audit and the Secretarial Audit Report is a value addition to all the stakeholders, including the regulators and Government.

Conclusion

The Corporate Governance ultimately translates into independence of directors and their transactions with company/group companies, transparency and disclosures by company towards stakeholders and accountability of the directors towards its stakeholders. Therefore, undoubtedly, the entire process of Secretarial Audit adds a lot of value to the Corporate Governance framework of the company, which ultimately helps the company in improving the ESG rating. This further helps the company in easily raising funds from the capital market.

About the Author



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